[BSP CIRCULAR NO. 280, March 29, 2001]

GUIDELINES ON THE ADOPTION IN THE PHILIPPINES OF RISK-BASED CAPITAL ADEQUACY FRAMEWORK

The Monetary Board in its Resolution No. 285 dated 16 February 2001, approved the following guidelines on the adoption in the Philippines of the risk-based capital adequacy framework pursuant to Section 34 of the General Banking Law of 2000. The guidelines shall initially cover only capital requirements for credit risks pending issuance of supplementary guidelines to incorporate market risk. Upon effectivity, the guidelines shall replace the existing provisions of Section X116 and its subsections of the Manual of Regulations for Banks, which are hereby revised to read, as follows.

"Sec. X116 Minimum Ratio - The risk-based capital ratio of a bank, expressed as a percentage of qualifying capital to risk-weighted assets, shall not be less than ten percent (10%) for both solo basis (head office plus branches) and consolidated basis (parent bank plus subsidiary financial allied undertakings, but excluding insurance companies).

The ratio shall be maintained daily

§ X 116 1 Qualifying Capital - The qualifying capital shall be the sum of --

a. Tier 1 (core) capital -

1. Paid-up common stock;
2. Paid-up perpetual and non-cumulative preferred stock;
3. Common stock dividends distributable;
4. Perpetual and non-cumulative preferred stock dividends distributable;
5. Surplus;
6. Surplus reserves;
7. Undivided profits (for domestic banks only); and
8. Minority interest in the equity of subsidiary financial allied undertakings which are less than wholly-owned: Provided, That a bank shall not use minority interests in the equity accounts of consolidated subsidiaries as avenue for introducing into its capital structure elements that might not otherwise qualify as Tier 1 capital or that would, in effect, result in an excessive reliance on preferred stock within Tier 1:

Provided, further, That the following items shall be deducted from the total of Tier 1 capital:

1. Common stock treasury shares,
2. Perpetual and non-cumulative preferred stock treasury shares;

3. Net unrealized losses on underwritten listed equity securities purchased;
4. Unbooked valuation reserves and other capital adjustments based on the latest report of examination as approved by the Monetary Board;
5. Total outstanding unsecured credit accommodations, both direct and indirect, to directors, officers, stockholders and their related interests (DOSRI);
6. Deferred income tax; and
7. Goodwill; and

b. Tier 2 (supplementary) capital which shall be the sum of-

b. 1 Upper Tier 2 capital-

1. Paid-up perpetual and cumulative preferred stock;
2. Paid-up limited life redeemable preferred stock;
3. Perpetual and cumulative preferred stock dividends distributable.
4. Limited life redeemable preferred stock dividends distributable,
5. Appraisal increment reserve - bank premises, as authorized by the Monetary Board;
6. Net unrealized gains on underwritten listed equity securities purchased. Provided, That the amount thereof that may be included in upper Tier 2 capital shall be subject to a 55% discount,
7. General loan loss provision Provided. That the amount thereof that may be included in upper Tier 2 capital shall be limited to a maximum of 1 25% of gross risk-weighted assets and any amount in excess thereof shall be deducted from the total risk weighted assets in computing the denominator of the risk-based capital ratio;
8. With prior BSP approval, unsecured subordinated debt with a minimum original maturity of at least ten (10) years, subject to the following conditions

i. It must not be secured nor covered by a guarantee of the issuer or related party

ii. It must be subordinated in the right of payment of principal and interest to all depositors and other creditors of the bank, except those creditors expressed to rank equally with, or behind holders of the debt. Subordinated creditors must waive their right to set off any amounts they owe the bank against subordinated amounts owed to them by the bank. The issue documentation must clearly state that the debt is subordinated;

iii. It must be fully paid-up. Only the net proceeds actually received from debt issues can be included as capital. If the debt is issued at a premium, the premium cannot be counted as part of capital,

iv. It must not be redeemable at the initiative of the holder;

v. It must not contain any clause which requires acceleration of payment of principal, except in the event of insolvency;

vi. It must not be repayable prior to maturity without the prior consent of the BSP; Provided, that repayment may be allowed only if --

- The bank's capital ratio is at least equal to the required minimum capital ratio; and

- The debt is simultaneously replaced with issues of new capital which is neither smaller in size nor of lower quality than the original issue;

vii. It may allow a moderate step-up in the interest rate in conjunction with a call option, only if the step-up occurs at a minimum of five (5) years after the issue date and if it results in an increase over the initial rate that is not more than 100 basis points or 50% of the initial credit spread, provided that only one (1) rate step up shall be allowed over the life of the instrument;

viii. It must provide for possible conversion into common shares or preferred shares or possible deferral of payment of principal and interest if bank's capital ratio becomes less than the required minimum capital ratio;

ix. It must provide for the principal and interest on the debt to absorb losses where the bank would not otherwise be solvent',

x. it must allow deferment of interest payment on the debt in the event of, and at the same time as, the elimination of dividends on all outstanding common or preferred stock of the issuer. It is acceptable for the deferred interest to bear interest, but the interest rate payable on deferred interest should not exceed market rates;

xi It must be underwritten by a third party not related to the issuer bank nor acting in reciprocity for and in behalf of the issuer bank;

xii. It must be issued in minimum denominations of at least five hundred thousand pesos (P500.000 00) or its equivalent: and

xiii. It must clearly state on its face that it is not a deposit and is not insured by the Philippine Deposit Insurance Corporation (PDIC); "

