



BANGKO SENTRAL NG PILIPINAS

OFFICE OF THE GOVERNOR

CIRCULAR NO. 889

Series of 2015

Subject: Treasury Activities of BSP Supervised Financial Institutions (BSFIs) and Amendments to the Qualifications of Directors and Officers

The Monetary Board, in its Resolution No. 1692 dated 15 October 2015 and No. 1703.A.2 dated 22 October 2015, approved the following changes to the relevant provisions of the Manual of Regulations for Banks (MORB) and the Q-Regulations of the Manual of Regulations for Non-Bank Financial Institutions (MORNBFi) to incorporate guidelines governing treasury activities of BSFIs and amend the qualifications of directors and officers.

Section 1. The following shall be included in MORB/MORNBFi as Section X602/4602Q:

" Section X602/4602Q Treasury Activities of BSP Supervised Financial Institutions (BSFIs)

" Statement of Policy. The Bangko Sentral ng Pilipinas (BSP) is cognizant that treasury activities may expose BSFIs to significant risks along with profitable opportunities. These regulations are being issued to set out minimum expectations on BSFIs' treasury activities pursuant to Section 4 of R.A. No. 8791 or the General Banking Law of 2000, which recognizes the authority of the BSP to issue rules of conduct and establish standards of operation for its supervised financial institutions. These regulations, which cover the governance and operation of the trading function, among others, are aligned with the thrust of the BSP to ensure that the activities of BSFIs are undertaken with prudence and integrity, and that these are supported by commensurate risk management systems and internal controls.

" §X602.1/4602Q.1 Treasury Operations.¹ A BSFI's treasury activities may be a significant source of operational risk,² apart from giving rise to market, liquidity and credit risks.³ Losses to the institution may arise from the failure to meet professional obligations to clients, faulty product design, unethical business practices, and the failure to execute transactional processes. The institution must likewise be cognizant of the increased exposure to reputational risk in the presence of such factors.

In this regard, the operational risk management framework for treasury activities shall include the following elements: a strong governance structure that safeguards the integrity of the Treasury unit, especially the trading function; comprehensive policies and procedures; effective internal controls; a reliable management information system that facilitates the comprehensive monitoring and timely reporting of exposures; and a robust process for dealing with clients.

The BSFI shall:

- a) Conduct its treasury activities with a high degree of integrity. Consistent with the principles embodied in §X141.3/§4141Q.3 of the Manual of Regulations for Banks/Q-Regulations of the Manual of Regulations for Non-Bank Financial Institutions, the board of directors shall be primarily responsible for establishing the tone of good governance from the top and setting standards of appropriate and ethical behavior for itself, senior management, and other employees. The board shall ensure compliance with market conduct rules, and the relevant requirements and standards of any regulatory body, professional body, clearing house or exchange, or government and any of its instrumentalities/agencies.

In accordance with the board's duty to articulate acceptable and unacceptable activities, transactions and behaviors, it must adopt a code of conduct and standards of practice that are binding on the Treasury unit, especially personnel involved in risk-taking. The code and standards should highlight and provide specific guidance on upholding market integrity and professionalism. Practices which undermine market integrity include engaging in trading transactions which have the effect, or are likely to have the effect, of creating a false or misleading appearance of active trading in any security, currency or commodity, or with respect to the market for, or the price of, any security, currency or commodity. The code and standards should likewise include safeguards to prevent conflict of interest or self-dealing in any form when allowing personnel to deal for their own account.

The code and standards shall be complementary to any codes adopted by the entire institution, as well as those promulgated by the industry. It is likewise the responsibility of the board to institute mechanisms to ensure compliance with the provisions of the code of

conduct and the standards of practice, as well as to mete out appropriate sanctions for violations thereof.

- b) Conduct Treasury activities within a board-approved structure that is designed to meet the BSFI's objectives while enabling the strict enforcement of controls. The structure shall clearly distinguish between different functions (e.g., between asset-liability management, trading/dealership, underwriting, and brokering) and recognize the need for effective separation between operational units. The scope of authority and responsibility of each personnel shall be adequately defined, documented, and clearly communicated.
- c) Appoint personnel who possess a high degree of integrity and sufficient expertise to understand the financial instruments dealt and transactions entered into by the Treasury unit. These qualifications shall not only apply to personnel who originate and process the transactions but also to those who are responsible for reviewing the transactions' conformity to the BSFI's accepted trading practices. There shall likewise be manpower adept at operating and maintaining the management information system (MIS).
- d) Segregate the duties of the front, risk control and back office functions. The dealers in the front office are primarily responsible for transacting and managing positions. In this regard, the settlement and confirmation of transactions, the recording of contracts in the accounting system, the revaluation of positions, the reconciliations and procedures required to avoid errors, and other related processes in the back office shall be performed outside the dealing room to ensure objectivity and to prevent manipulation or fraud. There should be comprehensive and well-documented policies and procedures that describe the activities performed by each function.
- e) Provide for the prompt evaluation and escalation of suspicious trading trends and patterns, and unusual gains or losses. While the primary responsibility for ensuring that transactions are undertaken with integrity lies with front office personnel, there should be units tasked to perform reviews of treasury activities. The unit responsible for executing such reviews shall be independent from the risk-taking function and accorded sufficient resources and stature in the institution. In this way, it shall be empowered to quickly escalate any activity that seems unusual or inconsistent with compliance, financial and operational controls to the appropriate authorities. "Appropriate

