

CIRCULAR NO. 280

As amended
Series of 2001

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 risks. 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.

“§ X116.1 Qualifying Capital. The qualifying capital shall be the sum of -

a. Tier 1 capital -

a.1 Core Tier 1 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 **(for domestic banks and Philippine branches of foreign banks); (by Circular 503 / 22 Dec 2005)**
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

a.2 Hybrid Tier 1 (HT1)

1. With prior BSP approval, perpetual preferred stock and perpetual unsecured subordinated debt, subject to the following conditions:

- i. The HT1 must be issued and fully paid-up. Only the net proceeds received from the issuance of HT1 shall be included as capital;
- ii. The dividends/coupons on the HT1 must be non-cumulative. It is acceptable to pay dividends/coupons in scrip or shares of stock if a cash dividend/ coupon is withheld: *Provided*, That this does not result on issuing lower quality capital: *Provided, further*, That where such dividend/coupon stock settlement feature is included, the bank should ensure that it has an appropriate buffer of authorized capital stock and appropriate stockholders and board authorization, if necessary, to fulfill their potential obligations under such issues;
- iii. The HT1 must be available to absorb losses of the bank without it being obliged to cease carrying on business. The agreement governing the issuance of the HT1 should specifically provide for the dividend/coupon and principal to absorb losses where the bank would otherwise be insolvent, or for the holders of the HT1 to be treated as if they were holders of a specified class of share capital in any proceedings commenced for the winding up of the bank. Issue documentation must disclose to prospective investors the manner by which the instrument is to be treated in loss situation.

Alternatively, the agreement governing the issuance of the HT1 can provide for automatic conversion into common shares or perpetual and non-cumulative preferred shares upon occurrence of certain trigger events, as follows:

- Breach of minimum capital ratio;
- Commencement of proceedings for winding up of the bank or
- Upon appointment of receiver for the bank.

The rate of conversion must be fixed at the time of subscription to the instrument. The bank must also ensure that it has appropriate buffer of authorized capital stock and appropriate stockholders and board authorization for conversion/issue to take place anytime;

- iv. The holders of the HT1 must not have a priority claim, in respect of principal and dividend/coupon payments of the HT1 in the event of winding up of the bank, which is higher than or equal with that of depositors, other creditors of the bank and holders of LT2 and UT2 capital instruments. The holder of the HT1 must waive his right to set-off any amount he owes the bank against any subordinated amount owed to him due to the HT1;
- v. The HT1 must be perpetual;
- vi. The HT1 must neither be secured nor covered by a guarantee of the issuer or related party or other arrangement that legally or economically enhances the priority of the claim of any holder of the HT1 as against

depositors, other creditors of the bank and holders of LT2 and UT2 capital instruments;

vii. The HT1 must not be redeemable at the initiative of the holder. It must not be repayable prior to maturity without the prior approval of the BSP: Provided, That repayment may be allowed only in connection with call option after a minimum of five (5) years from issue date: Provided, however, That a call option may be exercised within the first five (5) years from issue date when –

- The HT1 was issued for the purpose of a merger with or acquisition by the bank and the merger or acquisition is aborted;
- There is a change in tax status of the HT1 due to changes in the tax laws and/or regulations; or
- The HT1 does not qualify as Hybrid Tier 1 capital as determined by the BSP:

Provided, further, That such repayment prior to maturity shall be approved by the BSP only if the preferred share/debt is simultaneously replaced with issues of new capital which is neither smaller in size nor of lower quality than the original issue, unless the bank's capital ratio remains more than adequate after redemption.

It must not contain any clause which requires acceleration of payment of principal, except in the event of insolvency. The agreement governing the issuance of the HT1 must not contain any provision that mandates or creates an incentive for the bank to repay the outstanding principal of the instrument, e.g., a cross-default or negative pledge or a restrictive covenant, other than a call option which may be exercised by the bank;

viii. The main features of the HT1 must be publicly disclosed by annotating the same on the instrument and in a manner that is easily understood by the investor;

ix. The proceeds of the HT1 must be immediately available without limitation to the bank;

x. The bank must have full discretion over the amount and timing of dividends/coupons under the HT1 where the bank –

- Has not paid or declared a dividend on its common shares in the preceding financial year; or
- Determines that no dividend is to be paid on such shares in the current financial year.

The bank must have full control and access to waived payments;

xi. Any dividend/coupon to be paid under the HT1 must be paid only to the extent that the bank has profits distributable determined in accordance with existing BSP regulations. The dividend/coupon rate, or the formulation for calculating dividend/coupon payments must be fixed at the time of issuance of the HT1 and must not be linked to the credit standing of the bank;

xii. The HT1 may allow only one (1) moderate step-up in the dividend/coupon rate in conjunction with a call option, only if the step-up occurs at a

minimum of ten (10) years after the issue date and if it results in an increase over the initial rate that is not more than –

- 100 basis points less the swap spread between the initial index basis and the stepped-up index basis; or
- 50% of the initial credit spread less the swap spread between the initial index basis and the stepped-up index basis.

