

PDEX GUIDELINES ON THE TRADING AND SETTLEMENT ENVIRONMENT FOR LONG-TERM BANK-ISSUED INSTRUMENTS

A. BACKGROUND

These Guidelines on the Trading and Settlement Environment of Long-Term Bank-Issued Instruments (the “Guidelines”) are hereby issued by the Philippine Dealing & Exchange Corp. (PDEX) to implement a market environment for the trading of Long-Term Bank-Issued Instruments duly admitted for trading on PDEX consistent with the taxation framework for Long-Term Bank-Issued Instruments as set by Bureau of Internal Revenue (BIR) in Revenue Regulations No. 14-2012 and its related Revenue Memorandum Circulars, as may be amended from time to time. For the purpose of determining applicable taxes, every sale on the secondary market shall be treated as “pre-termination.”

B. SCOPE AND EFFECTIVITY

1. Trading and settlement of Long-Term Bank-Issued Instruments, duly admitted for trading on PDEX shall be in accordance with the PDEX Rules for the Fixed Income Securities Market, as Amended (PDEX Rules), the PDEX Trading Conventions for Fixed Income Securities in the Public Market, as Amended (PDEX Trading Conventions), and these Guidelines.
2. These Guidelines shall take effect upon announcement by PDEX. For Long-Term Bank-Issued Instruments listed in PDEX prior to the effectivity of these Guidelines, the effective date for the voluntary transition of each security to the trading and settlement environment under these Guidelines shall be announced by PDEX.

C. DEFINITION OF TERMS

As used in these Guidelines, the following terms shall have the following definitions:

“Accrued Interest” shall refer to the component of the settlement value computation that is calculated as the face value of the Securities multiplied by the coupon rate multiplied by the number of days between the previous coupon date and the settlement date and based on the applicable day count convention.

“Corporate Action Auto Claim System” (CAAC) shall refer to the PDS system that will track the holding period of a Security purchased by each PDEX-listed Long-Term Bank-Issued Instrument investor in order to determine the appropriate tax rate for a trade. This system shall also compute the amount of withholding taxes due from the Selling investor.

“Depository” shall refer to the Philippine Depository & Trust Corp. (PDTC).

“Global Bond Formula” shall refer to a tax-neutral formula for calculating the bond price given a quoted yield:

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

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

“Holding Period” or **“HP”** shall refer to the number of days from acquisition date of the Securities balance used to settle the transaction, to the settlement date of the sale transaction.

“Long Term Bank-Issued Instruments” shall refer only to coupon-bearing Long Term Negotiable Certificates of Time Deposits issued under BSP Circular No. 304, S. 2001 and its amendments, and Unsecured Subordinated Debt issued under BSP Memorandum Series of 2003 dated 17 February 2003 and its amendments.

“PDS Infrastructure” shall refer to the trading and settlement infrastructure of PDEX and PDTC.

“PDS Investor Code” or **“PIC”** shall refer to a code assigned to an investor by the Trading Participant that is associated with the SSA and Cash Settlement Account of such investor.

“Securities” shall refer to Long-Term Bank-issued Instruments, duly admitted for trading (i.e., listed or enrolled) on the Philippine Dealing & Exchange Corp. (“PDEX”).

“Securities Settlement Account” or **“SSA”** shall refer to a Depository account of a Trading Participant or an investor acting through a Trading Participant, or such other account allowed by PDEX, where such account shall be capable of being tax-tracked.

“Withholding Tax on Previously Earned Interest” shall refer to withholding taxes on interest payments, previously earned or received by the seller since his purchase of the Securities, not including the tax on accrued interest of the current coupon period. This tax shall be due from the seller based on graduated tax rates as defined by the BIR, if the seller originally purchased the Securities while they were tax-exempt but sells the Securities before reaching a holding period of at least 5 years. This withholding tax is calculated as the sum of the gross coupon payments received by the seller from holding the Security multiplied by the applicable withholding tax rate.

