



BANGKO SENTRAL NG PILIPINAS

OFFICE OF THE GOVERNOR

CIRCULAR NO. 781

Series of 2013

Subject: Basel III Implementing Guidelines on Minimum Capital Requirements

The Monetary Board, in its Resolution No. 2096 dated 14 December 2012, approved the implementing guidelines on the revised risk-based capital adequacy framework particularly on the minimum capital and disclosure requirements for the Philippine banking system in accordance with the Basel III standards.

Section 1. The following section/subsection of the Manual of Regulations for Banks (MORB) are hereby amended as follows:

"Sec. X115 Basel III Risk-Based Capital

The guidelines implementing the revised risk-based capital adequacy framework for the Philippine banking system to conform to Basel III recommendations is provided in *Appendix 63b*.

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). Other minimum capital ratios include Common Equity Tier 1 ratio and Tier 1 capital ratios of 6.0% and 7.5%, respectively. A capital conservation buffer of 2.5%, comprised of CET1 capital, shall likewise be imposed.

(The BSP's implementation plans for the new international capital standards or Basel 2 contained in the Basel Committee on Banking Supervision document "International Convergence of Capital Measurement and Capital Standards: A Revised Framework", are shown in Appendix 63)

Subsection X115.1 Scope

The Basel III guidelines apply to all UBs and KBs, as well as their subsidiary banks and QBs."

Section 2. Section 4115 Q of the Manual of Regulations for Non-Bank Financial Institutions (MORNBI) is hereby amended as follows:

"Sec. 4115Q (2008 - 4116Q) Basel III Risk-Based Capital. The guidelines implementing the revised risk-based capital adequacy framework for the Philippine banking system to conform to Basel III recommendations is provided in *Appendix Q-46b*.

These guidelines apply to all Universal Banks (UBs) and Commercial Banks (KBs), as well as their subsidiary banks and QBs. The risk-based capital ratio of a QB, 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 QB plus subsidiary financial allied undertakings, but excluding insurance companies). Other minimum capital ratios include Common Equity Tier 1 ratio and Tier 1 capital ratios of 6.0% and 7.5%, respectively. A capital conservation buffer of 2.5%, comprised of CET1 capital, shall likewise be imposed.

The ratios shall be maintained at all times.

Subsection 4115Q.1 (2008 - 4116Q) Scope. The Basel III guidelines apply to all UBs and KBs as well as their subsidiary banks and QBs.

Section 3. Parts - I (Risk-Based Capital Adequacy ratio), II (Qualifying Capital) and VIII (Disclosure Requirements) of Appendix 63b and Q-46b of the MORB and MORNBFi, respectively, are hereby amended. Part III is likewise amended to contain the guidelines on Capital Conservation Buffer. The revisions to Appendix 63b of the MORB and Appendix Q-46b of the MORNBFi are contained in Attachment A.

Effectively, the contents of the respective appendices are renumbered as follows:

Contents	From	To
Risk-based capital adequacy ratio	Part I	Part I
Qualifying capital	Part II	Part II
Capital Conservation Buffer		Part III
Credit risk-weighted assets	Part III	Part IV
Credit derivatives	Part IV	Part V
Securitization	Part V	Part VI
Market risk-weighted assets	Part VI	Part VII
Operational risk-weighted assets	Part VII	Part VIII
Disclosures in the annual reports	Part VIII	Part IX
Enforcement	Part IX	Part X

Section 4. Existing capital instruments as of 31 December 2010 which do not meet the eligibility criteria for capital instruments under the revised capital framework shall no longer be recognized as capital upon the effectivity of this Circular. Capital instruments issued under Circular Nos. 709 and 716 and before the effectivity of Circular No. 768 dated 21 September 2012 shall be recognized as qualifying capital until 31 December 2015.

Section 5. The guidelines shall be applicable to all universal and commercial banks including their subsidiary banks/quasi-banks.

Stand-alone thrift banks, rural banks, cooperative banks and quasi-banks, as well as their subsidiary banks/quasi-banks shall continue to be subject to the existing

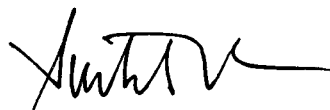
applicable regulations on risk based capital adequacy framework. However, capital instruments issued by said banks shall be subject to the criteria for inclusion as qualifying capital provided in Annexes A to C and E to F of Appendix 63b/Q-46 of the MORB/MORNBFI.

Section 6. Appendix 63d of the MORB and Appendix 46c of the MORNBFI are hereby deleted.

Section 7 Existing regulations that are deemed inconsistent with the new provisions are hereby superseded.

This circular takes effect on 01 January 2014.

FOR THE MONETARY BOARD:



AMANDO M. TETANGCO, JR.
Governor

15 January 2013

Att: A/S

**RISK-BASED CAPITAL ADEQUACY FRAMEWORK
FOR THE PHILIPPINE BANKING SYSTEM
(Appendix to Sec. X115 and Sec.4115Q (2008-4116Q))**

Introduction

This Appendix outlines the BSP implementing guidelines of the revised *International Convergence of Capital Measurement and Capital Standards*, popularly known as Basel II, and the reforms introduced in *Basel III: A global regulatory framework for more resilient banks and banking systems*. Basel II and Basel III comprise the international capital standards set by the Basel Committee on Banking Supervision (BCBS)¹.

The guidelines revises the risk-based capital adequacy framework for universal banks and commercial banks, as well as their subsidiary banks and quasi-banks. Thrift banks and rural banks as well as quasi-banks that are not subsidiaries of universal banks and commercial banks shall be subject to a different set of guidelines except the criteria for eligibility as qualifying capital.

The guidelines shall take effect on 01 January 2014.

¹ The Basel Committee on Banking Supervision is a committee of banking supervisory authorities that was established by the central bank governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Argentina, Australia, Belgium, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Spain, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. It usually meets at the Bank for International Settlements in Basel, Switzerland where its permanent Secretariat is located.