The swap spread should be fixed as of the pricing date and reflect the differential in pricing on that date between the initial reference security or rate and the stepped-up reference security or rate (Refer to [Annex A](#) for computation of dividend/coupon rate step-up);

- xiii. The HT1 must be underwritten or purchased by a third party not related to the issuer bank nor acting in reciprocity for and in behalf of the issuer bank;
- xiv. The HT1 must be issued in minimum denominations of at least five hundred thousand pesos (P500,000.00) or its equivalent;
- xv. The HT1 must clearly state on its face that it is not a deposit and is not insured by the Philippine Deposit Insurance Corporation (PDIC); and
- xvi. The bank must submit a written external legal opinion that the abovementioned requirements, including the subordination and loss absorption features, have been met:

Provided, That for purposes of reserve requirement regulation, the HT1 shall not be treated as time deposit liability, deposit substitute liability or other forms of borrowings: *Provided*, further, That the total amount HT1 that may be included in the Tier 1 capital shall be limited to a maximum of 15% of total Tier 1 capital (net of deductions therefrom). To determine the allowable amount of HT1, the amount of total Tier 1 capital (net of deductions therefrom) excluding the HT1 should be multiplied by 17.65%, the number derived from the proportion of 15% to 85% (i.e., $15\%/85\% = 17.65\%$); **(by Circular 503 / 22 Dec 2005)**

- 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 **issued with the condition that redemption thereof shall be allowed only if the shares redeemed are replaced with at least an equivalent amount of newly paid-in shares so that the total paid-in capital stock is maintained at the same level prior to redemption; (by Circular 397 / 19 Aug 2003)**
3. Perpetual and cumulative preferred stock dividends distributable;
4. Limited life redeemable preferred stock **with the replacement requirement upon redemption** dividends distributable; **(by Circular 397 / 19 Aug 2003)**
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 **(for domestic banks and Philippine branches of foreign banks); (by Circular 503 / 22 Dec 2005)**

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, hereinafter referred to as "UT2", subject to the following conditions:**
 - i. **The UT2 must be issued and fully paid-up. Only the net proceeds received from the issuance of UT2 shall be included as capital;**
 - ii. **The UT2 must be available to absorb losses of the bank without it being obliged to cease carrying on business. The agreement governing the issuance of the UT2 should specifically provide for the coupon and principal to absorb losses where the bank would otherwise be insolvent, or for the holders of the UT2 to be treated as if they were holder of a specified class of share capital in any proceedings commenced for the winding up of the bank. Issue documentation must disclose to prospective investors the manner by which the instrument is to be treated in loss situation.**

Alternatively, the agreement governing the issuance of the UT2 can provide for automatic conversion into common shares or perpetual and non-cumulative shares or perpetual and cumulative preferred shares upon occurrence of certain trigger events, as follows:

- **Breach of minimum capital ratio;**
- **Commencement of proceedings for winding up of the bank or**
- **Upon appointment of receiver for the bank.**

The rate of conversion must be fixed at the time of subscription to the instrument. The bank must also ensure that it has appropriate buffer of authorized capital stock and appropriate stockholders and board authorization for conversion/issue to take place anytime;

- iii. **The holders of the UT2 must not have a priority claim, in respect of principal and coupon payments of the UT2 in the event of winding up of the bank, which is higher than or equal with that of depositors, other creditors of the bank, and holders of LT2 capital instruments. The holder of the UT2 must waive his right to set-off any amount he owes the bank against any subordinated amount owed to him due to the UT2;**
- iv. **The UT2 must neither be secured nor covered by a guarantee of the issuer or related party or other arrangement that legally or economically enhances the priority of the claim of any holder of the UT2 as against depositors, other creditors of the bank and holders of LT2 capital instruments;**
- v. **The UT2 must not be redeemable at the initiative of the holder. It must not be repayable prior to maturity without the prior approval of the BSP: *Provided*, That repayment may be allowed only in connection with call option after a minimum of five (5) years from issue date: *Provided, however*, That a call option may be exercised within the first five (5) years from issue date when –**

- The UT2 was issued for the purpose of a merger with or acquisition by the bank and the merger or acquisition is aborted;
- There is a change in tax status of the UT2 due to changes in the tax laws and/or regulations; or
- The UT2 does not qualify as Upper Tier 2 capital as determined by the BSP:

Provided, further, That such repayment prior to maturity shall be approved by the BSP only if the debt is simultaneously replaced with issues of new capital which is neither smaller in size nor of lower quality than the original issue, unless the bank's capital ratio remains more than adequate after redemption,

It must not contain any clause which requires acceleration of payment of principal, except in the event of insolvency. The agreement governing the issuance of the UT2 must not contain any provision that mandates or creates an incentive for the bank to repay the outstanding principal of the instrument, e.g., a cross-default or negative pledge or a restrictive covenant, other than a call option which may be exercised by the bank;

- vi. The main features of the UT2 must be publicly disclosed by annotating the same on the instrument and in a manner that is easily understood by the investor;
- vii. The proceeds of the UT2 must be immediately available without limitation to the bank;
- viii. The bank must have the option to defer any coupon payment on the UT2 where the bank –
 - Has not paid or declared a dividend on its common shares in the preceding financial year; or
 - Determines that no dividend is to be paid on such shares in the current financial year;

It is acceptable for the deferred coupon to bear interest but the interest rate payable must not exceed market rates;

- ix. The coupon rate, or the formulation for calculating coupon payments must be fixed at the time of issuance of the UT2 and must not be linked to the credit standing of the bank;
- x. The UT2 may allow only one (1) moderate step-up in the coupon rate in conjunction with a call option, only if the step-up occurs at a minimum of ten (10) years after the issue date and if it results in an increase over the initial rate that is not more than –;
 - 100 basis points less the swap spread between the initial index basis and the stepped-up index basis; or
 - 50% of the initial credit spread less the swap spread between the initial index basis and the stepped-up index basis.

