



BANGKO SENTRAL NG PILIPINAS

OFFICE OF THE GOVERNOR

MEMORANDUM NO. M-2015-027

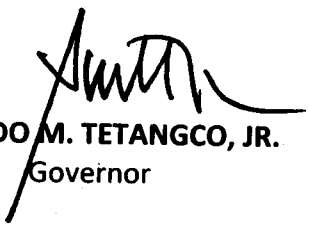
To : ALL TRUST CORPORATIONS

Subject : Capital Adequacy as Additional Component of the Trust Rating System

The Monetary Board, in its Resolution No. 945 dated 11 June 2015, approved the adoption of the attached "capital adequacy" component of the revised Trust Rating System (TRS). The capital component of the TRS is intended to evaluate the trust corporation's capacity to maintain capital commensurate to its fiduciary activities in addition to the five essential components of the revised TRS.

For information and guidance.

FOR THE MONETARY BOARD:


AMANDO M. TETANGCO, JR.
Governor

22 July 2015

Att.: a/s

Capital Adequacy

This rating reflects a trust corporation's (TC) capacity to maintain capital commensurate with the risks it is exposed to and its ability to identify, measure, monitor, and control these risks. Thus, the effect of operational, legal, reputation, strategic and other risks should be considered when assessing the adequacy of capital. Earnings performance should also be considered as poor earnings can hinder capital accretion.

Capital supports the volume, type and character of the TC's business, promotes public confidence, and is a source of financial support to protect the TC against unexpected losses, hence, is a key contributor to its safety and soundness. The TC's capital position shall be assessed in terms of its capability to support current and anticipated business activities and the inherent risks therein.

The capital rating should incorporate all examination-related adjustments. For example, capital should be adjusted to reflect any recommended examination adjustments such as additional provision expenses, reversal of improperly accrued income, corrected application of PAS or any other adjustments resulting in an increase or decline in capital.

In general, the capital component of TCs may be considered "satisfactory" (e.g. Capital component rating of 3 or 4) only when the TC has met the required capitalization commensurate to its level of business and is fundamentally sound, well managed and exhibits no significant weaknesses in the other TRS components or its risk management systems. Specifically, operations, controls and audits, and earnings should all be considered satisfactory and risk management systems should be appropriate to the level of risks assumed.

The assessment of capital shall be based on the evaluation of, but not limited to, the following factors:

1. Quantity of capital as evidenced by the level and trend of capital relative to peer and industry, and considering the TC's asset quality and earnings;
2. The composition and quality of capital as well as the off-setting effects of deferred losses and other charges and examination adjustments;
3. The adequacy of the TC's capital base given the its strategic and business plan, limit structure, exposures to risks and concentrations, and overall risk profile;
4. The TC's access to capital on reasonable terms and cost;
5. The Board's ability to pro-actively manage capital as evidenced by the Board's awareness of the TC's present and future capital needs;
6. The TC's concentrations of exposures to industries or economic sectors under stress that could affect its business plan;

7. The elevated levels of problem assets in conjunction with low levels of reserves (specific and/or general) relative to the level of classified and problem assets;
8. The TC's inability to accurately self-identify risk exposures and correspondingly provide appropriate provisioning;
9. The TC's weak operating earnings or consistent reliance on nontraditional activities, non-recurring income, sale of other assets including distressed assets, or other non-recurring income/gains;
10. The rapid growth of the business without a compensating growth in equity;
11. High levels of deferred or other charges in the capital structure; and
12. Any potential merger and acquisition (M&A) activity.

Below is the rating scale for the component *Capital*:

Rating	Definition	Description of Rating
4	"Strong"	A rating of 4 indicates a strong capital level relative to the risks the TC is exposed to. Level of capital are well above minimum regulatory requirements and risk exposures are reasonable and even low compared to equity. No significant deficiencies have been noted in Board oversight or risk management systems. Deferred losses, if any, are not sufficient to cause significant change in capital and problem assets are covered with ample reserves.
3	"Satisfactory"	A rating of 3 indicates a satisfactory capital level relative to the risks the TC is exposed to. Capital is above minimum regulatory requirements and risk exposures are moderate. Minor deficiencies may have been noted in Board oversight or risk management systems but risk is still well controlled. Deferred losses, if any, have resulted in only a nominal decline in capital and reserve coverage of classified and problem assets is satisfactory.
2	"Less Than Satisfactory"	A rating of 2 indicates a less than satisfactory level of capital that does not fully support the risks the TC is exposed to. The rating indicates a need for improvement, even if the TC's capital level exceeds minimum regulatory and statutory requirements. Capital is above regulatory requirement but risk exposures are high. Significant deficiencies may have been noted in Board oversight or risk management systems. Deferred losses, if recognized would cause a material decline in regulatory capital and reserve coverage of classified and problem assets is less than satisfactory.
1	"Deficient"	A rating of 1 indicates a deficient level of capital. In light of the TC's risk exposures, viability of the TC may be threatened. Assistance from shareholders or other external sources of financial support may be required; in some instances, such financial support needs to be immediately given. TCs that report capital at less than the prescribed minimum (net of deferred losses) should be assigned rating not higher than "2". Banks that report negative equity, net of deferred losses should always be assigned a rating of "1".