authorities” shall refer to persons, units, or committees that are independent of the Treasury function and its management but possess equivalent or higher stature, such as the Chief Executive Officer, Chief Operating Officer, the Chief Risk Officer, the Chief Compliance Officer, or a Board-level committee. Personnel tasked to perform reviews shall have, among others, sufficient understanding of the strategies engaged in by trading desks to allow them to evaluate whether trading activities are aligned with the risk appetite of the financial institution.

- f) Regularly and actively engage the control functions namely, risk management, internal audit and compliance, in the oversight of treasury activities. Owing to their inherent responsibilities and stature within the BSFI, the control functions are well placed to perform reviews and render assessments of the Treasury unit and its activities. The operational risk management framework shall include tools and mechanisms to identify, measure, monitor and control risks in all aspects of treasury operations. As an example, risk and performance indicators may consist of those that identify errors in deal entry, track the cancellation of deals, analyze unusual trading activity, and flag limit exceptions, among others. Meanwhile, the compliance function/system referred to in §X180.2/§4180Q.1 is responsible for the regular conduct of reviews to ensure that the BSFI’s activities conform to applicable laws, rules, and regulations, including securities laws, as well as its obligations as a market participant. Lastly, internal audit shall be tasked with evaluating the Treasury unit’s compliance with the BSFI’s own policies and procedures, especially in the conduct of trading activities, in accordance with §X186.2/§4186Q.2, as amended by Circular No. 871 dated 5 March 2015. The scope of internal audit shall likewise include the review of the performance of risk management and compliance duties in respect of treasury activities.
- g) Employ treasury systems that are able to support the volume and complexity of the treasury transactions in the areas of deal entry, confirmation, settlement and accounting. Institutions that engage in heavy trading should endeavor to move to the use of straight-through processing to minimize input errors. On the other hand, institutions whose processes involve manual intervention should ensure that the integrity of data is preserved through proper controls.

- h) Ensure that the MIS is able to serve the needs of its users. The MIS should enable the accumulation and production of accurate and timely financial, regulatory, and management reports. At a minimum, management reports should highlight trading positions, profits/losses, and limit utilization. If the institution uses more than one system for its information needs, it should establish controls and perform reconciliations to minimize the likelihood of producing corrupted consolidated data.
- i) Subject new products to a rigorous approval process. The handling of new products shall be embodied in an internal policy that, among others, defines the circumstances under which a product shall be considered "new." The policy shall likewise contain guidelines for the review of the product, including the conduct of an analysis of its risks, costs and benefits to the institution; the identification of product features, uses, and target markets, as applicable; potential risks and mitigants to such risks; and the procedures involved in operationalizing the product. The policy shall identify the stages within the product development process at which approvals shall be obtained and from whom. All relevant units should sign off on the product program as part of the new product approval process.
- j) Act with honesty, fairness, and professionalism, and pursue the best interests of its clients. Due to the increasingly sophisticated products being introduced in the market, a BSFI acting as a dealer or broker shall have a clearly articulated strategy for the sale and marketing of financial products. The BSFI is expected to manage the risks arising from such activities and protect the interest of its clients. In this regard, a BSFI shall have appropriate policies, procedures and controls in place to ensure the suitability of products being offered to its clients. It shall ensure that (1) the client understands the nature of the transaction and the risks involved and (2) the transaction meets the client's financial objectives and is aligned with his/its risk tolerance. It shall also provide sufficient, accurate and comprehensible information about the products, including inherent risks, in a clear and balanced manner to enable its clients to make informed financial decisions. The BSFI shall likewise use reasonable diligence to ascertain the best market for the products offered to customers and buy and sell in such market so that the result to the customer is as favorable as possible under prevailing market conditions.

Management should refer to the existing Consumer Protection Framework and Sales and Marketing Guidelines under Appendix 26/Q-16.

The failure of an institution covered by these guidelines to consistently observe the same may be considered by the BSP as conducting business in an unsafe or unsound manner, subject to applicable provisions of laws and regulations.

Supervisory Enforcement Actions. The BSP 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 BSP directives. In this regard, the BSP may, among others, issue directives to refrain from engaging in treasury activities with serious supervisory issues. Sanctions may likewise be imposed on the BSFI and responsible persons, which may include restrictions or prohibitions from certain authorities/activities; and warning, reprimand, suspension, removal and disqualification of concerned directors, officers and employees.

¹ This subsection should be read in conjunction with existing regulations on Operational Risk Management.

² Operational risk refers to the risk of loss resulting from inadequate or failed internal processes, people and systems; or from external events. This definition includes legal and compliance risks.