Part I. Risk-based capital adequacy ratio

1. Universal banks (UBs) and commercial banks (KBs) and their subsidiary banks and quasi-banks (QBs) shall be subject to the following risk-based capital adequacy ratios (CARs):
 - a. Common Equity Tier 1 must be at least 6.0% of risk weighted assets at all times;
 - b. Tier 1 capital must be at least 7.5% of risk weighted assets at all times; and
 - c. Qualifying capital (Tier 1 Capital plus Tier 2 Capital) must be at least 10.0% of risk weighted assets at all times.
2. Common Equity Tier 1 capital, Tier 1 capital and Qualifying capital are computed in accordance with the provisions of Part II. Risk weighted assets is the sum of (1) credit-risk weighted assets (Parts IV, V and VI), (2) market risk weighted assets (Parts VII and VIII), and (3) operational risk weighted assets (Part X).
3. The CAR requirement will be applied to all UBs and KBs and their subsidiary banks, and quasi-banks on both solo² and consolidated³ bases. The application of the requirement on a consolidated basis is the best means to preserve the integrity of capital in banks with subsidiaries by eliminating double gearing. However, as one of the principal objectives of supervision is the protection of depositors, it is essential to ensure that capital recognized in capital adequacy measures is readily available for those depositors. Accordingly, individual banks should likewise be adequately capitalized on a stand-alone basis.
4. To the greatest extent possible, all banking and other relevant financial activities (both regulated and unregulated) conducted by a bank and its subsidiaries will be captured through consolidation. Thus, majority-owned or -controlled financial allied undertakings should be fully consolidated on a line by line basis. Exemptions from consolidation shall only be made in cases where such holdings are acquired through debt previously contracted and held on a temporary basis, are subject to different regulation⁴, or where non-consolidation for regulatory capital purposes is otherwise required by law. All cases of exemption from consolidation must be made with prior clearance from the BSP.
5. Banks shall comply with the minimum CARs at all times notwithstanding that supervisory reporting shall only be on quarterly basis. Any breach, even if only

² Pertains to the reporting entity's head office and branches

³ Pertains to the reporting entity and its financial allied subsidiaries except insurance companies that are required to be consolidated on a line-by-line basis for the purpose of preparing consolidated financial statements

⁴ These currently pertain to insurance companies and securities brokers/dealers

temporary, shall be reported to the bank's Board of Directors and to BSP-SES within 3 banking days. For this purpose, banks shall develop an appropriate system to properly monitor their compliance.

6. The BSP reserves the right, upon authority of the Deputy Governor-SES, to conduct on-site inspection outside of regular or special examination, for the purpose of ascertaining the accuracy of CAR calculations as well as the integrity of CAR monitoring and reporting systems.

Part II. Qualifying capital

Qualifying Capital

1. Qualifying capital consists of the sum of the following elements, net of required deductions:
 - a. Tier 1 capital (going concern capital) is composed of:
 - i. Common Equity Tier 1 (CET1); and
 - ii. Additional Tier 1 (AT1) capital; and
 - b. Tier 2 (gone-concern) capital.
2. A bank/quasi-bank must ensure that any component of capital included in qualifying capital complies with all the eligibility criteria for the particular category of capital in which it is included.

Section A. Domestic Banks

Common Equity Tier 1 (CET1) Capital

3. Common Equity Tier 1 capital consists of:
 - a) Paid up Common stock issued by the bank that meet the eligibility criteria in Annex A;
 - b) Common stock dividends distributable;
 - c) Additional paid-in capital resulting from the issuance of common stock included in CET1 capital;
 - d) Deposit for common stock subscription;
 - e) Retained earnings;
 - f) Undivided profits;⁵

⁵For early adopters of PFRS 9, this account should include the net unrealized gains/losses on available-for-sale (AFS) debt securities;

g) Other Comprehensive Income

(1) Net unrealized gains or losses on available for sale (AFS) securities⁶; and

(2) Cumulative foreign currency translation;

- h) Minority interest in subsidiary banks which are less than wholly-owned:⁷ *Provided*, That the minority interest arises from issuances of common stock which, if issued by the bank itself, would meet all of the criteria for classification as CET1 capital: *Provided, further*, That the amount to be included as minority interest shall be reduced by the surplus Common Equity Tier 1 of the subsidiary attributable to minority shareholders: *Provided, furthermore*, That the surplus CET capital of the subsidiary attributable to minority shareholders is computed as the available CET1 capital minus the lower of: (1) the minimum CET capital requirement of the subsidiary and (2) the portion of the consolidated minimum CET requirement that is attributable to the subsidiary, multiplied by the percentage of CET held by minority shareholders.

Illustrative computation in Annex D.

Regulatory Adjustments to CET1 capital

4. The following must be deducted from/(added to) CET1 capital:

- a. Common stock treasury shares⁸, including shares that the bank could be contractually obliged to purchase;
- b. Gains (Losses) resulting from designating financial liabilities at fair value through profit or loss that are due to changes in its own credit worthiness⁹;

⁶ For early adopters of PFRS 9, this account shall refer only to “Net Unrealized gains(losses) on AFS equity securities; For AFS debt securities, refer to Footnote No.5. In view of the continuing evaluation by the Basel Committee on the appropriate treatment of unrealized gains/losses with respect to the evolution of the accounting framework, the BSP will revise its relevant regulation once the treatment of fair value adjustments in the calculation of CET1 has been determined.

⁷ Minority interest in a subsidiary that is a bank is strictly excluded from the parent bank’s common equity if the parent bank or affiliate has entered into any arrangements to fund directly or indirectly minority investment in the subsidiary whether through an SPV or through another vehicle or arrangement. The treatment of minority interest set out above is strictly available where all minority investments in the bank subsidiary solely represent genuine third party common equity contributions to the subsidiary.

⁸ Treasury shares are: (1) shares of the parent bank held by a subsidiary financial allied undertaking in a consolidated statement of condition, or (2) the reacquired shares of a subsidiary bank/quasi-bank that is required to compute its capital adequacy ratio in accordance with this framework.

⁹ This adjustment shall only apply to banks/non-banks which would not early adopt the provisions of PFRS 9 and recognize the gains/losses (relative to changes in own credit worthiness) in undivided profits.

- c. Unbooked valuation reserves and other capital adjustments based on the latest report of examination as approved by the Monetary Board;
- d. Total outstanding unsecured credit accommodations, both direct and indirect, to directors, officers, stockholders and their related interests (DOSRI);
- e. Total outstanding unsecured loans, other credit accommodations and guarantees granted to subsidiaries and affiliates;
- f. Deferred tax assets that rely on future profitability of the bank to be realized, net of any (1) allowance for impairment and (2) associated deferred tax liability, if and only if the conditions cited in PAS 12 are met; Provided, that, if the resulting figure is a net deferred tax liability, such excess cannot be added to Tier 1 capital;
- g. Goodwill, net of any allowance for impairment and any associated deferred tax liability which would be extinguished upon impairment or derecognition, including that relating to unconsolidated subsidiary banks, financial allied undertakings (excluding subsidiary securities dealers/brokers and insurance companies) (on solo basis) and unconsolidated subsidiary securities dealers/brokers, insurance companies and non-financial allied undertakings (on solo and consolidated bases);
- h. Other intangible assets, net of any allowance for impairment and any associated deferred tax liability which would be extinguished upon impairment or derecognition
- i. Gain on sale resulting from a securitization transaction;
- j. Defined benefit pension fund assets (liabilities)¹⁰;
- k. Investments in equity of unconsolidated subsidiary banks and quasi-banks, and other financial allied undertakings (excluding subsidiary securities dealers/brokers and insurance companies), after deducting related goodwill, if any (for solo basis);
- l. Investments in equity of unconsolidated subsidiary securities dealers/brokers and insurance companies after deducting related goodwill, if any (for both solo and consolidated bases);
- m. Significant minority investments (10%-50% of voting stock) in banks and quasi-banks, and other financial allied undertakings (for both solo and consolidated bases);
- n. Significant minority investments (10%-50% of voting stock) in securities dealers/brokers and insurance companies, after deducting related goodwill, if any (for both solo and consolidated bases);
- o. Minority investments (below 10% of voting stock) in unconsolidated subsidiary banks and quasi-banks, and other financial allied undertakings (excluding subsidiary securities dealers/brokers and insurance companies), after deducting related goodwill, if any (for both solo and consolidated bases);

