



Bangko Sentral ng Pilipinas

OFFICE OF THE GOVERNOR

**MEMORANDUM TO ALL BANKS AND
NON-BANK FINANCIAL INSTITUTIONS CONCERNED**

Subject: Amendments to the Guidelines for the Issuance of Unsecured Subordinated Debt Eligible as Tier 2 Capital so as to Include Hybrid Tier 1 Capital

Pursuant to Monetary Board Resolution No. 169 dated 10 February 2006, Memorandum to All Banks and Non-Bank Financial Institutions Concerned dated 17 February 2003, as amended, on the guidelines for the issuance of unsecured subordinated debt (USD) eligible as Upper Tier 2 (UT2) and Lower Tier 2 (LT2) capital under items b.b.1(8) and b.b.2(3), respectively, of Subsection X116.1 of the Manual of Regulations for Banks (MOR), is hereby further amended (a) to include issuance of USD eligible as Hybrid Tier 1 (HT1) capital under Item a.a.2(1) of the same Subsection of MOR and (b) to reflect the revised minimum requirements for USD eligible as UT2 and LT2 capital.

Accordingly, Items A.c, A.d, D.1.c.3, D.1.c.8, D.7, D.8.a.2, E.1.c.3, E.1.c.8, E.3, E.4.a.2, F.2 and I of the Memorandum to All Banks and Non-Bank Financial Institutions Concerned dated 17 February 2003, as amended, shall now read, as follows:

"A. Minimum Features of USD

x x x

- c. **Mandatory Provisions** – If the USD is not scripless in form, the following provisions must appear in bolder prints on the face of every note, debenture or other certificate evidencing the same:
 - i. This obligation is not a deposit and is not insured by the Philippine Deposit Insurance Corporation (PDIC);
 - ii. This obligation is neither secured nor covered by the guaranty of (name of Bank) or its subsidiaries and affiliates, or other arrangement that legally or economically enhances the priority of the claim of any holder of the USD as against depositors and other creditors (for LT2); depositors, other creditors and holders of LT2 capital instruments (for UT2); and depositors, other creditors and holders of LT2 and UT2 capital instruments (for HT1);

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- iii. This obligation does not have a priority claim, in respect of principal and coupon payments in the event of winding-up of the (name of Bank), which is higher than or equal with that of depositors and other creditors (for LT2); depositors, other creditors and holders of LT2 capital instruments (for UT2); and depositors, other creditors, holders of LT2 and UT2 capital instruments (for HT1); and
- iv. The obligation is ineligible as collateral for a loan granted by (name of Bank), its subsidiaries and affiliates.

If the USD is scripless in form, the foregoing provisions/information shall be furnished every buyer/investor in a separate written instrument receipt of which must be duly acknowledged by him.

- d. **Term** – The USD qualifying under HT1 capital shall be perpetual. The minimum maturity of a USD qualifying under UT2 and LT2 capital shall be ten (10) years and five (5) years, respectively.

X X X

"D. PUBLIC ISSUANCE OF UNSECURED SUBORDINATED DEBT

X X X

1. Application for Authority

X X X

- c. The application shall be accompanied by:

X X X

- 3) A written confirmation from the President or officer of equivalent rank of the Issuing Bank stating that all the conditions for USD under item a.a.2(1), item b.b.1(8) or item b.b.2(3), Subsection X116.1 of the MOR are complied with and that such conditions shall be contained in the USD Certificates if the USD is not in scripless form, in the Information Disclosure and Purchase Advice.

X X X

- 8) A written external legal opinion that all the conditions for USD under item a.a.2(1), item b.b.1(8) or item b.b.2(3), Subsection X116.1 of the MOR, including the subordination (for HT1, UT2 and LT2) and loss absorption (for HT1 and UT2) features, have been met.

X X X

7. Purchase Advice and Registry Confirmation

The Purchase Advice and Registry Confirmation shall contain all the terms and conditions on the issuance of USD and shall conspicuously state the following caveat:

- a. This USD is not a deposit and is not insured by the PDIC;
- b. This USD is neither secured nor covered by a guaranty of the Issuer/Underwriter/Arranger or related party of the Issuer/Underwriter/ Arranger or other arrangement that legally or economically enhances the priority of the claim of any holder of the USD as against depositors and other creditors (for LT2); depositors, other creditors and holders of LT2 capital instruments (for UT2); and depositors, other creditors and holders of LT2 and UT2 capital instruments (for HT1);
- c. This USD does not have a priority claim, in respect of principal and coupon payments in the event of winding-up of the Issuing Bank, which is higher than or equal with that of depositors and other creditors (for LT2); depositors, other creditors and holders of LT2 capital instruments (for UT2); and depositors, other creditors, holders of LT2 and UT2 capital instruments (for HT1);
- d. This USD is ineligible as collateral for a loan granted by the Issuing Bank, its subsidiaries or affiliates;
- e. This USD cannot be terminated by the holder nor by the Issuing Bank (for HT1). This USD cannot be terminated by the holder nor by the Issuing Bank before (maturity date) (for UT2 and LT2).

However, negotiations/transfers from one holder to another do not constitute pre-termination;

(Item D.7.e above shall apply if the Issuing Bank commits no pre-termination of the USD. Otherwise it shall read as follows):

This USD cannot be terminated by the holder (for HT1). This USD cannot be terminated by the holder before (maturity date) (for UT2 and LT2),

However, it may be pre-terminated at the instance of the Issuing Bank upon:

- 1) prior approval of the BSP subject to the following conditions:
 - i. The repayment is in connection with call option after a minimum of five (5) years from issue date, or even within the first five (5) years from issue date when:

- The USD was issued for the purpose of a merger with or acquisition by the Issuing Bank and the merger or acquisition is aborted;
 - There is a change in tax status of the USD due to changes in the tax laws and/or regulations; or
 - The USD does not qualify as HT1, UT2 or LT2 capital, as the case may be, as determined by the BSP; and
- ii. The debt is simultaneously replaced with the issues of new capital which is neither smaller in size nor of lower quality than the original issue, unless the Issuing Bank's capital adequacy ratio remains more than adequate after redemption; and

2) prior notice to holders on record.

Negotiations/transfers from one holder to another do not constitute pre-termination;

In case there is a feature allowing one-time step-up in the coupon rate in conjunction with a call option, the step-up shall be after a minimum of ten (10) years (for HT1 and UT2) and five (5) years (for LT2) after the issue date, and shall not result in an increase over the initial rate that is more than:

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

The swap spread shall be fixed at the pricing date and reflect the differential in pricing on that date between the initial reference security or rate and the stepped-up reference security or rate;

- f. The holders/owners of this USD cannot set off any amount they owe to the Issuing Bank against this USD;
- g. All negotiations/transfers of this USD prior to maturity must be coursed through a Market Maker until the operation of a fixed income exchange;
- h. The payment of principal may be accelerated on this USD only in the event of insolvency of the Issuing Bank;
- i. The coupon rate, or the formulation for calculating coupon payments shall be fixed at the time of the issuance of the USD and may not be linked to the credit standing of the Issuing Bank;

- j. The payment of principal and coupon due on this USD shall not be made to the extent that such payment will cause the Issuing Bank to become insolvent (for HT1 and UT2);
- k. The holders of the USD shall be treated as if they were holders of a specified class of share capital in any proceedings commenced for the winding-up of the Issuing Bank (for HT1 and UT2);

(Item D.7.k above shall apply if such is the manner by which the USD is to be treated in loss situation. Otherwise it shall read as follows):

This USD shall be automatically converted into common shares or perpetual and non-cumulative preferred shares (for HT1) or into common shares or perpetual and non-cumulative preferred shares or perpetual and cumulative preferred shares (for UT2) upon occurrence of certain trigger events as follows:

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

The rate of conversion shall be fixed at the time of the subscription of this USD.

- l. The amount and timing of coupons on this USD shall be discretionary on the Issuing Bank where the Issuing Bank has not paid or declared a dividend on its common shares in the preceding financial year, or determines that no dividend is to be paid on such shares in the current financial year; and the Issuing Bank shall have full control and access to waived payments (for HT1). The coupon payment on this USD shall be deferred where the Issuing Bank has not paid or declared a dividend on its common shares in the preceding financial year, or determines that no dividend is to be paid on such shares in the current financial year (for UT2);
- m. The coupon on this USD shall be non-cumulative. In case there is a feature allowing withheld cash coupon to be payable in scrip or shares of stock, the shares of stock to be issued shall not be of lower quality capital than the USD (for HT1); and
- n. The coupon to be paid on this USD shall be paid only to the extent that the Issuing Bank has profit distributable determined in accordance with existing BSP regulations (for HT1).

N.B.: The last five (5) (i.e., j, k, l, m and n) are applicable only to USD qualifying under HT1 and UT2 capital, as the case may be. The foregoing information shall also be shown in the Prospectus/Information Disclosure.

8. Pre-termination by the Issuer

- a. The Issuing Bank may pre-terminate the USD subject to the following conditions:

x x x

- 2) Compliance with item a.a.2(1)vii, item b.b.1(8)v or item b.b.2(3)iv, as may be applicable, of Subsection X116.1 of the MOR;

x x x

"E. PRIVATE OR NEGOTIATED ISSUANCE OF UNSECURED SUBORDINATED DEBT

x x x

1. Application for Authority of the Issuing Bank

x x x

- c. The application shall be accompanied by:

x x x

- 3) A written confirmation from the President or officer of equivalent rank of the Issuing Bank stating that all the conditions for USD under item a.a.2(1) excluding item (xiii) on underwriting provision, item b.b.1(8) excluding item (xi) on underwriting provision, or item b.b.2(3) excluding item (ix) on underwriting provision of Subsection X116.1 of the MOR are complied with and that such conditions shall be contained in the USD Certificates, Prospectus/-Information Disclosure and Debt Agreement/Contract.

x x x

- 8) A written external legal opinion that all the conditions for USD under item a.a.2(1), item b.b.1(8) or item b.b.2(3), Subsection X116.1 of the MOR, including the subordination (for HT1, UT2 and LT2) and loss absorption (for HT1 and UT2) features, have been met.

x x x

3. Debt Agreement/Contract

The Debt Agreement/Contract shall contain all the terms and conditions on the issuance of USD and shall conspicuously state the following caveat:

- a. This USD is not a deposit and is not insured by the PDIC.
- b. This USD is neither secured nor covered by a guarantee of the Issuer or related party of the Issuer or other arrangement that legally or economically enhances the priority of the claim of any holder of the USD as against depositors and other creditors (for LT2); depositors, other creditors and holders of LT2 capital instruments (for UT2); and depositors, other creditors and holders of LT2 and UT2 capital instruments (for HT1).
- c. This USD does not have a priority claim, in respect of principal and coupon payments in the event of winding-up of the Issuing Bank, which is higher than or equal with that of depositors and other creditors (for LT2); depositors, other creditors and holders of LT2 capital instruments (for UT2); and depositors, other creditors, holders of LT2 and UT2 capital instruments (for HT1);
- d. This USD is ineligible as collateral for a loan granted by the Issuing Bank, its subsidiaries or affiliates.
- e. This USD cannot be terminated by the holder nor by the Issuing Bank (for HT1). This USD cannot be terminated by the holder nor by the Issuing Bank before (maturity date) (for UT2 and LT2).

(Item E.3.e above shall apply if the Issuing Bank commits no pre-termination of the USD. Otherwise it shall read as follows):

This USD cannot be terminated by the holder (for HT1). This USD cannot be terminated by the holder before (maturity date) (for UT2 and LT2),

However, it may be pre-terminated at the instance of the Issuing Bank upon:

- 1) prior approval of the BSP subject to the following conditions:
 - i. The repayment is in connection with call option after a minimum of five (5) years from issue date, or even within the first five (5) years from issue date when:
 - The USD was issued for the purpose of a merger with or acquisition by the Issuing Bank and the merger or acquisition is aborted;
 - There is a change in tax status of the USD due to changes in the tax laws and/or regulations; or

- The USD does not qualify as HT1, UT2 or LT2 capital, as the case may be, as determined by the BSP; and
- ii. The debt is simultaneously replaced with the issues of new capital which is neither smaller in size nor of lower quality than the original issue, unless the Issuing Bank's capital adequacy ratio remains more than adequate after redemption; and

2) prior notice to investors/buyers.

In case there is a feature allowing one-time step-up in the coupon rate in conjunction with a call option, the step-up shall be after a minimum of ten (10) years (for HT1 and UT2) and five (5) years (for LT2) after the issue date, and shall not result in an increase over the initial rate that is more than:

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

The swap spread shall be fixed at the pricing date and reflect the differential in pricing on that date between the initial reference security or rate and the stepped-up reference security or rate;

- f. This USD may only be sold, transferred or negotiated to another qualified investor/buyer;
- g. The holders/owners of this USD cannot set off any amount they owe to the Issuing Bank against this USD;
- h. The payment of principal may be accelerated on this USD only in the event of insolvency of the Issuing Bank;
- i. The coupon rate, or the formulation for calculating coupon payments shall be fixed at the time of the issuance of the USD and may not be linked to the credit standing of the Issuing Bank;
- j. The payment of principal and coupon due on this USD shall not be made to the extent that such payment will cause the Issuing Bank to become insolvent (for HT1 and UT2);
- k. The holders of the USD shall be treated as if they were holders of a specified class of share capital in any proceedings commenced for the winding-up of the Issuing Bank (for HT1 and UT2);

(Item E.3.k above shall apply if such is the manner by which the USD is to be treated in loss situation. Otherwise it shall read as follows):

This USD shall be automatically converted into common shares or perpetual and non-cumulative preferred shares (for HT1) or into common shares or perpetual and non-cumulative preferred shares or perpetual and cumulative preferred shares (for UT2) upon occurrence of certain trigger events as follows:

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

The rate of conversion shall be fixed at the time of the subscription of this USD.

l. The amount and timing of coupons on this USD shall be discretionary on the Issuing Bank where the Issuing Bank has not paid or declared a dividend on its common shares in the preceding financial year, or determines that no dividend is to be paid on such shares in the current financial year; and the Issuing Bank shall have full control and access to waived payments (for HT1). The coupon payment on this USD shall be deferred where the Issuing Bank has not paid or declared a dividend on its common shares in the preceding financial year, or determines that no dividend is to be paid on such shares in the current financial year (for UT2);

m. The coupon on this USD shall be non-cumulative. In case there is a feature allowing withheld cash coupon to be payable in scrip or shares of stock, the shares of stock to be issued shall not be of lower quality capital than the USD (for HT1); and

n. The coupon to be paid on this USD shall be paid only to the extent that the Issuing Bank has profit distributable determined in accordance with existing BSP regulations (for HT1).

N.B.: The last five (5) items (i.e., j, k, l, m and n) are applicable only to USD qualifying under HT1 and UT2 capital, as the case may be.

4. Pre-termination by the Issuer

a. The Issuing Bank may pre-terminate the negotiated USD subject to the following conditions:

x x x

2) Compliance with item a.a.2(1)vii, item b.b.1(8)v or item b.b.2(3)iv, as may be applicable, of Subsection X116.1 of the MOR;

x x x

"F. ISSUANCE OVERSEAS OF UNSECURED SUBORDINATED DEBT

x x x

2. The requirements under Items A.c.i, D.7.a, E.3.a and E.3.f may be allowed to be dispensed with in cases of overseas issuance of USD; and

x x x

***I. ACCOUNTING TREATMENT**

Obligations arising from the issuance of USD (including the portion exceeding the allowable ceiling for purposes of determining the qualifying capital as provided in Subsection X116.1 of the MOR) shall be booked under the following General Ledger account titles:

1. "Other Equity Instruments – Others " for HT1 capital which shall be presented in the "Equity Accounts" section of the Balance Sheet; and
2. "Unsecured Subordinated Debt" for UT2 and LT2 capital, which shall be presented in the Liability Accounts section of the Balance Sheet.

However, only the proceeds actually received from the USD issues, (i.e., net of discounts, if any, and transaction costs) shall be considered as HT1, UT2 or LT2 capital.

The proceeds actually received from the USD issues, (i.e., net of discounts, if any, and transaction costs) eligible as UT2 or LT2 capital shall be considered in the computation of loanable funds for purposes of determining compliance with the mandatory allocation of funds for agri-agra credit required under P.D. No. 717, as amended.

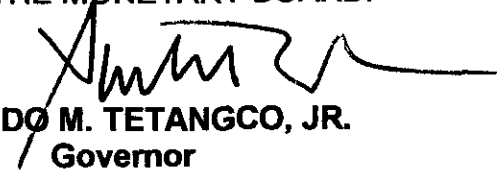
A USD eligible as HT1, UT2 or LT2 capital shall be accounted for in accordance with PAS 32 and PAS 39.

A USD denominated in foreign currency eligible as HT1, UT2 or LT2 may be recorded in the regular banking unit or foreign currency deposit unit (FCDU/EFCDU) of the Issuing Bank: *Provided*, That if booked in the FCDU/EFCDU, the following conditions shall be strictly observed:

1. The Issuing Bank shall indicate in its application that the USD shall be booked in its FCDU/EFCDU;
2. The USD shall remain in the FCDU/EFCDU books until full settlement; and
3. The USD shall be issued only to non-residents and offshore banking units in accordance with Section 72.2.e of CB Circular No. 1389, as amended."

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

FOR THE MONETARY BOARD:



AMANDO M. TETANGCO, JR.
Governor

23 March 2006