

PDEX GUIDELINES ON THE TRADING & SETTLEMENT ENVIRONMENT FOR LONG-TERM BANK-ISSUED INSTRUMENTS (THE “GUIDELINES”)

GENERAL

1. What types of bank-issued instruments are covered by the Guidelines?

The Guidelines cover only coupon-bearing Long Term Negotiable Certificates of Time Deposits (LTNCTDs) issued under BSP Circular No. 304, S. 2001 and its amendments, and Unsecured Subordinated Debt (UnSDs) issued under BSP Memorandum Series of 2003 dated 17 February 2003 and its amendments. The Guidelines shall apply to LTNCTDs and UnSDs listed for trading in PDEX.

2. BIR Revenue Regulations (RR) No. 14-2012 and relevant Revenue Memorandum Circulars (RMCs) provide that each sale of bank-issued instruments on the secondary market before the 5th year is a pre-termination, subjecting the sale to graduated rates of Final Withholding Tax (FWT). How is this treatment reconciled with the regulations of the *Bangko Sentral ng Pilipinas (BSP)* on LTNCTDs and UnSDs?

Bangko Sentral ng Pilipinas (BSP) Circular No. 834 Series of 2014, dated 26 May 2014, states the BSP’s position on pre-termination, to wit: “For tax purposes, negotiations/transfers from one (1) holder to another shall be subject to the pertinent provisions of the National Internal Revenue Code of 1997, as amended and Bureau of Internal Revenue (BIR) regulations.”

3. What is the Global Bond Formula (GBF)?

The GBF (also known in the market as “Gross Clean Price Formula”) is a formula for calculating a bond price given a quoted yield to maturity, denoted as follows:

$$\text{Clean Price (GBF)} = \left[\frac{MV}{\left(1 + \frac{YTM}{Cpn.Freq}\right)^{N-1 + \frac{DSC}{E}}} \right] + \left[\sum_{k=1}^N \frac{CPN}{\left(1 + \frac{YTM}{Cpn.Freq}\right)^{k-1 + \frac{DSC}{E}}} \right] - \left[\frac{CPN \cdot DCS}{360} \right]$$

Where:

Clean Price (GBF)	=	Clean Price Global Bond Formula
MV	=	Maturity Value
N	=	Number of Coupon Periods remaining bet. Settlement and Maturity date. If N has a fractional part, (i.e. settlement not on a coupon date) it is rounded to next higher whole number
CPN	=	Coupon amount received per coupon period
Cpn Freq.	=	Coupon Frequency
YTM	=	Yield to Maturity
DCS	=	Days from previous Coupon Date to Settlement Date (or Accrued no. of Days)
DSC	=	No. of Days from Settlement Date to next Coupon Date
E	=	No. of Days in Coupon Period (also E = DCS + DSC) In Phil. 30/360 convention, E is 360 for annual coupon, 180 for semi-annual coupon, and 90 for quarterly coupon bonds
K	=	Coupon Period

TAXATION - SELLER

4. When a holder of a bank-issued note who is an individual sells to another individual, what are the tax rates to be imposed on the seller?

Please see examples provided in BIR RR No. 14-2012 as quoted below:

Example No. 1

An instrument with a maturity period of 10 years was held by Mr. X (a resident citizen) for 2 years and was transferred to Mr. Y (a resident alien), who, in turn, held it for 8 years. The FWT due are as follows:

Mr. X	2 years 20% FWT
Mr. Y	8 years Exempt

Example No. 2

An instrument with maturity period of 10 years was held by Mr. X (a nonresident citizen) for 3 years and transferred it to Mr. Y (a resident alien). Mr. Y held it for 2 years before subsequently transferring it to Mr. Z (a resident citizen), who held it until the day of maturity or for 5 years. The FWT due are as follows:

Mr. X	3 years 12% FWT
Mr. Y	2 years 20% FWT
Mr. Z	5 years Exempt

Example No. 3

An instrument with maturity period of 10 years held by Mr. X (a nonresident alien engaged in trade or business in the Philippines) for 3 years and transferred it to Mr. Y (a resident citizen). Mr. Y held it for 2 years before subsequently transferring it to Mr. Z (a resident alien), who pre-terminated it after 4 years. The FWT due are as follows:

Mr. X	3 years 12% FWT
Mr. Y	2 years 20% FWT
Mr. Z	4 years 5% FWT

TAXATION - BUYER

5. What is the tax rate for an investor who buys a bank-issued note with a remaining maturity of less than five (5) years?

As provided in BIR RMC No. 81-2012 (A2), "The individual depositor or investor who acquired the instrument shall be subject to twenty percent (20%) FWT on his interest income because the remaining maturity period is less than five (5) years."

PDS INVESTOR CODE

6. What is the PDS Investor Code (PIC) and how is it created?

The PIC is an 11-character alphanumeric code assigned to an investor by a Dealer/Broker dealing with or representing the investor. It serves as a standing settlement instruction for all trades executed by that Trading Participant with/for a customer. The PIC indicates both the security location (BP ID) and cash location (*PhilPaSS* DDA or Cash Settlement Account) to be associated for the settlement/payment of that Investor's securities transaction. For the Bank-Issued Instruments environment, a PIC must be created and assigned by a Broker for each Investor, to enable investor-level securities settlement and facilitate tracking of holding period so that appropriate taxes due from the portfolio of bank-issued instruments held by the Investor is appropriately calculated. Once created, the PIC must be inputted

into an Order for that Investor in the Trading Workstation by the Investor's Buying or Selling Broker/Dealer salesman.