¹⁰ The adjustment pertains to the defined benefit asset or liability that is recognized in the balance sheet. Such that CET1 cannot be increased by derecognizing the liabilities, in the same manner, any asset recognized in the balance sheet should be deducted from CET1 capital;

- p. Minority investments (below 10% of voting stock) in securities dealers/brokers and insurance companies, after deducting related goodwill, if any (for both solo and consolidated bases);

For equity investments in financial entities (items k to p), total investments include:

- i. common equity exposures in both the banking and trading book; and
- ii. underwriting positions in equity and other capital instruments held for more than five (5) days;

Provided, that should the instrument of the entity in which the bank has invested does not meet the criteria for CET1 capital of the bank, the capital is to be considered common shares and thus deducted from CET1.

- q. Other equity investments in non-financial allied undertakings and non-allied undertakings;
- r. Capital shortfalls of unconsolidated subsidiary securities dealers/brokers and insurance companies (for both solo and consolidated bases);
- s. Reciprocal investments in common stock of other banks/quasi-banks and financial allied undertakings including securities dealers/brokers and insurance companies, after deducting related goodwill, if any (for both solo and consolidated bases);
- t. Materiality thresholds in credit derivative contracts purchased;
- u. Credit-linked notes and other similar products in the banking book with issue ratings below investment grade;
- v. Securitization tranches and structured products which are rated below investment grade or are unrated; and
- w. Credit enhancing interest only strips in relation to a securitization structure, net of the amount of "gain-on-sale" that must be deducted from Common Equity Tier 1 capital.

Additional Tier 1 (AT1) Capital

5. Additional Tier 1 capital consists of the following:

- a. Instruments issued by the bank that are not included in CET1 capital that meet the following:
 - i. criteria for inclusion in Additional Tier 1 capital as set out in Annex B;

- ii. required loss absorbency features for instruments classified as liabilities for accounting purposes. The loss absorbency requirements are provided in Annex E; and
 - iii. Required loss absorbency feature at point of non-viability as set out in Annex F.
- b. Additional paid-in capital resulting from the issuance of instruments included in AT1 capital;
 - c. Deposit for subscription of Additional Tier 1 capital instruments;
 - d. Minority interest in subsidiary banks which are less than wholly-owned:¹¹
Provided, That the minority interest arises from issuances of Tier 1 instruments, if issued by the bank itself, would meet all of the criteria for classification as Tier 1 capital: *Provided, further*, That the amount to be included as minority interest shall be reduced by the surplus Tier 1 capital of the subsidiary attributable to minority shareholders: *Provided, furthermore*, That the surplus Tier 1 capital of the subsidiary attributable to minority shareholders is computed as the available Tier 1 capital minus the lower of: (1) the minimum Tier 1 capital requirement of the subsidiary and (2) the portion of the consolidated minimum Tier 1 requirement that is attributable to the subsidiary, multiplied by the percentage of Tier 1 held by minority shareholders. *Provided, finally*, That the amount of Tier 1 Capital to be recognized in Additional Tier 1 capital will exclude amounts recognized in CET1 capital.

Illustrative computation in Annex D.

Regulatory Adjustments to AT1 capital

6. The following are the adjustments to AT1 capital:
- a. AT1 instruments treasury shares¹², including shares that the bank could be contractually obliged to purchase;
 - b. Investments in equity of unconsolidated subsidiary banks and quasi-banks, and other financial allied undertakings (excluding subsidiary securities dealers/brokers and insurance companies), after deducting related goodwill, if any (for solo basis);
 - c. Investments in equity of unconsolidated subsidiary securities dealers/brokers and insurance companies- after deducting related goodwill, if any (for both solo and consolidated bases);

¹¹ Please refer to Footnote No.7

¹² Please refer to Footnote No. 8

- d. Significant minority investments (10%-50% of voting stock) in banks and quasi-banks, and other financial allied undertakings (for both solo and consolidated bases);
- e. Significant minority investments (10%-50% of voting stock) in securities dealers/brokers and insurance companies, after deducting related goodwill, if any (for both solo and consolidated bases);
- f. Minority investments (below 10% of voting stock) in banks and quasi-banks, and other financial allied undertakings (for both solo and consolidated bases);
- g. Minority investments (below 10% of voting stock) in securities dealers/brokers and insurance companies, after deducting related goodwill, if any (for both solo and consolidated bases).

For equity investments in financial entities (items b to g), total investments include:

- i. other capital instruments in both the banking and trading book; and
- ii. underwriting positions in equity and other capital instruments held for more than five (5) days;

Provided, that should the instrument of the entity in which the bank has invested does not meet the criteria for AT1 capital of the bank, the capital is to be considered common shares and thus deducted from CET1 capital.

- h. Reciprocal investments in Additional Tier 1 capital instruments of other banks/quasi-banks and financial allied undertakings including securities dealers/brokers and insurance companies, after deducting related goodwill, if any (for both solo and consolidated bases);

Tier 2 Capital

7. Tier 2 capital is composed of the following:

- a. Instruments issued by the bank (and are not included in AT1 capital) that meet the following:
 - i. criteria for inclusion in Tier 2 capital as set out in Annex C; and
 - ii. Required loss absorbency feature at point of non-viability as set out in Annex F.
- b. Deposit for subscription of T2 capital;
- c. Appraisal increment reserve – bank premises, as authorized by the Monetary Board;

- d. General loan loss provision, limited to a maximum of 1.00% of credit risk-weighted assets, and any amount in excess thereof shall be deducted from the credit risk-weighted assets in computing the denominator of the risk-based capital ratio;
- e. Minority interest in subsidiary banks which are less than wholly-owned:¹³
Provided, That the minority interest arises from issuances of capital instruments, if issued by the bank itself, would meet all of the criteria for classification as Tier 1 or Tier 2 capital: *Provided, further*, That the amount to be included as minority interest shall be reduced by the surplus total capital of the subsidiary attributable to minority shareholders: *Provided, furthermore*, That the surplus total capital of the subsidiary attributable to minority shareholders is computed as the available total capital minus the lower of: (1) the minimum total capital requirement of the subsidiary and (2) the portion of the consolidated minimum total capital requirement that is attributable to the subsidiary, multiplied by the percentage of total capital held by minority shareholders. *Provided, finally*, That the total capital that will be recognized in Tier 2 will exclude amounts recognized in CET1 and AT1 capital.