The swap spread should be fixed as of the pricing date and reflect the differential in pricing on that date between the initial reference security or rate and the stepped-up reference or rate (Refer to Annex A for computation of coupon rate step-up)

- xi. The UT2 must be underwritten or purchased by a third party not related to the issuer bank nor acting in reciprocity for and in behalf of the issuer bank;
- xii. The UT2 must be issued in minimum denominations of at least five hundred thousand pesos (P500,000.00) or its equivalent;
- xiii. The UT2 must clearly state on its face that it is not a deposit and is not insured by the Philippine Deposit Insurance Corporation (PDIC); and
- xiv. The bank must submit a written external legal opinion that the abovementioned requirements, including the subordination and loss absorption features, have been met:

Provided, That the UT2 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, further*, That where it is denominated in a foreign currency, it shall be revalued in accordance with PAS 21: *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; **(by Circular 503 / 22 Dec 2005)**

- 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 **with the replacement requirement upon redemption**; and **(by Circular 397 / 19 Aug 2003)**
- 3. Sinking fund for redemption of limited life redeemable preferred stock **with the replacement requirement upon redemption**; and **(by Circular 397/19 Aug 2003)**

b.2 Lower Tier 2 capital –

- 1. **Paid-up limited life redeemable preferred stock without the replacement requirement upon redemption**: *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 4 years to less than 5 years, 40% if the remaining life is 3 years to less than 4 years, etc.); **(by Circular 397 / 19 Aug 2003)**
- 2. **Limited life redeemable preferred stock without the replacement requirement upon redemption dividends distributable**; **(by Circular 397 / 19 Aug 2003)**
- 3. **Unsecured subordinated debt with a minimum original maturity of at least five (5) years, hereinafter referred to as “LT2”, subject to the following conditions**:
 - i. **The LT2 must be issued and fully paid-up. Only the net proceeds received from the issuance of LT2 shall be included as capital**;
 - ii. **The holders of the LT2 must not have a priority claim, in respect of principal and coupon payments of the LT2 in the event of winding up of**

the bank, which is higher than or equal with that of depositors and other creditors of the bank. The holder of the LT2 must waive his right to set-off any amount he owes the bank against any subordinated amount owed to him due to the LT2;

- iii. The LT2 must neither be secured nor covered by a guarantee of the issuer or related party or other arrangement that legally or economically enhances the priority of the claim of any holder of the LT2 as against depositors and other creditors of the bank;
- iv. The LT2 must not be redeemable at the initiative of the holder. It must not be repayable prior to maturity without the prior approval of the BSP: Provided, That repayment may be allowed only in connection with call option after a minimum of five (5) years from issue date: Provided, however, That a call option may be exercised within the first five (5) years from issue date when –
 - The LT2 was issued for the purpose of a merger with or acquisition by the bank and the merger or acquisition is aborted;
 - There is a change in tax status of the LT2 due to changes in the tax laws and/or regulations; or
 - The LT2 does not qualify as Lower Tier 2 capital as determined by the BSP:

Provided, further, That such repayment prior to maturity shall be approved by the BSP only if the debt is simultaneously replaced with issues of new capital which is neither smaller in size nor of lower quality than the original issue, unless the bank's capital ratio remains more than adequate after redemption.

It must not contain any clause which requires acceleration of payment of principal, except in the event of insolvency. The agreement governing the issuance of the LT2 must not contain any provision that mandates or creates an incentive for the bank to repay the outstanding principal of the instrument, e.g., a cross-default or negative pledge or a restrictive covenant other than a call option which may be exercised by the bank;

- v. The main features of the LT2 must be publicly disclosed by annotating the same on the instrument and in a manner that is easily understood by the investor;
- vi. The proceeds of the LT2 must be immediately available without limitation to the bank;
- vii. The coupon rate, or the formulation for calculating coupon payments must be fixed at the time of issuance of the LT2 and must not be linked to the credit standing of the bank;
- viii. The LT2 may allow only one (1) moderate step-up in the coupon 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 less the swap spread between the initial index basis and the stepped-up index basis; or

- 50% of the initial credit spread less the swap spread between the initial index basis and the stepped-up index basis;

The swap spread should be fixed as of the pricing date and reflect the differential in pricing on that date between the initial reference security or rate and the stepped-up reference security or rate (Refer to Annex A for computation of coupon rate step-up);

- ix. The LT2 must be underwritten or purchased by a third party not related to the issuer bank nor acting in reciprocity for and in behalf of the issuer bank;
- x. The LT2 must be issued in minimum denominations of at least five hundred thousand pesos (P500,000.00) or its equivalent;
- xi. The LT2 must clearly state on its face that it is not a deposit and is not insured by the Philippine Deposit Insurance Corporation (PDIC); and
- xii. The bank must submit a written external legal opinion that the abovementioned requirements, including the subordination feature have been met:

Provided, That the LT2 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, further*, That where it is denominated in a foreign currency, it shall be revalued in accordance with PAS 21: *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; **(by Circular 503 / 22 Dec 2005)**

4. Deposit for perpetual and cumulative preferred stock subscription; and
5. Deposit for limited life redeemable preferred stock subscription **with the replacement requirement upon redemption: (by Circular 397 / 19 Aug 2003)**