Upon request by the Trading Participant, a PIC (with 11 characters) is assigned per investor (BP ID) per Broker. An investor trading through various brokers may have only 1 securities settlement account (BP ID) but with different PICs to identify the specific broker through whom the Investor is transacting.

7. Is there a one-is-to-one correspondence between the investor's securities settlement account and PIC assigned?

No. The PIC is assigned to an investor by the Trading Participant and is associated with the investor's securities settlement account and cash settlement account for secondary market trades. One securities settlement account of an investor may be associated with different cash settlement account for secondary market trades if it deals with several brokers. Hence, one securities settlement account may correspond to several PICs.

8. Can the CAAC system identify incorrectly entered PICs, i.e., PIC assigned to another investor client other than the ordering client of broker?

No. The CAAC system cannot identify an incorrectly entered PIC, it is only equipped to identify 'invalid' PICs.

9. What are invalid PICs?

Invalid PICs are those which have not been registered with PDTCC or which are not in conformity with the PIC format (Ex. No P=...#). Other instances of invalid PICs are as follows:

- PIC inputted by the TP is not a PIC enrolled with that TP
- No PIC inputted by the TP, if TP is a broker
- No PIC inputted for Dealer-QI transaction on client side

TRADING AND SETTLEMENT UNDER THE GUIDELINES

10. How is the Holding Period computed for purposes of determining the tax on accrued interest?

The Holding Period is the day count from the acquisition date to the settlement date of a transaction. The day count starts from the acquisition date of the Securities balance being used to settle the transaction, up to but excluding, the settlement date of the sale transaction.

Example: Investor A acquired the Bond X as of November 5, 2014 and sold it with value date November 12, 2014. What is the holding period of Investor A for Bond x?

Answer: 7 days.

11. How is the FIFO method applied when an investor selling part of its ISIN holdings, e.g., FXTN 10-42 were acquired at different value/acquisition dates?

For purposes of calculating the holding period, the CAAC algorithm allocates/selects the ISIN for each sell transaction of an investor on a "First In, First Out" (FIFO) basis. However, if the investor for the same ISIN has two (2) securities settlement accounts, one for his holdings with 0% FWT, e.g. acquired since issue date, and another for his holdings 20% FWT acquired from the secondary market when the remaining maturing of the ISIN was less than 5 years, the investor, with the use of the PIC, can choose from which securities settlement account to sell. The FIFO algorithm will then apply on the holdings held in the chosen securities account. This is illustrated below:

- An individual investor has both 0% and 20% account holdings for a bank-issued instrument with 6% semi-annual coupon, maturing on 13 June 2020:

FWT 0% Account			FWT 20% Account
Acquisition Date	Holding Period	Face Amount	PHP 50,000,000
13 June 2013	5 years	PHP 20,000,000	
13 June 2014	4 years	PHP 30,000,000	
13 June 2015	3 years	PHP 50,000,000	

- Investor sells PHP 50 million at par from FWT 0% account for value 13 June 2018 for a final settlement amount of PHP 49,640,000, computed as follows:

Settlement Value Computation			
Holding Period	Applicable Tax Rate	WPTEI	Gross Value
5 Years	0%	0	PHP 20,000,000
4 years	5%	PHP 360,000 (FV x 6% x 4 years x 5%)	PHP 30,000,000
Totals		- PHP 360,000	PHP 50,000,000

12. How is a “year” defined under the Guidelines?

For the purpose of determining the relevant holding period and the remaining maturity, a year shall be deemed completed on the anniversary date of the settlement date of the trade.

Example: Security ABCD was issued on 01 January 2013. It has a tenor of 7 years, with maturity date of 01 January 2020. Investor A acquired Security ABCD on 02 January 2014. Investor A sold the same to Investor B on 01 January 2017 with a settlement date of 02 January 2017.

On 02 January 2017, the following are the relevant periods:

- Holding Period of Investor A (Seller)- 3 years (from purchase date of 02 January 2014 to settlement date of sale 02 January 2017)
- Remaining Maturity of Security ABCD - less than 5 years (from settlement date of 02 January 2017 to maturity date 01 January 2020).

13. Can an individual sell securities without the necessary balance in his SSA?

No. An individual selling Bank-Issued Notes must have sufficient securities balance in his SSA at the point of trade for proper recognition of the inventory holding period by the Corporate Action Auto Claim (CAAC) System. (PDEX Guidelines, E3). The platform will tag the trade as “UNPROCESSED” and will not be allowed to proceed to PDS Clear for clearing and settlement.

14. Who will remit the Withholding Taxes on Previously Earned Interest due from the transaction to the Issuer?

The buyer-Trading Participant in the trade, either representing itself or an Investor, will remit to the Issuer, on settlement date or on the next business day immediately succeeding the settlement date as prescribed by the Issuer, any and all Withholding Taxes on Previously Earned Interest.

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