



BANGKO SENTRAL NG PILIPINAS

OFFICE OF THE GOVERNOR

CIRCULAR NO. 966

Series of 2017

Subject: Rationalizing the Regulatory Requirements of Trust, Other Fiduciary and Investment Management Accounts under Discretionary and Non-Discretionary Mandates

The Monetary Board, in its Resolution No. 1001 dated 15 June 2017, approved the following amendments to Subsections X409.2/4409Q.2, X411.4/4411Q.4, X425.1/4425Q.1 and Appendix 83/Q-48 of the Manual of Regulations for Banks (MORB) and of the Manual of Regulations for Non-Bank Financial Institutions (MORNBFi), respectively, to tailor fit the regulatory requirements with the degree of discretion exercised by the trust entities in managing clients' portfolio.

Section 1. Subsections X409.2/4409Q.2 of the MORB/MORNBFi are hereby amended to read as follows:

"Subsection X409.2/4409Q.2 Lending and investment disposition. x x x"

"When a trustee or fiduciary is granted discretionary powers in the investment disposition of trust or other fiduciary funds and unless otherwise specifically enumerated in the agreement or indenture and directed in writing by the client, court of competent jurisdiction or other competent authority, loans and investments of the fund shall be limited to:

- a. Traditional deposit products of Universal and Commercial Banks in the Philippines with long-term credit rating of at least AA- or its equivalent by a third party credit assessment agency recognized by the Bangko Sentral;
- b. Evidences of indebtedness of the Republic of the Philippines and of the Bangko Sentral, and any other evidences of indebtedness or obligations where the servicing and repayment of which are fully guaranteed by the Republic of the Philippines or loans against such government securities;
- c. Loans fully guaranteed by the Republic of the Philippines as to the payment of principal and interest;
- d. Tradable securities issued by the government of a foreign country or any supranational entity with long-term credit rating of at least AA- or its equivalent by a third party credit assessment agency recognized by the Bangko Sentral;
- e. Loans fully secured by a hold-out on, assignment or pledge of deposits maintained either with the bank proper or other banks, or

- of deposit substitutes of the bank/institution, or of mortgage and chattel mortgage bonds issued by the trustee or fiduciary;
- f. Loans fully secured by real estate or chattels in accordance with Section X311/4311Q and Subsections X178.7/4178.7 and X304.1/4304Q.1; and
- g. Placements in the Bangko Sentral Term Deposit Facility (TDF) and the Overnight Deposit (ODF) subject to the applicable provisions of Section X601/X4601Q and Appendix 78a/Q-47a.¹

The specific directives required under this Subsection shall consist of the following information:

- (1) The transaction to be entered into;
- (2) Name of the issuer or borrower;
- (3) Amount involved; and
- (4) Terms of the security, including collateral, if any.”

Trust Entities (TEs) with composite rating of at least “3” under the Revised Trust Rating System in the latest Bangko Sentral examination will not be subject to the investment limitations provided under this subsection.”

Section 2. Subsections X411.4/4411Q.4 of the MORB/MORNBFI are hereby amended to read as follows:

“Subsection X411.4/4411Q.4 Lending and investment disposition. x x x”

“When an investment manager is granted discretionary powers in the investment disposition of investment management funds and unless otherwise specifically enumerated in the agreement or indenture and directed in writing by the client, loans and investments of the fund shall be limited to:

- a. Traditional deposit products of Universal and Commercial Banks in the Philippines with long-term credit rating of at least AA- or its equivalent by a third party credit assessment agency recognized by the Bangko Sentral;
- b. Evidences of indebtedness of the Republic of the Philippines and of the Bangko Sentral, and any other evidences of indebtedness or obligations where the servicing and repayment of which are fully guaranteed by the Republic of the Philippines or loans against such government securities;
- c. Loans fully guaranteed by the Republic of the Philippines as to the payment of principal and interest;
- d. Tradable securities issued by the government of a foreign country or any supranational entity with long-term credit rating of at least AA- or its equivalent by a third party credit assessment agency recognized by the Bangko Sentral;

¹ The Monetary Board, in its Resolution No. 1945 dated 27 October 2016 approved the discontinuance of access of trust entities to the BSP deposit facilities. Trust entities shall no longer have outstanding placement in the ODF and TDF by 30 June 2017.