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

1. Limited life redeemable preferred stock treasury shares without the replacement requirement upon redemption;
2. Sinking fund for redemption of limited life redeemable preferred stock without the replacement requirement upon redemption: *Provided*, That the amount to be deducted shall be limited to the balance of redeemable preferred stock after applying the cumulative discount factor: **(by Circular 397 / 19 Aug 2003)**

Provided, That the total amount of lower Tier 2 capital that may be included in the Tier 2 capital shall be limited to a maximum of 50% **(by Circular 361 / 9 Dec 2002)** 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 100% **(by Circular 361 / 9 Dec 2002)** 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 of other banks/enterprises:
5. **Reciprocal investments in unsecured subordinated term debt instruments of other banks/quasi-banks (by Circular 399 / 1 Sept 2003) qualifying as Hybrid Tier 1, Upper Tier 2 and Lower Tier 2 (by Circular 503 / 22 Dec 2005), in excess of the lower of (i) an aggregate ceiling of 5% of total Tier 1 capital of the bank excluding Hybrid Tier 1 (by Circular 503 / 22 Dec 2005); or (ii) 10% of the total outstanding unsecured subordinated term debt issuance of the other bank/quasi-banks (by Circular 399 / 1 Sept 2003), (by Circular 361 / 9 Dec 2002)**

Provided, That any asset deducted from the qualifying capital in computing the numerator of the risk-based capital ratio shall not be included in the risk-weighted assets in computing the denominator of the ratio.

For foreign bank branches, Tier 1 capital elements shall consist of -

1. Assigned capital; and
2. **Net due “to” head office, branches, subsidiaries and other offices outside the Philippines as defined under Subsec. X121.5.d (inclusive of earnings not remitted to head office per Subsec. X121.5.c), *Provided*, that the amount of “Net due to account” shall be limited to an amount prescribed under Subsec. X121.6: *Provided, further*, that should there be any “Net due from account”, the same shall be deducted from the Tier 1 capital. (by Circular 503 / 22 Dec 2005)**

“§ X116.2 Risk-Weighted Assets. The risk-weighted assets shall be determined by assigning risk weights to amounts of on-balance sheet assets and to credit equivalent amounts of off-balance sheet items (inclusive of derivative contracts): *Provided*, That the following shall be deducted from the total risk-weighted assets:

1. General loan loss provision (in excess of the amount permitted to be included in upper Tier 2 capital); and
 2. Unbooked valuation reserves and other capital adjustments affecting asset accounts based on the latest report of examination as approved by the Monetary Board.
- a. For on-balance sheet assets, the risk-weighted amount shall be the product of the book value of asset multiplied by the risk weight associated with that asset, as follows:

0% risk weight -

1. Cash on hand;
2. Claims on or portions of claims guaranteed by or collateralized by securities issued by -
 - i. Philippine national government and BSP; and
 - ii. Central governments and central banks of foreign countries with the highest credit quality as defined in Subsec. X116.3;

3. **Claims on or portions of claims guaranteed by or collateralized by securities issued by multilateral development banks; - (by Circular 416 / 21 Jan 2004)**
4. Loans to the extent covered by hold-out on, or assignment of deposits/deposit substitutes maintained with the lending bank;
5. Loans or acceptances under letters of credit to the extent covered by margin deposits;
6. Portions of special time deposit loans covered by Industrial Guarantee and Loan Fund (IGLF) guarantee;
7. Real estate mortgage loans to the extent guaranteed by the Home Guaranty Corporation (HGC);
8. Loans to the extent guaranteed by the Trade and Investment Development Corporation of the Philippines (TIDCORP);
9. Foreign currency notes and coins on hand acceptable as international reserves; and
10. Gold bullion held either in own vaults, or in another's vaults on an allocated basis, to the extent it is offset by gold bullion liabilities;

20% risk weight -

1. Checks and other cash items;
2. Claims on or portions of claims guaranteed by or collateralized by securities issued by non-central government public sector entities of foreign countries with the highest credit quality as defined in Subsec. X116.3;
3. Claims on or portions of claims guaranteed by Philippine incorporated banks/quasi-banks with the highest credit quality as defined in Subsec. X116.3;
4. Claims on or portions of claims guaranteed by foreign incorporated banks with the highest credit quality as defined in Subsec. X116.3;
5. **Claims on Philippine incorporated private enterprises with the highest credit quality as defined in Subsec. X116.3;**
6. **Claims on foreign incorporated private enterprises with the highest credit quality as defined in Subsec. X116.3; (by Circular 475 / 14 Feb 2005)**
7. Loans to exporters to the extent guaranteed by Small Business Guarantee and Finance Corporation (SBGFC); **Provided, That loans to exporters to the extent guaranteed by the Guarantee Fund for Small and Medium Enterprises (GFSME) outstanding as of the date of the effectivity of the merger of the SBGFC and the GFSME shall continue to have a zero percent risk weight: Provided, further, That the zero percent risk weight shall not apply to loans renewed after the merger of the SBGFC and the GFSME. (by Circular 416 / 21 Jan 2004)**
8. Foreign currency checks and other cash items denominated in currencies acceptable as international reserves

50% risk weight –

1. Loans for housing purpose, fully secured by first mortgage on residential property that is or will be occupied or leased out by the borrower; **which are not classified as non-performing – (by Circular 475 / 14 December 2005)** and
2. **Local government unit (LGU) bonds which are covered by Deed of Assignment of Internal Revenue Allotment of the LGU and guaranteed by the LGU Guarantee Corporation; - (by Circular 310 / 10 December 2001)**

75% risk weight –

1. Defined small and medium enterprise (SME) and microfinance loan portfolio that meets the following criteria:

For individual claims that may form part of the SME and microfinance loan portfolio-

- i. Claim must be on a small or medium business enterprise as defined under existing BSP regulations; and
- ii. Claims must be in the form of:
 - Direct loans; or
 - Unavailed portion of committed credit lines and other business facilities such as outstanding guarantees issued and unused letters of credit, provided that the credit equivalent amounts thereof shall be determined in accordance with Subsection X116.2.b of the Manual of Regulations for Banks.