Illustrative computation in Annex D

Regulatory Adjustments to Tier 2 capital

- 8. The following adjustments shall be charged against Tier 2 capital:
 - a. Tier 2 instruments treasury shares¹⁴, including shares that the bank could be contractually obliged to purchase;
 - b. Investments in equity of unconsolidated subsidiary banks and quasi-banks, and other financial allied undertakings (excluding subsidiary securities dealers/brokers and insurance companies), after deducting related goodwill, if any (for solo basis);
 - c. Investments in equity of unconsolidated subsidiary securities dealers/brokers and insurance companies—after deducting related goodwill, if any (for both solo and consolidated bases);
 - d. Significant minority investments (10%-50% of voting stock) in banks and quasi-banks, and other financial allied undertakings (for both solo and consolidated bases);
 - e. Significant minority investments (10%-50% of voting stock) in securities dealers/brokers and insurance companies, after deducting related goodwill, if any (for both solo and consolidated bases);

¹³ Please refer to footnote No.7

¹⁴ Please refer to Footnote No.8

- f. Minority investments (below 10% of voting stock) in banks and quasi-banks, and other financial allied undertakings (for both solo and consolidated bases);
- g. Minority investments (below 10% of voting stock) in securities dealers/brokers and insurance companies, after deducting related goodwill, if any (for both solo and consolidated bases).

For equity investments in financial entities (items b to g), total investments include:

- i. other capital instruments in both the banking and trading book; and
- ii. underwriting positions in equity and other capital instruments held for more than five (5) days;

Provided, that should the instrument of the entity in which the bank has invested does not meet the criteria for T2 capital of the bank, the capital is to be considered common shares and thus deducted from CET1 capital.

- h. Sinking fund for the redemption of T2 capital instruments
 - i. Reciprocal investments in T2 capital instruments of other banks/quasi-banks and financial allied undertakings including securities dealers/brokers and insurance companies, after deducting related goodwill, if any (for both solo and consolidated bases);
9. Any asset deducted from 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.

Section B. (Reserved for Branches of Foreign Banks)

Part III. Capital Conservation Buffer

1. A Capital Conservation Buffer of 2.5% of risk-weighted assets, comprised of CET1 capital, shall be required of U/KBs and their subsidiary banks and quasi-banks.
2. This buffer is meant to promote the conservation of capital and build up of adequate cushion that can be drawn down by banks to absorb losses during periods of financial and economic stress.
3. Where a bank does not have positive earnings, has CET1 of not more than 8.5% (CET1 Ratio of 6% plus conservation buffer of 2.5%) and has not complied with the 10% minimum CAR, it would be restricted from making positive distributions, as illustrated below:

Level of CET 1 capital	Restriction on Distributions
<6.0%	No distribution
6.0%-7.25%	No distribution until more than 7.25% CET1 capital is met
>7.25%-8.5%	50% of earnings may be distributed
>8.5%	No restriction on distribution

4. Elements subject to the restriction on distributions include dividends, share buybacks, discretionary payments on other Tier 1 capital instruments, and discretionary bonus payments to staff.
5. Payments which do not result in the depletion of CET1 are not considered distributions.
6. Earnings refer to distributable profits calculated prior to the deduction of elements subject to the restriction on distributions. The earnings is computed after the tax which would have been reported had none of the distributable items been paid.
7. The framework shall be applied on both solo and consolidated basis. The distribution constraints when applied to solo basis (individual bank level) would allow conservation of resources in specific parts of the group.
8. Drawdowns on the capital conservation buffers are generally allowed, subject to certain restrictions on distributions. However, U/KBs and their subsidiary banks and quasi-banks shall be subject to a capital restoration plan within the timeframe determined by the BSP. This restoration plan shall likewise be required for banks under the PCA framework.

9. While banks are not prohibited from raising capital from private sector in case they wish to distribute in excess of the constraints, this matter should be discussed with the BSP and included in the capital planning process.

Part IX Disclosures in the Annual Reports and Published Financial Statements

1. This section lists the specific information that banks have to disclose, at a minimum, in their Annual Reports, except Item "i", paragraph 3 which should also be disclosed in banks' quarterly Published Balance Sheet
2. Full compliance of these disclosure requirements is a prerequisite before banks can obtain any capital relief (i.e., adjustments in the risk weights of collateralized or guaranteed exposures) in respect of any credit risk mitigation techniques.

A. Capital structure and capital adequacy

3. The following information with regard to banks' capital structure and capital adequacy shall be disclosed in banks' Annual Reports, except Item "i" below which should also be disclosed in banks' quarterly published Balance Sheet:
 - a) CET 1 capital and a breakdown of its components;
 - b) Tier 1 capital and a breakdown of its components;
 - c) Tier 2 capital and a breakdown of its components;
 - d) Total qualifying capital;
 - e) Capital Conservation Buffer;
 - f) Capital requirements for credit risk (including securitization exposures);
 - g) Capital requirements for market risk;
 - h) Capital requirements for operational risk; and
 - i) Total CAR, Tier 1 and CET1 ratios on both solo and consolidated bases.
4. In addition to the above disclosure requirements, the following shall likewise be disclosed to improve transparency of regulatory capital and enhance market discipline:
 - a) Full reconciliation of all regulatory capital elements back to the balance sheet in the audited financial statements;
 - b) All regulatory adjustments/deductions, as applicable;
 - c) Description of the main features of capital instruments issued; and
 - d) Comprehensive explanations of how ratios involving components of regulatory capital are calculated.
5. On top of the above disclosure requirements, banks/quasi-banks shall be required to make available on their websites the full terms and conditions of all instruments included in regulatory capital.

B. Risk exposures and assessments

6. For each separate risk area (credit, market, operational, interest rate risk in the banking book), banks must describe their risk management objectives and policies, including:

- a) Strategies and processes;
- b) The structure and organization of the relevant risk management function;
- c) The scope and nature of risk reporting and/or measurement systems; and
- d) Policies for hedging and/or mitigating risk, and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.

Credit risk

7. Aside from the general disclosure requirements stated in paragraph 4, the following information with regard to credit risk have to be disclosed in banks' Annual Reports:
 - a) Total credit risk exposures (i.e., principal amount for on-balance sheet and credit equivalent amount for off-balance sheet, net of specific provision) broken down by type of exposures as defined in Part III;
 - b) Total credit risk exposure after risk mitigation, broken down by:
 - i. type of exposures as defined in Part III; and
 - ii. risk buckets, as well as those that are deducted from capital;
 - c) Total credit risk-weighted assets broken down by type of exposures as defined in Part III;
 - d) Names of external credit assessment institutions used, and the types of exposures for which they were used;
 - e) Types of eligible credit risk mitigants used including credit derivatives;
 - f) For banks with exposures to securitization structures, aside from the general disclosure requirements stated in paragraph 4, the following minimum information have to be disclosed:
 - i. Accounting policies for these activities;
 - ii. Total outstanding exposures securitized by the bank; and
 - iii. Total amount of securitization exposures retained or purchased broken down by exposure type;
 - g) For banks that provide credit protection through credit derivatives, aside from the general disclosure requirements stated in paragraph 4, total outstanding amount of credit protection given by the bank broken down by type of reference exposures should also be disclosed; and
 - h) For banks with investments in other types of structured products, aside from the general disclosure requirements stated in paragraph 4, total outstanding amount of other types of structured products issued or purchased by the bank broken down by type should also be disclosed.

Market risk

8. Aside from the general disclosure requirements stated in paragraph 4, the following information with regard to market risk have to be disclosed in banks' Annual Reports:

- a) Total market risk-weighted assets broken down by type of exposures (interest rate, equity, foreign exchange, and options); and
- b) For banks using the internal models approach, the following information have to be disclosed:
 - i. The characteristics of the models used;
 - ii. A description of stress testing applied to the portfolio;
 - iii. A description of the approach used for backtesting/validating the accuracy and consistency of the internal models and modeling processes;
 - iv. The scope of acceptance by the BSP; and
 - v. A comparison of VaR estimates with actual gains/losses experienced by the bank, with analysis of important outliers in backtest results.

Operational risk

- 9. Aside from the general disclosure requirements stated in paragraph 4, banks have to disclose their operational riskweighted assets in their Annual Reports.

Interest rate risk in the banking book

- 10. Aside from the general disclosure requirements stated in paragraph 4, the following information with regard to interest rate risk in the banking book have to be disclosed in banks' Annual Reports:
 - a) Internal measurement of interest rate risk in the banking book, including assumptions regarding loan prepayments and behavior of nonmaturity deposits, and frequency of measurement; and
 - b) The increase (decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to internal measurement of interest rate risk in the banking book.

Common Shares

Criteria for classification as common shares for regulatory capital purposes

1. It represents the most subordinated claim in liquidation.
2. It is entitled to a claim on the residual assets that is proportional with its share of issued capital, after all senior claims have been repaid in liquidation (i.e., has an unlimited and variable claim, not a fixed or capped claim).
3. Its principal is perpetual and never repaid outside of liquidation (setting aside discretionary repurchases or other means of effectively reducing capital in a discretionary manner that is allowable under relevant law).
4. The bank does nothing to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled nor do the statutory or contractual terms provide any feature which might give rise to such an expectation.
5. The distributions are paid out of distributable items (retained earnings included). The level of distributions is not in any way tied or linked to the amount paid in at issuance and is not subject to a contractual cap (except to the extent that a bank is unable to pay distributions that exceed the level of distributable items).
6. There are no circumstances under which the distributions are obligatory. Non payment is therefore not an event of default.
7. The distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. This means that there are no preferential distributions, including in respect of other elements classified as the highest quality issued capital.
8. It is the issued capital that takes the first and proportionately greatest share of any losses as they occur¹. Within the highest quality capital, each instrument absorbs losses on a going concern basis proportionately and *pari passu* with all the others.
9. The paid in amount is recognized as equity capital (i.e., not recognized as a liability) for determining balance sheet insolvency.

¹ In cases where capital instruments have a permanent write-down feature, this criterion is still deemed to be met by common shares.

10. The paid in amount is classified as equity under the relevant accounting standards.
11. It is directly issued and paid-in and the bank can not directly or indirectly have funded the purchase of the instrument.
12. It must be underwritten by a third party not related to the issuer bank/quasi-bank nor acting in reciprocity for and in behalf of the issuer bank/quasi-bank.
13. The paid in amount is neither secured nor covered by a guarantee of the issuer or related entity² or subject to any other arrangement that legally or economically enhances the seniority of the claim.
14. It is only issued with the approval of the owners of the issuing bank, either given directly by the owners or, if permitted by applicable law, given by the Board of Directors or by other persons duly authorized by the owners.
15. It is clearly and separately disclosed on the bank's balance sheet.

² A related entity can include a parent company, a sister company, a subsidiary or any affiliate. A holding company is a related entity irrespective of whether it forms part of the consolidated banking group .

Additional Tier 1 Capital

Criteria for inclusion in Additional Tier 1 capital

1. It must be issued and paid-in.
2. It must be subordinated to depositors, general creditors and subordinated debt of the bank/quasi-bank.
3. It is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank/quasi-bank creditors.
4. It is perpetual, ie., there is no maturity date and there are no step-ups or other incentives to redeem.
5. It may be callable at the initiative of the issuer only after a minimum of five years, subject to the following conditions:
 - a. To exercise a call option a bank/quasi-bank must receive prior supervisory approval;
 - b. A bank/ quasi-bank must not do anything which creates an expectation that the call will be exercised; and
 - c. Banks/quasi-banks must not exercise a call unless:
 - i. They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank/quasi-bank;¹ or
 - ii. The bank/ quasi-bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised;
6. Any repayment of principal (eg. through repurchase or redemption) must be with prior supervisory approval and banks should not assume or create market expectations that supervisory approval will be given.
7. With regard to dividend/coupon discretion:
 - a. The bank/ quasi-bank must have full discretion at all times to cancel distributions/payments²;

¹ Replacement issues can be concurrent with but not after the instrument is called.

² A consequence of full discretion at all times to cancel distributions/payments is that “dividend pushers” are prohibited. An instrument with a dividend pusher obliges the issuing bank to make a dividend/coupon payment on the instrument if it has made a payment on another (typically more junior) capital instrument or share. This obligation is inconsistent with the requirement for full

- b. Cancellation of discretionary payments must not be an event of default;
 - c. Banks/ quasi-banks must have full access to cancelled payments to meet obligations as they fall due;
 - d. Cancellation of distributions/payments must not impose restrictions on the bank except in relation to distributions to common stockholders.
8. Dividends/coupons must be paid out of distributable items.
 9. The instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the bank's/ quasi-bank 's credit standing.
 10. The instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of national insolvency law.
 11. Instruments classified as liabilities for accounting purposes must have principal loss absorption through either (i) conversion to common shares or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point. The trigger point is set at CET1 ratio of 7.25% or below or as determined by the BSP. The bank must submit an expert's opinion on the accounting treatment/classification of the instruments.

The guidelines on loss absorbency features of AT1 capital as provided in Annex E shall likewise be observed.

12. It must have a provision that requires the instrument to either be written off or converted into common equity upon the occurrence of a trigger event.

The trigger event occurs when a bank/quasi-bank is considered nonviable as determined by the BSP. Non-viability is defined as a deviation from a certain level of Common Equity Tier 1 (CET1) Ratio, inability of the bank/quasi-bank to continue business (CLOSURE), or any other event as may be determined by the BSP, which ever comes earlier.

The issuance of any new shares as a result of the trigger event must occur prior to any public sector injection of capital so that the capital provided by the public sector is not diluted.

The guidelines on loss absorbency features of AT1 capital at point of non-viability as provided in Annex F shall likewise be observed.