Provided, that it shall be subject to a cumulative discount factor of 20% per year during the last five (5) years to maturity (i.e., 20% if the remaining life is 3 years to less than 40% if the remaining life is 3 years to less than 4 years, etc.): Provided, further, That where it is denominated in a foreign currency, it shall be revalued periodically (at least monthly) in Philippine peso at prevailing exchange rate using the same exchange rate used for revaluation of foreign currency-denominated assets, liabilities and forward contracts under existing regulations: Provided, furthermore, That, for purposes of reserve requirement regulation, it shall not be treated as time deposit liability, deposit substitute liability or other forms of borrowings;

9. Deposit for common stock subscription; and

10. Deposit for perpetual and non-cumulative preferred stock subscription;

Provided, That the following items shall be deducted from the total of upper Tier 2 capital:

1. Perpetual and cumulative preferred stock treasury shares;
2. Limited life redeemable preferred stock treasury shares; and
3. Sinking fund for redemption of limited life redeemable preferred stock; and

b.*2 Lower Tier 2 capital -*

1. Unsecured subordinated debt with a minimum original maturity of at least five (5) years, subject to the following conditions;

i. It must not be secured nor covered by a guarantee of the issuer or related party;

ii. It must be subordinated in the right of payment of principal and interest to all depositors and other creditors of the bank, except those creditors expressed to rank equally with, or behind holders of the debt Subordinated creditors must waive their right to set off any amounts they owe the bank against subordinated amounts owed to them by the bank. The issue documentation must clearly state that the debt is subordinated;

iii. It must be fully paid-up. Only the net proceeds actually received from debt issues can be included as capital. If the debt is issued at a premium, the premium cannot be counted as part of capital;

iv. It must not be redeemable at the initiative of the holder;

v. It must not contain any clause which requires acceleration of payment of principal, except in the event of insolvency;

vi. It must not be repayable prior to maturity without the prior consent of the BSP: Provided, That repayment may be allowed only if --

> - The bank's capital ratio is at least equal to the required minimum capital ratio;
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> and
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> - The debt is simultaneously replaced with issue of new capital which is neither smaller in size nor of lower quality than the original issue;

vii. It may allow a moderate step-up in the interest rate in conjunction with a call option, only if the step-up occurs at a minimum of five (5) years after the issue date and if it results in an increase over the initial rate that is not more than 100 basis points or 50% of the initial credit spread, provided that only one (1) rate step up shall be allowed over the life of the instrument;

viii. It must be underwritten by a third party not related to the issuer bank nor .acting in reciprocity for and in behalf of the issuer bank;

ix. It must be issued in minimum denominations of at least five hundred thousand pesos (P500.000.00) or its equivalent; and

x. it must clearly state on its face that it is not a deposit and is not insured by the -Philippine Deposit Insurance Corporation (PDIC):

Provided, further. That it shall be subject to a cumulative discount factor of 20% per year during the last five (5) years to maturity (i.e., 20% if the remaining life is 4 years to less than 5 years, 40% if the remaining life is 3 years to less than 4 years, etc): *Provided, furthermore,* That where it is denominated in a foreign Currency, it shall be revalued periodically (at least monthly) in Philippine peso using the same exchange rate used for revaluation of foreign currency-denominated assets, liabilities and forward contracts under existing regulations; *Provided, furthermore,* That, for purposes of reserve requirement regulation, it not be treated as equivalent to a time deposit liability, deposit substitute or other forms of borrowings;

2. Deposit for perpetual and cumulative preferred stock subscription; and
3. Deposit for limited life redeemable preferred stock subscription;

Provided, That the total amount of lower Tier 2 capital that may be included in the Tier 2 capita! shall be limited to a maximum of 25% of total Tier 1 capital (net of deductions therefrom): *Provided, further,* That the total amount of upper and lower Tier 2 capital that may be included in the qualifying capital shall be limited to a maximum of 50% of total Tier 1 capital (net of deductions therefrom);

c. Less deductions from the total of Tier 1 and Tier 2 capital, as follows:

1. Investments in equity of unconsolidated subsidiary banks and other financial allied undertakings, but excluding insurance companies;

2. Investments in debt capital instruments of unconsolidated subsidiary banks;

3. Investments in equity of subsidiary insurance companies and non-financial allied undertakings; and

4. Reciprocal investments in equity and debt capital instruments of other banks ' enterprises: