



BANGKO SENTRAL NG PILIPINAS

OFFICE OF THE GOVERNOR

CIRCULAR NO. 1042

Series of 2019

Subject: Guidelines on Investment Activities of BSP-Supervised Financial Institutions (BSFIs)

The Monetary Board, in its Resolution No. 1054 dated 11 July 2019, approved the guidelines on sound risk management practices pertaining to investment activities of BSFIs and the related amendments to the Manual of Regulations for Banks (MORB)/Manual of Regulations for Non-Bank Financial Institutions (MORNBFI).

Section 1. Section 614/4612Q shall be added, as follows:

Sec. 614/4612Q INVESTMENT ACTIVITIES OF BSP-SUPERVISED FINANCIAL INSTITUTIONS (BSFIS)

Policy Statement. The Bangko Sentral recognizes that the effective management of risks associated with a BSP-supervised financial institution's (BSFI) investment activities is essential in ensuring its continued safety and soundness. These guidelines are being issued to set expectations on the prudent conduct of investment activities and the minimum practices that a BSFI should establish for the management and control of risks associated with investments. These guidelines neither limit nor expand the activities that BSFIs may undertake under existing regulations.

Scope of Application. These guidelines cover all of a BSFI's investments in the trading and banking books. These guidelines do not apply to a BSFI's (a) investments that grant control over an enterprise and are accounted for using the equity method, (b) transactions in derivatives involving stand-alone contracts, and (c) receivables arising from repurchase agreements.

Risk Management Framework. A BSFI shall have systems to manage the risks arising from its investment activities. While risk management systems will differ among BSFIs, the following elements are fundamental in ensuring that risks are effectively identified, measured, monitored and controlled:

a. Board and senior management oversight

As investment activities comprise a major area of a BSFI's operations, the board of directors shall perform the following, in accordance with Section 132/Subsection 4143Q.1 (Specific duties and responsibilities of the board of directors):

- (1) Approve portfolio objectives, overall investment strategies, general investment policies, and limits that are consistent with the BSFI's financial condition and risk tolerance. Board-approved objectives, strategies, policies and procedures, and limits shall be documented and clearly communicated to all the personnel involved in their implementation. Changes in strategies and the manner by which investments are managed shall be made under the control of the BSFI's appropriate board-level committees.
- (2) Actively monitor the performance and risk profile of its investments against established objectives, strategies, and policies. Consistent with Section 132/Subsection 4143Q.2 (Specific duties and responsibilities of the board of directors), the members of the board shall act judiciously on matters pertaining to investments. They shall ensure that investment transactions or proposals undergo a thorough evaluation process.
- (3) Ensure that there is an effective management structure for conducting the BSFI's investment activities that enables the achievement of the objectives, the strict enforcement of controls, and the independence between different functions (e.g., trading and asset/liability management), in accordance with Item "b" of Sec. 611 /Subsec. 4602Q.1 (Treasury Operations).

As senior management is responsible for implementing board-approved strategic objectives, it shall therefore:

- (1) Develop portfolio objectives that set out the acceptable instruments, expected business returns, desired asset allocation and diversification parameters, and other elements of sound investment management. Portfolios managed for the purpose of generating short term profits must be distinct from those utilized to maintain ample balance sheet liquidity, generate accrual income or modify and manage risk profiles.
- (2) Set clear lines of authority and responsibility for investing and managing the risks attendant thereto. Personnel conducting investment activities shall have the requisite technical knowledge and experience.

b. Policies, Procedures, and Limits

A BSFI shall institute policies, procedures, and limits that provide a framework for managing investment activities. The framework shall be consistent with the organization's broader business strategies, capital

adequacy, technical expertise, and risk tolerance. In setting policies, procedures and limits, a BSFI shall be guided by the following:

- (1) Policies and procedures should clearly articulate guidelines for the acquisition and recording of investments. A BSFI should be able to designate at the onset a specific investment objective (e.g., trading or short-term profit taking, or generating accrual income) for a particular security/portfolio and identify the desks/personnel responsible for managing such positions.
- (2) Policies should promote the development of a comprehensive understanding of the risks associated with investments prior to acquisition and on an ongoing basis. In particular, these should require the following:
 - (a) an appropriate level of due diligence to be conducted prior to taking a position in any investment. The depth of the due diligence should depend on an instrument's quality, the complexity of its structure, and the size of the investment. Structured products, in particular, should be subject to more thorough analyses than those applied to traditional products;
 - (b) the investment analysis to be founded on an analytical review of investment opportunities, and be sufficient to support a conclusion that a financial instrument is a sound investment;
 - (c) the due diligence review to cover:
 - i. an analysis of the risks and cash flow characteristics of the specific investments, especially for products that have unusual, leveraged, or highly variable cash flows;
 - ii. an assessment of the valuation and accounting policies to be adopted by the BSFI and the extent of its compliance with accounting rules;
 - iii. an analysis of assumed and actual investment exit strategies, particularly for securities that are illiquid or not readily marketable, and the resulting effect on earnings; and
 - iv. the identification of appropriate methodologies for the allocation of capital based on the risk inherent in the BSFI's investment activities, and the identification of all material risks and their potential impact on the safety and soundness of the institution;
 - (d) periodic and timely reviews of the investment strategy and performance to be conducted at the individual and portfolio levels;
 - (e) the due diligence and ongoing reviews to be performed by qualified personnel or a unit independent from the risk-taking function. Any third-party analysis independent of the seller or

counterparty (e.g., reports prepared by investment managers or credit rating agencies) may only be used to complement a BSFI's own evaluation. Irrespective of any responsibility, legal or otherwise, assumed by a dealer, counterparty, or financial advisor regarding a transaction, the investing BSFI is ultimately responsible for understanding and managing the risks of the transaction; and

- (f) the adequate documentation of the due diligence reviews and the formal approval of results thereof.

The conduct of due diligence reviews for new plain vanilla instruments to be entered into by a BSFI for the purpose of trading or short-term profit taking (i.e., to be held in the trading book) may be made at the option of the BSFI: *Provided*, That the incremental positions arising from the investments do not require higher country, market, and other applicable risk limits.

- (3) The limits for investment activities shall be consistent with the BSFI's institution-wide risk limits. The limits structure may apply at the institutional, portfolio, sub-portfolio, or individual instrument levels, or a combination thereof. The BSFI's determination of the appropriate limits structure shall be guided by the diversity, complexity and purpose of its portfolios (e.g., A BSFI with substantial holdings of non-resident issued instruments should establish country risk limits.)
- (4) The limits structure should reflect the amount of exposure that the BSFI is willing to accept, taking into consideration the impact of such exposure to earnings and capital in both normal and stressed conditions. Limits and triggers should be customized to address the nature of the products and any unique risk characteristics thereof (e.g., instruments bearing optionality features or credit event triggers).

c. Risk Measurement, Monitoring and Management Information Systems (MIS)

Given the impact of investments on the risk profile of an institution, BSFIs shall ensure that they possess the capability to measure and monitor the risks associated with their investments prior to acquisition and periodically thereafter. In doing so, a BSFI shall be guided by the following:

- (1) A BSFI shall have the capability to value its positions and measure exposures to each type of risk arising from such positions under both normal and stressed market conditions. Moreover, the risk measurement system should be able to generate timely information about the market value of investments carried at cost and any

significant decline from the carrying value. For this purpose, the BSFI shall use reliable data and appropriate tools and metrics that have been properly and independently vetted and approved prior to use (see also Item "d(3) *Internal Controls and Audit*"). A BSFI with investments in complex instruments shall use a more sophisticated tool for identifying, measuring and controlling risks. On the other hand, BSFIs whose investments are limited to plain vanilla instruments in the banking book should, at a minimum, have the capability to periodically mark the positions to market/obtain the market values of their positions.