- e. Loans fully secured by a hold-out on, assignment or pledge of deposits maintained either with the bank proper or other banks, or of deposit substitutes of the bank/institution, or of mortgage and chattel mortgage bonds issued by the investment manager; and
- f. Loans fully secured by real estate or chattels in accordance with Section X311/4311Q and Subsections X178.7/4178.7 and X304.1/4304Q.1.

The specific directives required under this Subsection shall consist of the following information:

- (1) The transaction to be entered into;
- (2) Name of the issuer or borrower;
- (3) Amount involved; and
- (4) Terms of the security, including collateral, if any."

TEs with composite rating of at least "3" under the Revised Trust Rating System in the latest Bangko Sentral examination will not be subject to the investment limitations provided under this subsection."

Section 3. Reporting requirements for discretionary and non-discretionary accounts under Subsections X425.1/4425Q.1 of the MORB/MORNBFI are hereby amended to read as follows:

"Subsection X425.1/4425Q.1 To trustor, beneficiary, principal. An entity acting as trustee, fiduciary or investment manager shall render reports on the trust, other fiduciary or Investment Management Accounts (IMAs) to the trustor, beneficiary, principal or other party in interest or the court concerned or any party duly designated by the court order, as the case may be. The reports shall be in such forms as to apprise the party concerned of the significant developments in the administration of the account and shall comply with the following guidelines:

- a. All clients shall be provided with a schedule of earning assets which contains the following information:
 - (1) Borrower's or issuer's name;
 - (2) Type of instrument;
 - (3) Collateral, if any;
 - (4) Principal amount or Acquisition cost;
 - (5) Market value;
 - (6) Marking-to-market gains or losses;
 - (7) Earning rate or yield;
 - (8) Amount of earnings/Accrued interest;
 - (9) Transaction date; and
 - (10) Maturity date, if any.

- b. Additional reports shall be required depending on the investment discretion as follows:
- (1) For Discretionary accounts, the reports shall also consist of balance sheet, income statement; investment activity report; and Return on Investment report.
 - (2) For Non-discretionary accounts, a confirmation of transaction shall be required covering every purchase and sale instructions. It shall contain the following information:
 - (i) Transaction entered into;
 - (ii) Borrower's or issuer's name;
 - (iii) Amount involved;
 - (iv) Terms of the security, including collateral, if any;
 - (v) Settlement price;
 - (vi) Value date and settlement date; and
 - (vii) Fees and charges related to the transaction.
- c. The reports, except for Item "b.(2)", shall be prepared in such frequency as required under the agreement but shall not in any case be longer than once every quarter; and
- d. The reports shall be made available to clients not later than twenty (20) calendar days from the end of the reference date/period in Item "c" above."

Section 4. Part III.A.2 Items (a) and (b) of Appendix 83/Q-48 of the MORB/MORNBFI is hereby amended to read as follows:

"(a) Account opening process. Xxx

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- Client Suitability Assessment (CSA)

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- Minimum Information Required for CSA

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- Investment policy statement

TE managing discretionary accounts shall have in place a method by which suitability of investment is determined based on the results of the CSA and formulated via an Investment Policy Statement (IPS). It shall communicate to prospective clients the results of the assessment, recommend the investment product / portfolio /

strategy, and explain the reasons why, on the basis of the given information, its recommendation is to the best interest of the client as of a defined timeframe. The TE shall make a recommendation only after having reasonably determined that the proposed investment is suitable to the client's and/or beneficiary's risk profile/tolerance, financial situation, investment experience, and investment objectives.