For the SME and microfinance loan portfolio -

- i. It must be a highly diversified portfolio, i.e., it has at least 500 borrowers that are distributed over a number of industries; and
- ii. The past due ratios of the defined SME and microfinance loan portfolio for each of the immediately preceding three (3) years do not exceed 5%.

For the bank –

- i. It must have adequate risk management process approved by the Board of Directors, including as a minimum, a rigorous credit approval process and an adequate loan tracking system that allows timely monitoring of loan releases, collection and arrearages, and any restructuring and refinancing; and
- ii. The bank must be financially sound and in compliance with major prudential requirements, particularly the following –
 - CAMELS composite rating of at least “3” and management score of at least “3” in its latest BSP examination; and
 - Minimum applicable capital adequacy ratio. *(by Circular 364 / 9 Jan 2003)*

2. Non-performing loans for housing purpose, fully secured by first mortgage on residential property that is or will be occupied or leased out by the borrower; *Provided*, That risk weighting for such loans shall be increased to 100% in 2007; *(by Circular 475 / 14 Feb 2005)*

125% risk weight –

1. All non-performing loans (except non-performing loans for housing purpose, fully secured by first mortgage on residential property that is or will be occupied or leased out by the borrower) and all non-performing debt securities; *Provided*, That risk weighting for such exposures shall be increased to 150% in 2007; *(by Circular 475 / 14 Feb 2005)*

100% risk weight –

All other assets including, among others, the following:

1. Claims on central governments and central banks of foreign countries other than those with the highest credit quality;
2. Claims on Philippine local government units;
3. Claims on non-central government public sector entities of foreign countries other than those with the highest credit quality;
4. Claims on government-owned or controlled commercial corporations;
5. Claims on Philippine incorporated banks/quasi-banks other than those with the highest credit quality;
6. Claims on foreign incorporated banks other than those with the highest credit quality;
7. **Claims on Philippine incorporated private enterprises and claims on foreign incorporated private enterprises other than those with the highest credit quality; (by Circular 475 / 14 Feb 2005)**
8. Loans to companies engaged in speculative residential building or property development;
9. Equity investments (except those deducted from capital);
10. Bank premises, furniture, fixtures and equipment (net);
11. Appraisal increment – bank premises, furniture, fixtures and equipment (net);
12. Real and other properties owned or acquired (net);
13. Foreign currency notes and coins on hand not acceptable as international reserves;
14. Gold bullion held in either own vaults, or in another's vaults on an allocated basis, that is not offset by gold bullion liabilities; and
15. Foreign currency checks and other cash items not denominated in foreign currencies acceptable as international reserves;

except those which are deducted from capital, as follows:

1. Unsecured credit accommodations, both direct and indirect, to DOSRI;
 2. Deferred income tax;
 3. Goodwill;
 4. Sinking fund for redemption of limited life redeemable preferred stock with the replacement requirement upon redemption;
 5. Sinking fund for redemption of limited life redeemable preferred stock without the replacement requirement upon redemption (limited to the balance of redeemable preferred stock after applying the cumulative discount factor);
 6. Equity investments in unconsolidated subsidiary banks and other financial allied undertakings, but excluding insurance companies;
 7. Investments in debt capital instruments of unconsolidated subsidiary banks;
 8. Equity investments in subsidiary insurance companies and non-financial allied undertakings;
 9. Reciprocal investments in equity of other banks/enterprises;
 10. **Reciprocal investments in unsecured subordinated term debt instruments of other banks/quasi-banks (by Circular 399 / 1 Sept 2003), in excess of the lower of (i) an aggregate ceiling of 5% of total Tier 1 capital of the bank; or (ii) 10% of the total outstanding unsecured subordinated term debt issuance of the other bank/quasi-banks; (by Circular 399 / 1 Sept 2003) and (by Circular 361 / 9 Dec 2002)**
 11. Net due "from" head office, branches, subsidiaries and other offices outside the Philippines, if any (for foreign bank branches).
- a. For off-balance sheet items, the risk-weighted amount shall be calculated using a two-step process. First, the credit equivalent amount of an off-balance sheet item shall be

determined by multiplying its notional principal amount by the appropriate credit conversion factor, as follows:

100% credit conversion factor -

This shall apply to direct credit substitutes, e.g., general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances), and shall include -

1. Outstanding guarantees issued - foreign loans;
2. Outstanding guarantees issued – other than foreign loans and shipside bonds/airway bills; and
3. Export letters of credit – confirmed.

This shall also apply to sale and repurchase agreements and asset sales with recourse where the credit risk remains with the bank (to the extent not included in the balance sheet), as well as to forward asset purchases, forward deposits and partly-paid shares and securities which represent commitments with certain drawdown: *Provided*, That these items shall be weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.