- (2) A BSFI shall adopt a proper framework for valuing all positions, including those that are concentrated, less liquid and stale, and make appropriate valuation adjustments for uncertainties in determining the fair value of its investments. It shall likewise establish triggers that would determine whether a presumptive case for challenging the valuation model exists.
- (3) The valuation methodologies shall be adequately documented. The documentation shall set out the BSFI's practices for the initial pricing and marking-to-market/model of its positions. The documentation should also cover model inputs and assumptions, the detail of which would depend on the nature of the financial instruments held by BSFI and its sources of independent prices.
- (4) The Management of a BSFI with significant holdings of complex financial products such as structured products, asset-backed and mortgage-backed securities, or those measured using either inputs other than quoted market prices or unobservable inputs, shall be responsible for reviewing and understanding the assumptions used to price such instruments. The reviews should be sufficiently documented. Further, a BSFI that employs internal models shall have adequate procedures to validate the models and to periodically review all elements of the modeling process, including the assumptions.
- (5) When an incremental change in the value of an investment position is likely to have a significant effect on the risk profile of the BSFI, the BSFI is expected to analyze the impact of such change on its overall financial condition.
- (6) Reports to the board and senior management shall summarize the risks related to the BSFI's investment activities and the performance of portfolios vis-à-vis the established investment objectives and constraints, as well as any exceptions to established policies, procedures, and limits. Reporting should be frequent enough to provide timely and adequate information and enable the execution of

appropriate adjustments to address the changing nature of the BSFI's risk profile. The BSFI is expected to adjust the frequency of reporting when there are developments that warrant closer monitoring of its positions (e.g., periods of excessive market volatility) and when actions are taken to adjust the level of its exposures.

d. Internal Controls and Audit

In addition to complying with the supervisory expectations set out in Sections 162/4185Q and 163/4186Q, a BSFI shall:

- (1) Adopt internal controls that shall ensure the robustness of the approval process for new investment products/activities. Consistent with the requirements under Item "f" of Sec. 611/Subsec. 4602Q.1 (*Treasury Operations*), a BSFI shall ensure that the risks involved in new products/activities are fully understood through the implementation of a formal risk assessment program, and that adequate policies, procedures and controls are in place prior to roll out;
- (2) Adopt appropriate accounting policies and processes, and maintain adequate records pertaining to investments. In this respect, a BSFI shall strictly comply with relevant accounting standards and at the same time ensure the consistency of its accounting policies and practices with portfolio objectives and strategies;
- (3) Ensure the integrity of investment valuations, risk measurement methodologies, and controls that address model risk. The valuation process shall be undertaken independently from the risk-taking units. New valuation and risk measurement models shall be validated by an independent, suitably qualified individual/group prior to use. The models, including any material changes made thereon, shall likewise be periodically reviewed to ensure that they remain fit for their intended use. Model validation processes of a BSFI shall meet the minimum expectations set forth under Appendices 70/Q-43 (Guidelines on Market Risk Management) and Section 143/Subsection 4178Q.13 (Credit Risk Measurement, Validation and Stress Testing);
- (4) Conduct independent reviews of the risk management system on a periodic basis, but by no means to exceed three years, to ensure its integrity and reasonableness. These may be in the form of internal or external audits that cover, at a minimum:
 - (a) compliance with and the appropriateness of investment policies, procedures and limits;

- (b) propriety of fair valuations and the related processes and controls;
and
- (c) a determination of whether the BSFI's risk measurement and monitoring systems are commensurate to the nature and complexity of its activities.

Risks of Investment Activities. The management of risks arising from a BSFI's investment activities shall be integrated into the BSFI's overall risk management system, as required under Sections 141/4173Q (*Supervision by Risk*); 143/4178Q (*Credit Risk Management*); 144/4175Q (*Market Risk Management*); and 146/4179Q (*Operational Risk Management*).

The guidelines below set out the supervisory expectations on the management of the major risks that are inherent to investment activities. It is incumbent upon a BSFI to identify and manage other risk areas based on a thorough assessment of its activities.

a. Market Risk

The management of exposures to market risk arising from investment activities requires the BSFI to clearly designate positions belonging to either the trading book or the banking book. In accordance with the provisions of Section 125 (Market Risk Capital Requirement) and its appendices, the trading book consists of proprietary positions in financial instruments which are taken on with the intention of short-term resale or benefiting in the short-term from actual or expected differences between the buying and selling prices or from other price or interest rate variations; positions which arise from the execution of trade orders from customers and market making; and positions taken in order to hedge other elements of the trading book. All other instruments held by a BSFI shall be categorized as banking book positions.

Trading book

- (1) A BSFI that actively engages in the trading of securities is primarily exposed to the risk of adverse movements in the price of their holdings before such holdings can be liquidated or offset. It shall have the capability to measure such exposures on a timely basis, and control the effect of changing rates and prices on its earnings and capital.
- (2) A BSFI shall conduct a price sensitivity analysis for individual or a class of instruments, under both normal and stress scenarios, as part of the due diligence requirement prior to acquiring a position in any investment and on a continuing basis. Where appropriate, such analysis shall encompass a wider range of scenarios, including non-parallel changes in the yield curve and other relevant factors, such as changes in interest rate volatility and in

credit spreads. It is recognized, however, that the substance and form of such analyses will vary according to the complexity of an instrument.

- (3) Market risk from trading portfolios shall be calculated at least daily. While this is commonly measured using value-at-risk (VaR),¹ a BSFI may use other risk models. In any case, the board and senior management shall ensure that the measure used is reasonably accurate and rigorous; appropriate to the sophistication and complexity of the BSFI's products, activities and lines of business; and adequately incorporated into the BSFI's risk management process.

Banking Book

- (4) A BSFI with banking book portfolios that are subjected to regular mark-to-market valuation shall monitor the price sensitivity of relevant securities over different interest rate/yield curve scenarios. Price sensitivity limits or triggers at portfolio levels or on individual securities should also be established.

b. Interest Rate Risk in the Banking Book

Investments under the banking book usually represent a significant component of a BSFI's overall interest rate risk profile. Exposures from investments shall feed into the BSFI's institution-wide measurement and monitoring of interest rate risk through earnings- and/or economic value-based methodologies.

c. Credit Risk

- (1) A BSFI's investment policies and objectives shall be consistent with its overall credit risk strategy, as set out under Sec. 143/4178Q.2 and 4178Q.4 (*Role of the Board and Senior Management and Credit risk strategy*).
- (2) In accordance with Sec. 143/Subsec. 4178Q.7 (*Credit granting and loan evaluation/analysis process and underwriting standards*), which requires the conduct of a comprehensive assessment of the creditworthiness of obligors, a BSFI shall not acquire an investment without conducting an independent assessment of the creditworthiness of the issuer. The latter shall form part of the due diligence review to be conducted in accordance with Item "b(2)" (*Policies, Procedures and Limits*) of this Section.
- (3) In addition to the guidelines on the factors to be considered in approving credits under Item "b" of Sec. 143/Subsec. 4178Q.7, a BSFI shall consider a

¹ VaR is the probable maximum loss over a target horizon at a given confidence level.

variety of factors relevant to a particular security when determining whether it is a permissible and sound investment. The range and type of specific factors a BSFI should consider will vary depending on the particular type and nature of a security. An individual security may require more or less analysis depending on its risk characteristics. The following are examples of factors that a BSFI may consider as part of its credit risk due diligence review:

- (a) Credit spread to a benchmark security and risk of default compared to bonds of similar credit quality;
 - (b) Issuer's capacity to pay, and operating and financial performance levels and trends through internal credit analysis and/or other third-party analytics, as appropriate for the particular security;
 - (c) The value of an instrument with a prepayment option compared to a plain vanilla security of similar credit quality;
 - (d) Potential impact to an instrument's value of specific product features such as credit-related triggers; and
 - (e) For an investment in a securitization structure, the class or tranche, loss allocation rules, specific definition of default, support provided by credit and/or liquidity enhancements, and the impact of collateral deterioration and potential credit losses under adverse economic conditions.
- (4) Complex financial instruments, such as those enumerated in Item "k" of Sec. 143 (*II. Operating Under a Sound Credit Granting Process*)/Subsec. 4178Q.7 (*Credit granting and loan evaluation/analysis process and underwriting standards*), shall be subject to a greater degree of credit-related due diligence, even when the credit quality is perceived to be very high.
- (5) A BSFI shall conduct a thorough analysis of country and transfer risks in accordance with the guidelines under Section 143/Subsection 4178Q.10 (Country and transfer risks), as appropriate. Moreover, BSFIs should monitor exposures on a broader (e.g., regional) basis as a country's economic, social and political conditions may be adversely affected through the contagion of problems in other countries. When a BSFI's country and transfer risks are significant, such risk shall also be considered in its Internal Capital Adequacy Assessment Process (refer to Appendix 94 *Guidelines on Bank's Internal Capital Adequacy Assessment Process*).
- (6) A BSFI's policies shall incorporate credit risk diversification and concentration limits and prudently define what constitutes concentration to a single or related issuer/s, consistent with the provisions under Section 143/Subsection 4178Q.9 (Credit limits, large exposures and credit risk concentrations).

- (7) A BSFI's investments shall be subjected to periodic impairment testing in accordance with existing accounting rules and prudential standards. A BSFI shall have processes in place to determine on a timely and holistic basis whether credit risk on an individual financial instrument has increased significantly since its initial recognition, and accordingly provide accounting adjustments when necessary. The analysis shall take into account not only the credit risk of the individual issuer but also the relevant country and transfer risks.
- (8) Engaging in investment activities also exposes a BSFI to counterparty credit risk. Counterparty credit risk arises when a counterparty to a transaction who has received a payment or delivery of assets defaults before delivery of the asset or payment, or when technical difficulties interrupt delivery or settlement despite the counterparty's ability or willingness to perform.

Transactions with a counterparty shall not commence until a credit line has been approved. Credit limits shall consider both settlement and pre-settlement exposures for all counterparties with whom the bank trades. While the structure of the credit approval process may differ across institutions, the process should reflect the organizational and geographic structure of the institution and the specific needs of its treasury activities.

d. Market Liquidity Risk

- (1) The BSFI's process of specifying permissible instruments shall clearly articulate the desired market liquidity² characteristics of investments under both trading and banking books. For instance, a BSFI may limit its investments to or in certain securities in view of a perceived lack of market liquidity. Such characteristics shall be aligned with the investment objectives set by the Board.
- (2) The due diligence review required under Item "b(2)" of this Section (*Risk Management Framework*) shall take into account the market liquidity of proposed investments and relate the effect that such characteristics have on achieving the BSFI's investment objectives. A BSFI shall ensure that it considers the effects that market risk can have on the liquidity of different types of instruments under various scenarios.
- (3) A BSFI shall ensure that valuation and risk measurement models are able to capture the illiquidity of investments. Complex and illiquid instruments can often involve greater risk than those that are actively traded. For instance, securities with embedded options may make them highly illiquid

² Market liquidity risk is defined under Appendix 71/Q-44.

during periods of market volatility and stress, despite their high credit rating. If market prices or rates do not move as expected, the demand for such instruments can evaporate, decreasing the market value of the instrument. Such risk is particularly acute for instruments that are highly leveraged.

e. Operational Risk

- (1) A BSFI shall be mindful that effective internal controls at the business units serve as the first line of defense in the management of operational risk in investment activities. Consistent with the operational support for other activities within a BSFI, personnel handling back office functions shall be as independent as practicable from business units. A BSFI shall institute internal controls that ensure the separation of duties and supervision of persons executing transactions from those responsible for processing contracts, confirming transactions, controlling various clearing accounts, preparing or posting the accounting entries, approving the accounting methodology or entries, and performing revaluations.³
- (2) Adequate resources shall be devoted to supporting processes, such that systems and capacity are commensurate with the size and complexity of investment activities. Effective risk management should include, at least, the following:
 - (a) Personnel. Due to the increasingly complex nature of instruments available in the marketplace, BSFIs shall ensure that personnel responsible for managing operational risks have strong technical skills. This enables a better understanding of the complex financial structures of certain investment instruments.
 - (b) Documentation. A BSFI shall set policies on the required documentation for specific financial instruments, especially complex instruments, as well as for saving and safeguarding important documents, and maintaining possession and control of instruments.
 - (c) Conflict of interest. In accordance with Item "a" of Sec. 611/Subsec. 4602Q.1, a BSFI shall develop policies and guidelines governing conflicts of interest between traders and other market counterparties. Policies should likewise be developed to ensure that all directors, officers, and employees act in the best interest of the BSFI. Such policies may contain restrictions and prohibitions on engaging in personal transactions, and on the receipt of gifts and gratuities from approved dealer firms and their representatives.

³ See also Item "d" of Subsec. 611 /4602Q.1 (*Treasury Operations*).

- (3) A BSFI shall comprehensively evaluate the enforceability of any agreements related to its investment activities before individual transactions are consummated. Institutions shall also ensure that the counterparty is authorized to enter into the transaction and that the terms of the agreement are legally enforceable. A BSFI should have knowledge of laws and interpretations governing the use of these instruments and arrangements.

Application of the guidelines.

- a. General Rule. These guidelines shall apply to all banks and non-bank financial institutions performing quasi-banking functions (QBs) and their financial subsidiaries.
- b. Group Structures. The parent bank/QB shall be responsible for ensuring that the risks in the investment activities of its financial subsidiaries are managed in accordance with the guidelines in this Section.
- c. Branches of Foreign Banks. A foreign bank branch may adopt the risk management approach of its parent/regional office/group in respect of its investment activities: *Provided*, That the applicable provisions under this Section are met.
- d. Minimum Requirements for Stand-alone Thrift, Rural and Cooperative Banks and Quasi-Banks with Investments that are Limited to Peso Denominated Government Securities.
 - (1) The board shall approve investment objectives consistent with the BSFI's financial condition, profile and risk tolerance. Senior management shall set clear lines of authority and responsibility for investing and monitoring the risks attendant to the BSFI's investments. These functions shall be conducted by personnel with adequate technical knowledge and experience;
 - (2) A BSFI shall institute policies and procedures for formally approving investments in government securities. The BSFI shall ensure that it conducts an analysis of its investments prior to acquisition and on an ongoing basis. The periodic analysis should incorporate a review of the key risks, including market, market liquidity, liquidity and operational risks, and their impact to earnings and capital, as well as the BSFI's mechanisms for divesting of the investments, if so warranted;
 - (3) The Board shall institute limits that reflect its tolerance for risks related to investment activities (e.g., maximum amount of government securities that may be invested in by the BSFI at any

point in time, maximum acceptable amount of mark-to-market losses for investments designated at fair value through other comprehensive income or profit and loss). An independent unit/officer shall be assigned to monitor the exposures against the limits and report breaches, as well as the resolution of the breaches, to senior management and the board in timely manner;

- (4) The BSFI shall properly value its investments and measure its exposures under both normal and stressed market conditions (e.g., circumstances that result in sudden decline in value of investments affecting the BSFI's other comprehensive income). The result of stress tests should aid the board and senior management of the BSFI in determining whether the risks and rewards associated with its investments are consistent with its investment objective and business strategy; and
- (5) The BSFI shall set out a process for the effective and timely monitoring and reporting to the Board and senior management of information pertaining to its investments (e.g., coupon vs. prevailing interest rates, market values, gains/losses arising from derecognition).

Supervisory enforcement actions. The Bangko Sentral reserves the right to deploy its range of supervisory tools to promote adherence to the requirements set forth in these guidelines and bring about timely corrective actions and compliance with Bangko Sentral directives. The Bangko Sentral may, among others, cite a BSFI for conducting business in an unsafe or unsound manner should its investment activities result in abnormal risk to the institution. A BSFI may likewise be directed to refrain from engaging in specific investment activities with serious supervisory issues. Lastly, sanctions may be imposed on the BSFI and responsible persons, which may include restrictions or prohibitions from certain authorities/activities; and reprimand, suspension, removal and disqualification of concerned directors, officers and employees."

Section 2. Sec. 381 of the Manual of Regulations for Banks is hereby amended as follows:

"381 PURCHASE OF RECEIVABLES AND OTHER OBLIGATIONS

The following regulations shall govern the purchase of receivables and other obligations.

Yield on purchase of receivables. The rate of yield, including commissions, premiums, fees and other charges, xxx.

Purchase of receivables on a "without recourse" basis. xx.

Purchase of commercial paper. xx

Reverse repurchase agreements with Bangko Sentral. xx.

Investment in readily marketable bonds and other debt securities. The following rules and regulations shall govern investment in readily marketable bonds and other debt securities.

a. Banks may invest in the following:

- (1) Readily marketable bonds and other debt securities which are of such use or demand as to make them the subject of constant dealings in securities markets, with such frequent quotations of price as to make the price easily and definitely ascertainable, and the security easy to realize upon sale at any time: *Provided*, That the bonds and other debt securities have complied with the rules on registration of securities under the Securities Regulation Code: *Provided, further*, That RBs/Coop Banks investing in readily marketable bonds and other debt securities shall comply with the prudential criteria enumerated under Sec. 111 and Sec. 614. In addition to said criteria, the investment shall not be held for trading purposes.

RBs/Coop Banks shall submit a one-time notarized certification that the pre-qualification requirements under Sec. 111 (Prudential criteria) have been complied with to the appropriate supervising department of the Bangko Sentral within ten (10) calendar days from date of initial investment. In addition, banks shall conduct a continuous self-assessment of their compliance with said pre-qualification requirements.

TBs may invest in evidences of indebtedness which are registered with the SEC but are not readily marketable securities: *Provided*, That these evidences of indebtedness shall be acquired with recourse against a bank or a QB.

It shall be the responsibility of the investing bank to undertake a due diligence review on its prospective investments, consistent with the risk management guidelines under Sec. 614.

- (2) Evidences of indebtedness of the Republic of the Philippines or the Bangko Sentral, and any other evidences of indebtedness or obligations the servicing and repayment of which are guaranteed by the Republic of the Philippines; *Provided*, That the reports on risk management system under Section 614 are met.

(3) Securities that serve as an alternative mode of compliance with the mandatory credit allocations under Philippine laws.

- b. Any violation of the provision stated in Item “a” above shall subject the bank and its concerned officer/s to applicable enforcement action enumerated under Sec. 111.

Regular banking unit (RBU) of UB/KBs and TBs xxx”

Section 3. App. 94 of the Manual of Regulations for Banks is hereby amended as follows:

**“GUIDELINES ON BANKS’ INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS
(Appendix to Section 130)**

A. Introduction

1. This document sets out the broad guidelines that UBs and KBs (hereinafter referred to as ‘banks’) should follow in the design and use of their Internal Capital Adequacy Assessment Process (ICAAP). xxx.
2. Although the Framework prescribes the guidelines xxx.

B. Guiding principles

1. Banks must have a process for assessing their capital adequacy relative to their risk profile (an ICAAP). xxx.
2. xxx.
3. xxx.
4. xxx.
5. xxx.
6. xxx.
7. The ICAAP should capture the risks covered under the Framework – credit risk, market risk, and operational risk. xxx. These other material risks may include any of the following:
 - a. Risks *not fully* captured under the Framework, for example, credit concentration risk, country and transfer risks arising from cross border investments, risk posed by nonperforming assets, risk posed by contingent exposures, etc.;
 - b. Risks not covered under the Framework. As a starting point, banks may choose to use the other risks identified under Sec. 141 (*Supervision by Risk*). xxx; and
 - c. Risk factors external to banks. xxx.

8. Banks should have a documented process for assessing risks. xxx.

xxx

Section 4. The following transitory provision shall be incorporated as footnote to Section 614/4612Q as follows:

Banks/QBs shall be given a period of six (6) months from the effectivity of this Section to develop or make appropriate changes to their policies and procedures on the risk management system for investment activities.

Section 5. This Circular shall take effect fifteen (15) calendar days following its publication either in the Official Gazette or in a newspaper of general circulation.

FOR THE MONETARY BOARD:



BENJAMIN E. DIOKNO
Governor

25 July 2019