“Withholding Tax on Accrued Interest” shall refer to the *Tax on Accrued Interest* component of the settlement value computation, calculated as the Accrued Interest

multiplied by the applicable withholding tax rate, i.e. 20%, 12%, 5%, or 0%, as the case may be on the seller of the Security.

D. GENERAL PROVISIONS

1. The PDS Infrastructure shall provide a market environment that allows investors of any tax classification to trade Securities between and among themselves without restriction, except as prescribed by the Issuer in the terms and conditions of each admitted Security.
2. The PDS Infrastructure shall provide and operate the system that will compute the appropriate withholding tax on accrued interest for each holder of a Security within a coupon payment period, thereby enabling the Issuer to withhold the correct amount of taxes on coupon payments on every coupon payment date.
3. The PDS Infrastructure shall also provide and operate the system that will compute the appropriate withholding tax on previously earned interest for a seller of a Security that sells before reaching a 5-year holding period, thereby enabling the Issuer to withhold the correct amount of withholding taxes due on previously earned coupon payments.

E. PRE-TRADE REQUIREMENTS

The following pre-trade requirements shall be met for the implementation of the market framework under these Guidelines:

1. **Designation of a SSA.** Each investor acting through a Trading Participant shall designate a Securities Settlement Account to be used for the settlement of trades of such investor. The account information of a SSA shall include the tax category of the investor and the tax rate applied to security holdings in the account.
2. **Assignment of a PIC.** Each SSA of a customer of a Trading Participant shall be assigned by such Trading Participant a PDS Investor Code that is associated with the SSA and cash settlement account of such investor.
3. **Available Balance at a Selling Individual's Securities Settlement Account.** An individual selling Long-Term Bank-Issued Instruments must have sufficient Securities balance in his SSA at the point of trade for proper recognition of the inventory holding period by the CAAC system.

F. TRADING

1. For every order executed on behalf of a customer, the PIC of such customer shall be correctly entered by the Trading Participant as part of the details of each trade. PDS shall provide a mechanism for the handling of incorrectly and/or invalidly entered PICs.
2. For a selling investor's trade, the Securities inventory will be sold from the SSA associated with the entered PIC of the seller on a "first in, first out" (FIFO) basis. The

applicable withholding tax rate for the trade shall be based on the holding period of the Securities in the seller's inventory subject of the sale transaction.

3. Clean Prices and Yields to Maturity quoted and transacted for Long-Term Bank-Issued Instruments shall be based on the Global Bond Formula. The Trading System will not calculate any applicable taxes for each Long-Term Bank-Issued Instrument transaction and instead have an active link with the CAAC system which will generate the final settlement amount.

4. Settlement Value Computation.

1. The Withholding Tax on Accrued Interest up to settlement date and Tax on Previously Earned Interest due from the Seller shall be computed by the CAAC system and shall each be displayed distinctly on the CAAC system trade blotter.

- i. The Withholding Tax on Accrued Interest is computed as the Accrued Interest up to the settlement date of the trade multiplied by the applicable tax rate of the seller based on the holding period of the inventory subject of the sale transaction.
- ii. The Withholding Tax on Previously Earned Interest is computed as the sum of the interest payments earned and received by the seller during the holding period of the securities multiplied by the applicable tax rate of the seller based on the holding period of the inventory subject of the sale transaction.

2. Applicable Withholding Tax Rate. The applicable withholding tax rate for a trade of a tax-withheld selling investor shall be determined using the following schedule:

- i. **Seller's Applicable Tax Rate.** The applicable withholding tax rate of the seller is
 1. 0% if the Security was held by the seller for at least 5 years;
 2. 5% if the Security was held by the seller for at least 4 years but shorter than 5 years;
 3. 12% if the Security was held by the seller for at least 3 years but shorter than 4 years; or
 4. 20% if the Security was held by the seller for less than 3 years.
- ii. **Buyer's Applicable Tax Rate.** The applicable withholding tax rate of the buyer is
 1. 0% if the period between the settlement date of the trade to the maturity date of the Security is at least 5 years.
 2. 20% if the period between the settlement date of the trade to the maturity date of the Security is less than 5 years.

3. 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:

1. Holding Period of Investor A (Seller)- 3 years (from purchase date of 02 January 2014 to settlement date of sale 02 January 2017)
 2. Remaining Maturity of Security ABCD - less than 5 years (from settlement date of 02 January 2017 to maturity date 01 January 2020).
5. Traders will have a front-end application of the CAAC system to view in real-time the settlement amount of the trade after the two withholding taxes, if applicable, are considered. The CAAC system blotter will show amounts at the three stages of calculation of the settlement amount namely:

1. **Clean Price plus Accrued Interest.** This is the amount as initially computed by the trading platform based on a clean price and accrued interest, computed as:

i. $CP + AI$.

where

CP = **Clean Price.** Clean Price is the price per 100 face value of the Bonds that pays periodic interest and is based on ISMA 30/360E day count convention. For purposes of computing the Settlement Value, Clean Price is rounded to the 7th decimal place (e.g.: 100.1234567).

AI = **Accrued Interest**

2. **Clean Price plus Accrued Interest less Withholding Tax on Accrued Interest.** This is the amount from stage 1 less the applicable withholding tax on the accrued interest on the current coupon computed as:

i. $CP + AI - WTAI$.

where

$WTAI$ = **Withholding Tax on Accrued Interest**

3. **Settlement Amount.** This is the final amount for settlement that shall be sent to the PDS clearing and settlement system for authorization for settlement. This amount takes into account the applicable withholding tax on the accrued interest and the applicable withholding tax on previously earned interest, computed as:

i. $SA = CP + AI - WTAI - WTPEI$

where

SA = **Settlement Amount**

$WTPEI$ = **Withholding Tax on Previously Earned Interest**

G. SETTLEMENT

1. Traded Securities shall be settled and maintained in the investor's nominated Securities Settlement Account for the proper tracking of the appropriate withholding taxes.
2. The buyer in the trade, either representing itself or an Investor, will withhold both the Withholding Taxes on Accrued Interest and Withholding Taxes on Previously Earned Interest due from the seller.
3. The buyer in the trade, either representing itself or an Investor, will remit to the bank, as issuer of the Securities, 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 it has withheld.
4. **Balance in the SSA.** After settlement of a trade transaction, the balance of Securities in the SSA shall be used as basis for the calculation of the appropriate Withholding Tax on Accrued Interest due from the seller for each trade transaction considering the seller's tax classification and his Holding Period as provided for in the Guidelines.

H. Coupon Proceeds on Coupon Date

On coupon payment date, the coupon payment due to each holder of the Securities shall be computed net of the applicable final withholding taxes.

I. Change in Investor's Tax Classification and Tax Rate

In the event of a change in an investor's tax status (e.g., a taxable investor becomes exempt or vice versa), the following provisions shall apply:

1. Upon submission of the documents as required by the Issuer to establish the investor's new tax classification and tax rate, the investor, acting through a Trading Participant, shall:
 - i. Open a new SSA with the new tax rate;
 - ii. Transfer balances from the old SSA and with the old tax classification, to the new SSA on the effective date of the new tax classification and tax rate; provided, however, that an individual investor whose tax classification changes as a result of the sale or acquisition of Long-Term Bank-Issued Instruments is not required to transfer balances.
2. The CAAC shall appropriately calculate the final withholding taxes due to the investor on coupon payment date, reflecting the taxes due under the old and new tax classification on the basis of the holding period.

J. Encumbered Security Balance in the SSA

Securities in the SSA tagged and segregated as encumbered in the PDS system under instruction of the investor shall not be available for settlement of trades.