13. The write-down will have the following effects:

discretion at all times. Furthermore, the term "cancel distributions/payments" means extinguish these payments. It does not permit features that require the bank to make distributions/payments in kind.

- a. Reduce the claim of the instrument in liquidation;
 - b. Reduce the amount re-paid when a call is exercised; and
 - c. Partially or fully reduce coupon/dividend payments on the instrument.
14. Neither the bank/quasi-bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the bank/ quasi-bank directly or indirectly have funded the purchase of the instrument.
15. The instrument cannot have any features that hinder recapitalization, such as provisions that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame.
16. It must be underwritten by a third party not related to the issuer bank/quasi-bank nor acting in reciprocity for and in behalf of the issuer bank/ quasi-bank;
17. It must clearly state on its face that it is not a deposit and is not insured by the Philippine Deposit Insurance Corporation (PDIC).
18. The bank/quasi-bank must submit a written external legal opinion that the above-mentioned requirements, including the subordination and loss absorption features have been met.
19. If the instrument is not issued out of an operating entity or the holding company in the consolidated group (eg a special purpose vehicle – “SPV”), proceeds must be immediately available without limitation to an operating entity or the holding company in the consolidated group in a form which meets or exceeds all of the other criteria for inclusion in Additional Tier 1 capital.³

³ Capital issued to third parties out of a special purpose vehicle cannot be included in Common Equity Tier1. Instruments meeting the criteria for eligibility as Additional Tier 1 capital will be treated as if the bank itself has issued the capital directly to 3rd parties. In cases where the capital has been issued to 3rd parties through an SPV via a fully consolidated subsidiary of the bank, such capital subject to the requirements for eligibility as AT1 capital, be treated as if the subsidiary itself had issued it directly to the third parties and may be included in the banks consolidated additional Tier 1 capital based on the treatment of minority interest.

Tier 2 Capital

Criteria for inclusion in Tier 2 Capital

1. It must be issued and paid-in.
2. It must be subordinated to depositors and general creditors of the bank/quasi-bank.
3. It is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and general creditors of the bank/quasi-bank.
4. With regard to maturity:
 - a. It must have a minimum original maturity of at least five years;
 - b. Its recognition in regulatory capital in the remaining five years before maturity will be amortized on a straight line basis as shown in the table below; and

Remaining maturity	Discount factor
5 years & above	0%
4 years to <5 years	20%
3 years to <4 years	40%
2 years to <3 years	60%
1 year to <2 years	80%
< 1 year	100%

- c. There are no step-ups or other incentives to redeem.
5. It may be callable at the initiative of the issuer only after a minimum of five years:
 - a. To exercise a call option, a bank/quasi-bank must receive prior supervisory approval; and
 - b. A bank must not do anything which creates an expectation that the call will be exercised¹; and
 - c. Banks/quasi-banks must not exercise a call unless:

¹ An option to call the instrument after five (5) years) but prior to the start of the amortization period will not be viewed as an incentive to redeem as long as the bank/quasi-bank does not do anything that creates an expectation that the call will be exercised at this point

- i. They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank/quasi-bank;² or
 - ii. The bank/quasi-bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.
- 6. The investor must have no rights to accelerate the repayment of future scheduled payments (coupon or principal), except in bankruptcy and liquidation.
- 7. The instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the bank's/quasi-bank's credit standing.
- 8. Neither the bank nor a related party over which the bank/quasi-bank exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly have funded the purchase of the instrument.
- 9. It must be underwritten by a third party not related to the issuer bank/quasi-bank nor acting in reciprocity for and in behalf of the issuer bank/quasi-bank.
- 10. It must have a provision that requires the instrument to either be written off or converted into common equity upon the occurrence of a trigger event.

The trigger event occurs when a bank/quasi-bank is considered nonviable as determined by the BSP. Non-viability is defined as a deviation from a certain level of Common Equity Tier 1 (CET1) Ratio, inability of the bank/quasi-bank to continue business (CLOSURE) or any other event as determined by the BSP, whichever comes earlier.

The issuance of any new shares as a result of the trigger event must occur prior to any public sector injection of capital so that the capital provided by the public sector is not diluted.

The guidelines on loss absorbency features of Tier 2 capital at point of non-viability as provided in Annex F shall likewise be observed.

- 11. The write-down will have the following effects:
 - a. Reduce the claim of the instrument in liquidation;
 - b. Reduce the amount re-paid when a call is exercised; and
 - c. Partially or fully reduce coupon/dividend payments on the instrument.

² Replacement issues can be concurrent with but not after the instrument is called.

12. The bank/quasi-bank must submit a written external legal opinion that the above-mentioned requirements, including the subordination and loss absorption features have been met.
13. It must clearly state on its face that it is not a deposit and is not insured by the Philippine Deposit Insurance Corporation (PDIC).
14. If the instrument is not issued out of an operating entity or the holding company in the consolidated group (eg a special purpose vehicle – “SPV”), proceeds must be immediately available without limitation to an operating entity or the holding company in the consolidated group in a form which meets or exceeds all of the other.³

³Capital issued to third parties out of a special purpose vehicle cannot be included in Common Equity Tier1. Instruments meeting the criteria for eligibility as Tier 2 capital will be treated as if the bank itself has issued the capital directly to 3rd parties. In cases where the capital has been issued to third parties through an SPV via a fully consolidated subsidiary of the bank, such capital subject to the requirements for eligibility as Tier 2 capital, be treated as if the subsidiary itself had issued it directly to third parties through an SPV via a fully consolidated subsidiary of the bank, such capital subject to the requirements for eligibility as AT1 capital, be treated as if the subsidiary itself had issued it directly to the third parties and may be included in the banks consolidated additional Tier 1 capital based on the treatment of minority interest.

Illustrative Sample

Computation of eligible minority interests to be included in parent bank's capital base

The case:

A banking group consists of two legal entities that are both banks – Bank P is the parent and Bank S is the subsidiary. Their individual balance sheets are set out below.

Bank P – Balance Sheet		Bank S - Balance Sheet	
<u>Assets</u>		<u>Assets</u>	
Loans	90	Loans	160
CET1 investments in Bank S	30		
AT1 investments in Bank B	9		
Tier 2 investments in Bank S	4		
<u>Liabilities and Equity</u>		<u>Liabilities and Equity</u>	
Deposits	70	Deposits	90
Tier 2 capital instruments	20	Tier 2 capital instruments	16
AT1 capital instruments	12	AT1 capital instruments	11
CET1 capital instruments	31	CET1 capital instruments	43

The consolidated balance sheet of the banking group is set out below:

Consolidated balance sheet	
Assets	
Loans	250
Liabilities and equity	
Deposits	160
Tier 2 issued by subsidiary to third parties	12
Tier 2 issued by parent	20
AT1 issued by subsidiary to third parties	2
AT1 issued by parent	12
Common Equity issued by subsidiary to third parties (i.e., minority interest)	13
Common Equity issued by parent	31

The balance sheet of Bank P shows that in addition to its loans to customers, it has investments in Bank S as follows:

1. 70% of common shares;
2. 82% of Additional Tier 1 capital; and
3. 25% of Tier 2 capital.

	Amount issued to Bank P		Amount issued to third parties		Total
CET1	30	70%	13	30%	43
AT1	9	82%	2	18%	11
Tier 1	39		15		54
Tier 2	4	25%	12	75%	16
Total Capital	43		27		70

(A) Computation of minority interests arising from ordinary shares issued by a consolidated bank subsidiary

Step 1 –

Calculate the surplus CET1 of Bank S in excess of its 8.5% minimum CET1 plus conservation buffer requirement (i.e., 6.0% + 2.5%). Bank S is assumed to have risk weighted assets of 100.

Minimum and surplus capital of Bank S		
	Minimum plus capital conservation buffer	Surplus capital
CET1	8.5 (= 8.5% * 100)	34.5 (= 43 - 8.5)

Step 2 –

Calculate the eligible portion of minority interest (MI) arising from CET1 issued by Bank S that is allowed to be included in the consolidated capital of Bank P (i.e., item (e)).

Bank S : amount of capital issued to third parties included in consolidated capital					
	Total amount issued (a)	Amount issued to third parties (b)	Surplus capital (c)	Surplus attributable to third parties (i.e., amount excluded from consolidated capital) (d) = (c) * (b)/(a)	Amount included in consolidated capital (e) = (b) - (d)
CET1	43	13	34.5	10.4	2.6

Step 3 –

The eligible amount of MI to be included in the consolidated CET1 Capital of Bank P is 2.6.

	Total amount issued by Bank P (all of which is to be included in consolidated capital)	Amount issued by Bank S to third parties to be included in consolidated capital of Bank P	Total amount issued by Bank P and Bank S to be included in consolidated capital of Bank P
CET1	31	2.6	33.6

(B) Minority interests arising from ordinary shares and Additional Tier 1 capital instruments issued by a consolidated bank subsidiary

Step 1 –

Calculate the surplus Tier 1 Capital of Bank S in excess of its 10% minimum Tier 1 capital plus capital conservation buffer requirement (i.e., 7.5% + 2.5%). Bank S is assumed to have risk weighted assets of 100.

Minimum and surplus capital of Bank S		
	Minimum plus capital conservation buffer	Surplus capital
Tier 1	10 (= 10% * 100)	44 (=(43+11) – 10)

Step 2 –

Calculate the eligible portion of MI arising from Tier 1 Capital issued by Bank S that is allowed to be included in the consolidated capital of Bank P (i.e., item (e))

Bank S : amount of capital issued to third parties included in consolidated capital					
	Total amount issued (a)	Amount issued to third parties (b)	Surplus capital (c)	Surplus attributable to third parties (i.e., amount excluded from consolidated capital) (d) = (c) * (b)/(a)	Amount included in consolidated capital (e) = (b) - (d)
CET1	43	13	34.5	10.4	2.6
Tier 1	54	15	44	12.2	2.8

Step 3 –

The eligible amount for inclusion in Bank P's consolidated AT1 Capital is 0.2, arrived at by excluding from the eligible amount for inclusion as Tier 1 Capital (i.e., 2.8) the amount that has already been recognized in CET1 (i.e., 2.6).

	Total amount issued by Bank P (all of which is to be included in consolidated capital)	Amount issued by Bank S to third parties to be included in consolidated capital of Bank P	Total amount issued by Bank P and Bank S to be included in consolidated capital of Bank P
CET1	31	2.6	33.6
AT1	12	0.2	12.2
Tier 1	43	2.8	45.8

(C) Minority interests arising from Tier 1 capital instruments and Tier 2 capital instruments issued by a consolidated bank subsidiary

Step 1 –

Calculate the surplus total capital of Bank S in excess of 12.5% minimum total capital plus conservation buffer requirement (i.e., 10% + 2.5%). Bank S is assumed to have risk weighted assets of 100.

Minimum and surplus capital of Bank S		
	Minimum plus capital conservation buffer	Surplus capital
Tier 2	12.5 (= 12.5% * 100)	57.5 (=(43+11+16) - 12.5)

Step 2 –

Calculate the eligible portion of MI arising from total capital by Bank S that is allowed to be included in the consolidated capital of Bank P (i.e., item (e)).

Bank S : amount of capital issued to third parties included in consolidated capital					
	Total amount issued (a)	Amount issued to third parties (b)	Surplus capital (c)	Surplus attributable to third parties (i.e., amount excluded from consolidated capital) (d) = (c) * (b)/(a)	Amount included in consolidated capital (e) = (b) - (d)
CET1	43	13	34.5	10.4	2.6
Tier 1	54	15	44	12.2	2.8
Total Capital	70	27	57.5	22.2	4.8

Step 3 –

The eligible amount for inclusion in Bank P's consolidated capital is 2.0, arrived at by excluding from the eligible amount for inclusion as total capital (i.e., 4.8) the amount that has already been recognized in Tier 1 Capital (i.e., 2.8).

	Total amount issued by Bank P (all of which is to be included in consolidated capital)	Amount issued by Bank S to third parties to be included in consolidated capital of Bank P	Total amount issued by Bank P and Bank S to be included in consolidated capital of Bank P
CET1	31	2.6	33.6
AT1	12	0.2	12.2
Tier 1	43	2.8	45.8
Tier 2	20	2.0	22.0
Total Capital	63	4.8	67.8

Loss Absorbency requirements for Additional Tier 1 Capital

1. Capital instruments classified as liabilities for accounting purposes must have principal loss absorption when the pre-specified trigger point is breached, through either:
 - a. conversion to common shares ; or
 - b. write-off mechanism which allocates losses to the instrument.
2. The trigger point for conversion or write-off is set at 7.25% Common Equity Tier 1 or below or as determined by the BSP.
3. The write-off or conversion to common equity must generate CET1 under the relevant accounting standards. The instrument will only receive recognition in Tier 1 up to the amount of CET1 generated by a full write-off of the instrument.
4. The aggregate amount to be written off or converted for all such instruments on breaching the trigger point must be at least the amount needed to immediately return the bank's CET1 ratio at more than 7.25%, or if this is not possible, the full principal value of the instrument.
5. The bank/quasi-bank has the option to choose its main loss absorption mechanism for its Additional Tier 1 instruments which must be explicitly provided in the terms and condition of the issuance of the instruments.

In case the conversion mechanism was chosen as an option, the terms and condition of the issuance shall likewise provide that in case, said conversion cannot be implemented due to certain legal constraints, the write-off mechanism shall take effect.