The IPS is a clear reference frame for investment decisions and must be based on the investment objectives and risk tolerance of the client. It must include, at a minimum, a description of the following:

- i. Client's risk tolerance;
- ii. Investment and/or return objectives;
- iii. Liquidity requirements;
- iv. Investment horizon;
- v. Investment strategy and rebalancing;
- vi. Portfolio construction process, including asset allocation and security selection criteria;
- vii. Investment restrictions – identifying any limitation which the client may have for the portfolio such as, but not limited to, single/group exposure limits, investment restrictions (e.g., prohibited investments), and client's consent for taking losses; and
- viii. Investment performance review - indicating proposed market benchmarks and the desired frequency of the performance review reporting.

A TE shall review the IPS of each client, offer suggestions on clarifying any necessary changes in the IPS, and discuss with the client various techniques and strategies to be used to meet the client's investment goals. A TE shall have a mechanism in place to ensure that this review is done periodically and that only appropriate investments and investment strategies are included in a client's portfolio and are aligned with the IPS.

For Unit Investment Trust Fund (UITF), the IPS is equivalent to the investment objective of the fund specifically stated in the Declaration of Trust.

- Option of client for re-classification

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For non-discretionary accounts, the TE shall observe the above requirements for every transaction allowing clients to invest in products/portfolio/strategy with a higher risk than those corresponding to their CSA profile results.

- Frequency of CSA and IPS

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(b) Identification of degree of discretion granted by client to the TE. This process involves the determination of the extent of discretion granted to the TE to manage the client's portfolio.

(1) Discretionary. The TE has authority or discretion to invest the funds/property of the client in accordance with the parameters set forth by the client; and

(2) Non-discretionary. Investment activity of the TE is directed by the client or limited only to specific securities or properties and expressly stipulated in the agreement or upon written instruction of the client.

(c) Documentation. The trust, fiduciary or investment management relationship shall be formally established through a written legal document, such as the trust or investment management agreement. The engagement documents shall clearly specify the extent of fiduciary assignments / responsibilities of the TE and articulate the nature and limits of each party's status as trustor / principal or trustee / agent. Policies and procedures shall provide that trust or investment management agreements are signed by the trust officer, or subordinate officer of the trust department, or in the case of UITF, branch managers / officers duly authorized by the board of directors.

The documentation process must also consider the following:

(1) The Agreement must conform to the requirements provided under Subsec. X409.1/4409Q.1 for trust and other fiduciary accounts and Subsec. X411.1/4411Q.1 for investment management accounts. In addition, the Agreement shall contain the following provisions:

(i) xxx

xxx

(2) The Agreement shall be in plain language understandable by the client and/or personnel of the TE responsible for explaining the contents of the agreement to the client.

(3) For complex investment products, such as financial derivatives instruments or those that use synthetic investment vehicles, the TE shall disclose to the client and require client's prior written conformity to the following:

(i) xxx

xxx

(4) In order to give a fair and adequate description of the investment service or financial instrument, the TE shall provide a clearly stated and easily understood Risk Disclosure Statement to its clients, which forms part of or attached to the trust, fiduciary or investment management agreement. The Risk Disclosure Statement shall contain, among other things, the following provisions:

(i) xxx

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Additional risk disclosures may be provided as appropriate.

The TE must ensure that the trust, fiduciary and investment management agreements and documents have been reviewed and found to be legally in order."

Section 5. Transitory Provision. The following provision shall be incorporated as a footnote to Subsections X409.2/4409Q.2 on "Lending and Investment Disposition of Trust and Other Fiduciary Business", X411.4/4411Q.4 on "Lending and Investment Disposition of Investment Management Activities", and X425.1/4425Q.1 on "Reports Required to Trustor, Beneficiary, Principal", and Part III.A.2 Item (a) on "Account Opening Process" of Appendix 83/Q-48 of the MORB/MORNBFI:

Trust entities shall be given six (6) months from the effectivity of this Circular to make appropriate changes in their policies, processes, and procedures in order to comply with the above requirements.

Section 6. Effectivity. 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:


NESTOR A. ESPENILLA, JR.
Governor