50% credit conversion factor –

This shall apply to certain transaction-related contingent items, e.g., performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions, and shall include –

1. Standby letters of credit - domestic (net of margin deposit) established as a guarantee that a business transaction will be performed; and
2. Standby letters of credit - foreign (net of margin deposit).

This shall also apply to -

1. Note issuance facilities and revolving underwriting facilities; and
2. Other commitments, e.g., formal standby facilities and credit lines with an original maturity of more than one (1) year. This shall include –
 - i. Underwritten accounts unsold.

20% credit conversion factor -

This shall apply to short-term, self-liquidating trade-related contingencies, e.g., documentary credits collateralized by the underlying shipments, and shall include –

1. Outstanding guarantees issued - shipside bonds/airway bills;
2. Domestic letters of credit outstanding (net of margin deposit);
3. Sight import letters of credit outstanding (net of margin deposit);
4. Usance import letters of credit outstanding (net of margin deposit);
5. Deferred letters of credit (net of margin deposit); and

6. Revolving letters of credit (net of margin deposit) arising from movement of goods and/or services.

0% credit conversion factor -

This shall apply to commitments with an original maturity of up to one (1) year, or which can be unconditionally cancelled at any time, and shall include –

1. Committed credit line for commercial paper issues.

This shall also apply to those not involving credit risk, and shall include –

1. Inward bills for collection;
2. Outward bills for collection;
3. Items held for safekeeping/custodianship;
4. Trust department accounts
5. Late deposits/payments received
6. Items held as collaterals;
7. Travelers' checks; etc.

Second, the credit equivalent amount shall be treated like any on-balance sheet asset and shall be assigned the appropriate risk weight, i.e., according to the obligor, or if relevant, the qualified guarantor or the nature of collateral.

- b. For derivative contracts, the credit equivalent amount shall be the sum of the current credit exposure (or replacement cost) and an estimate of the potential future credit exposure (or add-on): *Provided*, That the following shall not be included in the computation:
 1. Instruments which are traded on exchange where they are subject to daily receipt and payment of cash variation margin; and
 2. Exchange rate contracts with original maturity of 14 calendar days or less.

The current credit exposure shall be the positive mark-to-market value of the contract (or zero if the mark-to-market value is zero or negative). The potential future credit exposure shall be the product of the notional principal amount of the contract multiplied by the appropriate potential future credit conversion factor, as indicated below:

Residual Maturity	Interest Rate Contract	Exchange Rate Contract
One (1) year or less	0.0%	1.0%
Over one (1) year to five (5) years	0.5%	5.0%
Over five (5) years	1.5%	7.5%

Provided, That for contracts with multiple exchanges of principal, the factors are to be multiplied by the number of remaining payments in the contract: *Provided*,

further, That for contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be set equal to the time until the next reset date, and in the case of interest rate contracts with remaining maturities of more than one (1) year that meet these criteria, the potential future credit conversion factor is subject to a floor of five tenths percent (0.5%): *Provided, furthermore*, That no potential future credit exposure shall be calculated for single currency floating/floating interest rate swaps, i.e., the credit exposure on these contracts would be evaluated solely on the basis of their mark-to-market value.

The credit equivalent amount shall be treated like any on-balance sheet asset, and shall be assigned the appropriate risk weight, i.e., according to the obligor, or if relevant, the qualified guarantor or the nature of collateral: *Provided*, That a 50% risk weight shall be applied in respect of obligors which would otherwise attract a 100% risk weight.

The extent to which a claim is guaranteed/collateralized shall be determined by the amount of guarantee coverage/current market value of securities pledged, in comparison with the book value of the on-balance sheet asset or the notional principal amount of the off-balance sheet exposure, except for derivative contracts for which determination is generally made in relation to credit equivalent amount.”

“§ X116.3 Definitions.

- a. *Amount due from the BSP*. This refers to all deposits of the reporting bank with the BSP.
- b. *Appraisal increment reserve*. This shall form part of capital only if authorized by the Monetary Board.
- c. *Bank premises, furniture, fixtures and equipment net of depreciation*. This refers to the cost of land and improvements used as bank premises, and furniture, fixtures and equipment owned by the bank.
- d. *Cash on hand*. This refers to total cash held by the bank consisting of both notes and coins in Philippine currency.
- e. *Central government of a foreign country*. This refers to the central government which is regarded as such by a recognized banking supervisory authority in that country.
- f. *Claims*. This refer to loans or debt obligations of the entity on whom the claim is held, and shall include, but shall not be limited to, the following accounts, inclusive of accumulated market gains/(losses) and accumulated bond discount/(premium amortization), and net of specific allowance for probable losses:
 1. Due from BSP;
 2. Due from other banks;
 3. Interbank loans receivable;
 4. Loans and discounts;
 5. Agrarian reform and other agricultural credit loans - P.D. 717;
 6. Development incentive loans;
 7. Bills purchased;
 8. Customers' liability on bills/drafts under LCs/TRs;
 9. Customers' liability for this bank's acceptances outstanding;
 10. Restructured loans;
 11. Trading account securities – loans;
 12. Underwriting accounts - debt securities (for UBs);

13. Underwriting accounts - equity securities (for UBs);
14. Trading account securities – investments;
15. Trading account securities – equity (for UBs);
16. Available for sale securities;
17. Investments in bonds and other debt instruments; and
18. Others, e.g., accounts receivable and accrued interest receivable.