6. Banks/quasi-banks opting to use the conversion mechanism must address all legal impediments and obtain all prior authorization to ensure immediate recapitalization through conversion when the trigger point is breached. Failure to satisfy these requirements would render the instruments ineligible for inclusion in Additional Tier 1 capital.
7. Banks/quasi-banks must make the necessary adjustments to their Articles of Incorporation to accommodate the conversion of capital instruments to common shares for loss absorbency. Moreover, banks/quasi-banks must ensure that it has an appropriate buffer of authorized capital stock.
8. Where additional Tier 1 capital instruments provide for conversion into common shares when the trigger point is breached, the issue documentation must include among others:

- a. the specific number of common shares to be received upon conversion, or specify the conversion formula for determining the number of common shares received; and
- b. number of shares to be received based on the specified formula.

Provided, that the capital instruments converting into ordinary shares shall have a maximum conversion rate of 50% of the ordinary share price at the time of issue.

- 9. In issuing Additional Tier 1 capital, the bank may:
 - a. differentiate between/among instruments as to whether the instrument is required to be converted or written-off upon breaching the trigger point; and
 - b. provide for a hierarchy as to which additional Tier 1 instruments will be converted or written-off.
- 10. Where the issue documentation provides for a ranking of the conversion or write-off, the terms attached to such hierarchy must not impede the ability of the capital instrument to be immediately converted or written-off, as required.
- 11. Written commitment to undertake the necessary actions to effect the conversion must be accomplished by the bank/quasi-bank. Otherwise, the write-off mechanism will take effect as the main loss absorbency mechanism.
- 12. Where, following the breach of the trigger point, the conversion cannot be undertaken, the write-off mechanism shall likewise take effect.
- 13. The write-off mechanism shall have the following effects:
 - a. reduce the claim of the instrument in liquidation;
 - b. reduce the amount re-paid when a call is exercised; and
 - c. partially or fully reduce coupon/dividend payments on the instruments.
- 14. The conversion to common shares or write-off of capital instruments prompted by the breach of the trigger point does not preclude the BSP from requiring further conversion or write-off upon the occurrence of the trigger event.

Loss Absorbency requirements for Additional Tier 1 Capital and Tier 2 Capital at the point of non-viability

1. Additional Tier 1 and Tier 2 capital instruments are required to have loss absorbency features at the point of non-viability.
2. Upon the occurrence of the trigger event, AT1 and T2 capital instruments should be able to absorb losses either through:
 - a. conversion to common shares ; or
 - b. write-off mechanism which allocates losses to the instrument.
3. AT1 and T2 capital instruments will then be converted to common shares or written off upon the occurrence of the trigger event.

The trigger event occurs when a bank/quasi-bank is considered nonviable as determined by the BSP. Non-viability is defined as a deviation from a certain level of Common Equity Tier 1 (CET1) Ratio, inability of the bank/quasi-bank to continue business (CLOSURE) or any other event as determined by the BSP, whichever comes earlier.

4. The write-off or conversion to common equity must generate Common Equity Tier1 and Total Capital under the relevant accounting standards. The instrument will only receive recognition in Tier 1 and Total Capital up to the amount of CET1 generated by a full write-off of the instrument.
5. In the absence of any contractual terms to the contrary, AT1 capital instruments shall be utilized first before Tier 2 capital instruments are converted or written-off, until viability of the bank is re-established.
6. In the event that the bank/non-bank does not have any AT1 instruments, then the conversion/write-off shall automatically apply to Tier 2 capital.
7. The bank/quasi-bank has the option to choose its main loss absorption mechanism at the point of non-viability which must be explicitly provided in the terms and condition of the issuance of the instruments.

In case the conversion mechanism was chosen as an option, the terms and condition of the issuance shall likewise provide that in case, said conversion cannot be implemented due to certain legal constraints, the write-off mechanism shall take effect.

8. Banks/quasi-banks opting to use the conversion mechanism must address all legal impediments and obtain all prior authorization to ensure immediate recapitalization through conversion when the trigger event occurs. Failure to

satisfy these requirements would render the instruments ineligible for inclusion as either Additional Tier 1 capital or Tier 2 capital.

9. Banks/quasi-banks must make the necessary adjustments to their Articles of Incorporation to accommodate the conversion of capital instruments to common shares for loss absorbency at the point of non-viability. Moreover, banks/quasi-banks must ensure that it has an appropriate buffer of authorized capital stock.
10. Where AT1 or T2 capital instruments provide for conversion into common shares when the trigger event occurs, the issue documentation must include among others:
 - a. the specific number of common shares to be received upon conversion, or specify the conversion formula for determining the number of common shares received; and
 - b. number of shares to be received based on the specified formula.

Provided, that the capital instruments converting into ordinary shares shall have a maximum conversion rate of 50% of the ordinary share price at the time of issue.

11. In issuing Additional Tier 1 or Tier 2 capital, the bank may:
 - a. differentiate between/among instruments as to whether the instrument is required to be converted or written-off upon the occurrence of the trigger event; and
 - b. provide for a hierarchy as to which instruments will be converted or written-off among the AT1 capital instruments as well as among the T2 capital instruments.
12. Where the issue documentation provides for a ranking of the conversion or write-off, the terms attached to such hierarchy must not impede the ability of the capital instrument to be immediately converted or written-off, as required.
13. Written commitment to undertake the necessary actions to effect the conversion must be accomplished by the bank/quasi-bank. Otherwise, the write-off mechanism will take effect as the main loss absorbency mechanism.
14. Where, upon the occurrence of the trigger event, the conversion cannot be undertaken, the write-off mechanism shall likewise take effect.
15. The write-off mechanism shall have the following effects:
 - a. reduce the claim of the instrument in liquidation;
 - b. reduce the amount re-paid when a call is exercised; and
 - c. partially or fully reduce coupon/dividend payments on the instruments.

16. In case of bank closure prior to the breach of the trigger event, a provision that provides for automatic write-off of AT1 and T2 instruments must be included in the terms and conditions of the issuance.

GROUP TREATMENT

17. The relevant jurisdiction in determining the trigger event is the jurisdiction in which the capital is being given recognition for regulatory purposes. However, the group treatment will only apply to wholly-owned subsidiary banks/non-banks.

18. Where an issuing bank/non-bank is a subsidiary of a wider banking group regulated by the BSP or it's parent wishes the instrument to be included in the capital of the consolidated group in addition to its solo capital, the terms and conditions of the subsidiary bank/non-bank AT1 and T2 capital instruments must specify an additional trigger event as follows:

AT1 and T2 capital instruments will be converted to common shares or written off once the parent bank is considered non-viable.

19. In case of a BSP supervised entity that is a subsidiary of another institution that is not regulated by the BSP, if the instruments are to be recognized as capital under BSP requirements, in addition to the applicability of the trigger event, said instruments must provide that;
 - a. any supervisor of the parent entity cannot impede the right of BSP to require the write-off or conversion of the instruments in relation to the BSP supervised entity; and
 - b. any right of write-off or conversion by the parent supervisor must generate CET1 in the BSP supervised entity.
20. Further, any common stock paid as compensation to the holders of the instrument must be common stock of either the issuing bank or of the parent company of the consolidated group.