Accruals on a claim shall be classified and risk weighted in the same way as the claim. Bills purchased shall be classified as claims on the drawee banks.

- g. *Consolidated basis.* This refers to combined statement of condition of parent bank and subsidiary financial allied undertakings, but excluding insurance companies.
- h. *Debt capital instruments.* This refers to unsecured subordinated term debt instruments qualifying as capital of banks.
- i. *Equity investments.* This refers to investments in capital stock of companies, firms or enterprises, made for purposes of control, affiliation or other continuing business advantage.
- j. *Exchange rate contracts.* This includes cross-currency interest rate swaps, forward foreign exchange contracts, currency futures, currency options purchased and similar instruments.
- k. *Financial allied undertakings.* This refers to enterprises or firms with homogenous or similar activities/business/functions with the financial intermediary and may include but not limited to leasing companies, banks, investment houses, financing companies, credit card companies, financial institutions catering to small and medium scale industries (including venture capital corporations), companies engaged in stock brokerage/securities dealership, companies engaged in foreign exchange dealership/brokerage, holding companies (for UBs), and such other similar activities as the Monetary Board may declare as appropriate from time to time, but excluding insurance companies.
- l. ***Claims on foreign country and foreign incorporated bank/private enterprise and Philippine incorporated bank/quasi bank/private enterprise with the highest credit quality.*** This refers to claims on a country, bank or private enterprise given the highest credit ratings by any of the following BSP-recognized credit rating agencies:

International rating agencies:

Rating agency	Highest rating
Moody's	"Aa3" and above
Standard & Poor's	"AA-" and above
FitchRatings	"AA-" and above
And such other rating agencies as may be approved by the Monetary Board	

Domestic rating agencies:

Rating agency	Highest rating
PhilRatings	"PRS Aa" and above
And such other rating agencies as may be approved by the Monetary Board	

Provided: That for purposes of this Circular;

- **Any reference to credit rating shall refer to issue-specific rating; the issuer rating may be used only if the claim being risk-weighted is a senior obligation of the issuer and is of the same denomination applicable to the issuer rating (e.g., local currency issuer rating may be used for risk weighting local currency denominated senior claims), or in cases of guarantees;**
 - **For loans, risk weighting shall depend on either the rating of the borrower or the rating of the unsecured senior obligation of the borrower: Provided, That the loan is of the same denomination applicable to the borrower rating or rating of the unsecured senior obligation;**
 - **Domestic debt issuances may be rated by BSP-recognized domestic or international credit rating agencies who may use a national rating scale acceptable to the BSP, while international debt issuances should be rated by BSP-recognized international credit rating agencies only; and**
 - **If a claim has only one rating by any of the BSP recognized rating agencies, that rating shall be used to determine the risk weight of the claim; in cases where there are two or more ratings which map into different risk weights, the higher of the two lowest risk weights should be used. (by Circular 475 / 14 Feb 2005)**
- m. *Forward asset purchases.* This refers to a commitment to purchase a loan, security or other asset at a specified future date, usually on prearranged terms.
- n. *Forward forward deposits.* This refers to an agreement between two (2) parties whereby one will pay and the other will receive an agreed rate of interest on a deposit to be placed by one party with the other at some predetermined date in the future.
- o. *Gold bullion held in another's vault on an allocated basis.* This refers to gold bullion held by others to the order to the bank, and which is separately ascertainable.
- p. *Goodwill.* This refers to an intangible asset that represents the excess of the purchase price over the fair market value of identifiable assets acquired less liabilities assumed in acquisitions accounted for under the purchase method of accounting.
- q. *Interest rate contracts.* This includes single-currency interest rate swaps, basis swaps, forward rate agreements, interest rate futures, interest rate options purchased and similar instruments.
- r. *Loans for housing purpose, fully secured by first mortgage on residential property that is or will be occupied or leased out by the borrower.* This shall not include loans to companies engaged in speculative residential building or property development.
- s. *Loans or acceptances under letters of credit to the extent covered by margin deposits.* This shall not include the unnegotiated letters of credit or the unutilized portion thereof, or other items booked under contingent accounts. This shall also not include margin deposits against loans or acceptance accounts which are fully liquidated.
- t. *Loans to the extent covered by hold-out on, or assignment of, deposits or deposit substitutes maintained in the lending bank.* A loan shall be considered as secured by a hold-out on, or assignment of deposit or deposit substitute only if such deposit or deposit substitute account is covered by a hold-out agreement or deed of assignment signed by the depositor or investor/placer in favor of the bank. This shall not include loans transferred to/carried by the bank's trust department secured by deposit hold-out/assignment.
- u. *Multilateral development banks.* This refers to the World Bank Group comprised of the International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC), Asian Development Bank (ADB), African Development Bank (AfDB), the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IADB), the European Investment Bank (EIB); the Nordic Investment Bank (NIB); the Caribbean Development Bank (CDB), the Council of Europe Development Bank (CEDB) and such others as may be recognized by the BSP.

- v. *Non-central government public sector entity of a foreign country.* This refers to entities which are regarded as such by a recognized banking supervisory authority in the country in which they are incorporated.
- w. *Note issuance facilities and revolving underwriting facilities.* This refers to an arrangement whereby a borrower may draw down funds up to a prescribed limit over an extended period by repeated issues to the market of promissory notes which the bank committed to underwrite.
- x. *Other commitments.* This includes undrawn portion of any binding arrangements which obligate the bank to provide funds at some future date.
- y. *Other commitments with an original maturity of up to one (1) year.* This includes any revolving or undated open-ended commitments, e.g., overdrafts or unused credit lines, providing that they can be unconditionally cancelled at any time and subject to credit revision at least annually.
- z. *Partly-paid shares and securities.* This arises where only a part of the issue price or nominal face value of a security purchased has been subscribed and the issuer may call for the outstanding balance (or a further installment), either on a date predetermined at the time of issue, or at an unspecified future date.
- aa. *Perpetual preferred stock.* This refers to preferred stock that does not have a maturity date, that cannot be redeemed at the option of the holder of the instrument, and that has no provision that will require future redemption of the issue. Consistent with these provisions, any perpetual preferred stock with a feature permitting redemption at the option of the issuer may qualify as capital only if the redemption is subject to prior approval of the BSP.
- bb. *Philippine local government units.* This refers to the Philippine government units below the level of national government, such as city, provincial, and municipal governments.
- cc. *Philippine national government.* This shall refer to the Philippine national government and their agencies such as departments, bureaus, offices, and instrumentalities, but excluding government-owned and controlled commercial corporations.
- dd. *Private sector.* This refers to entities other than banks and governments. This shall also include commercial companies owned by the public sector, such as government-owned or controlled commercial corporations.
- ee. *Redeemable preferred stock.* This refers to preferred stock which under existing regulation may be redeemed at the specific dates or periods fixed for redemption, only upon prior approval of the BSP and, **where the conditions of the issuance specifically state, (by Circular 397 / 19 Aug 2003)** only if the shares redeemed are replaced with at least an equivalent amount of newly paid-in shares so that the total paid-in capital stock is maintained at the same level immediately prior to redemption: *Provided, That redemption shall not be earlier than five (5) years after the date of issuance: Provided, further, That such redemption may not be made where the bank is insolvent or if such redemption will cause insolvency, impairment of capital or inability of the bank to meet its debts as they mature.*
- ff. *Sale and repurchase agreements and asset sales with recourse.* This refers to arrangements whereby a bank sells a loan, security or fixed asset to a third party with a commitment to repurchase the asset after a certain time, or in the event to a certain contingency.
- gg. *Solo basis.* This refers to combined statement of condition of head office and branches.
- hh. *Subsidiary.* This refers to a corporation or firm more than 50% of the outstanding voting stock of which is directly or indirectly owned, controlled or held with the power to vote by a bank.
- ii. *Treasury shares.* This refers to shares of the parent bank held by a subsidiary financial allied undertaking in a consolidated statement of condition."
- jj. ***Private enterprises. This refers to all commercial companies whether organized in the form of a corporation, partnership, or sole proprietorship. (by Circular 475 / 14 Feb 2005)***

kk. **Non-performing debt securities.** This refers to debt securities as described below:

- For zero-coupon debt securities, and debt securities with quarterly, semi-annual, or annual coupon payments, they shall be considered non-performing when principal and or coupon payment is unpaid for thirty (30) days or more after due date.
- For debt securities with monthly coupon payments, they shall be considered non-performing when three (3) or more coupon payments are in arrears: Provided, however, That when the total amount of arrearages reaches twenty percent (20%) of the total outstanding balance of the debt security, the total outstanding balance of the debt security shall be considered as non-performing.

“§ X116.4 Required Reports. Banks shall submit a report of their risk-based capital ratio on a solo basis (head office plus branches) and on a consolidated basis (parent bank plus subsidiary financial allied undertakings, but excluding insurance companies) quarterly to the appropriate supervising and examining department of the BSP in the attached prescribed forms within the deadlines, i.e., 15 banking days and 30 banking days after the end of the reference quarter, respectively. **Only banks with subsidiary financial allied undertakings (excluding insurance companies) which under existing regulations are required to prepare consolidated statements of condition on a line-by-line basis shall be required to submit report on consolidated basis. The abovementioned reports shall be classified as Category A-2 reports.” (by Circular 361 / 9 Dec 2002)**

“§ X116.5 Sanctions. Whenever the capital accounts of a bank are deficient with respect to the prescribed net worth to risk assets ratio, the Monetary Board after considering a report of the appropriate supervising and examining department of the BSP on the state of solvency of the institution concerned, shall limit or prohibit the distribution of the net profits and shall require that part or all of net profits be used to increase the capital accounts of the bank until the minimum requirement has been met. The Monetary Board may restrict or prohibit the making of new investments of any sort by the bank, with the exception of purchases of readily marketable evidences of indebtedness issued by the Philippine national government and BSP included in Item a(2)i of Subsec. X116.2, until the minimum requirement capital ratio has been restored.”

“§ X116.6 Temporary Relief. In case of a bank merger, or consolidation, or when a bank is under rehabilitation under a program approved by the BSP, the Monetary Board may temporarily relieve the surviving bank, consolidated bank, or constituent bank or corporations under rehabilitation from full compliance with the required capital ratio for a maximum period of one (1) year.”

This Circular shall take effect on 1 July 2001. Banks shall, however, be required to submit trial reports using the new report format commencing on end-April 2001 report until the effectivity of this Circular.

FOR THE MONETARY BOARD:

RAFAEL B. BUENAVENTURA
Governor