³ BSFIs should refer to Sec. X175 of the MORB/Sec.4175Q of the MORNBF for the Guidelines on Market Risk Management, Sec. X176 of the MORB/Sec. 4176Q of the MORNBF for the Guidelines on Liquidity Risk Management and Circular No. 855 dated 29 October 2014 for the Guidelines on Sound Credit Risk Management Practices.”

Section 2. Subsections X141.2(a) and X142.2 of the MORB are hereby amended to read as follows:

(a) “§ X141.2 Qualifications of a director.

a. A director shall have the following minimum qualifications:

“(1) Xxx

“(2) Xxx

“(3) Xxx

"(4) He must be fit and proper for the position of a director of the bank. In determining whether a person is fit and proper for the position of a director, the following matters must be considered: integrity/probity; physical/mental fitness; relevant education/financial literacy/training; possession of competencies relevant to the job, such as knowledge and experience, skills, diligence and independence of mind; and sufficiency of time to fully carry out responsibilities.

"In assessing a director's integrity/probity, consideration shall be given to the director's market reputation, observed conduct and behavior, as well as his ability to continuously comply with company policies and applicable laws and regulations, including market conduct rules, and the relevant requirements and standards of any regulatory body, professional body, clearing house or exchange, or government and any of its instrumentalities/agencies.

"An elected director has the burden to prove that he/she possesses all the foregoing minimum qualifications and none of the disqualifications by submitting the documentary requirements listed in Appendix 98. X x x

"The members of the board of directors shall possess the foregoing qualifications in addition to those required or prescribed under R.A. No. 8791 and other applicable laws and regulations."

(b) "§ X142.2 Qualifications of an officer

"An officer shall have the following minimum qualifications:

"a. Xxx

"b. Xxx

"c. He must be fit and proper for the position he is being proposed/appointed to. In determining whether a person is fit and proper for a particular position, the following matters must be considered: integrity/probity, education/training, and possession of competencies relevant to the function such as knowledge and experience, skills and diligence.

"In assessing an officer's integrity/probity, consideration shall be given to the officer's market reputation, observed conduct and behavior, as well as his ability to continuously comply with company policies and applicable laws and regulations, including market conduct rules, and the relevant requirements

and standards of any regulatory body, professional body, clearing house or exchange, or government and any of its instrumentalities/agencies.

"In the case of Coop Bank, the manager must have actual banking experience (at least manager or assistant manager).

"An appointed officer has the burden to prove that he/she possesses all the foregoing minimum qualifications and none of the disqualifications by submitting the documentary requirements listed in Appendix 6. X x x

"The foregoing qualifications for officers shall be in addition to those required or prescribed under R.A. No. 8791 and other applicable laws and regulations."

Section 3. Subsections 4141Q.2(a) and Section 4142Q of the MORNBFI are hereby amended to read as follows:

(a) "§ 4141Q.2 Qualifications of a Director

"a. A director shall have the following minimum qualifications:

"(1) Xxx

"(2) Xxx

"(3) Xxx

"(4) He must be fit and proper for the position of a director of QB/trust entity. In determining whether a person is fit and proper for the position of a director, the following matters must be considered: integrity/probity; physical/mental fitness; relevant education/financial literacy/training; possession of competencies relevant to the job, such as knowledge and experience, skills, diligence and independence of mind; and sufficiency of time to fully carry out responsibilities.

"In assessing a director's integrity/probity, consideration shall be given to the director's market reputation, observed conduct and behavior, as well as his ability to continuously comply with company policies and applicable laws and regulations, including market conduct rules, and the relevant requirements and standards of any regulatory body, professional body, clearing house or exchange, or government and any of its instrumentalities/agencies.

"An elected director has the burden to prove that he/she possesses all the foregoing minimum qualifications and none of the disqualifications by submitting the documentary requirements listed in *Appendix Q-57*. X x x

"The members of the board of directors shall possess the foregoing qualifications in addition to those required or prescribed under R.A. No. 8791 and other applicable laws and regulations."

- (b) **"Sec. 4142Q Definition and Qualifications of Officers.** Officers shall include the president, executive vice president (EVP), senior vice-president, vice president, general manager, treasurer, secretary, trust officer and others mentioned as officers of the QB/trust entity, or those whose duties as such are defined in the by-laws, or are generally known to be the officers of the QB/trust entity (or any of its branches and offices other than the head office) either through announcement, representation, publication or any kind of communication made by the QB/trust entity: X x x

"An officer shall have the following minimum qualifications:

"a. Xxx

"b. Xxx

"c. He must be fit and proper for the position he is being proposed/appointed to. In determining whether a person is fit and proper for a particular position, the following matters must be considered: integrity/probity, education/training, and possession of competencies relevant to the function such as knowledge and experience, skills and diligence.

"In assessing an officer's integrity/probity, consideration shall be given to the officer's market reputation, observed conduct and behavior, as well as his ability to continuously comply with company policies and applicable laws and regulations, including market conduct rules, and the relevant requirements and standards of any regulatory body, professional body, clearing house or exchange, or government and any of its instrumentalities/agencies.

"An appointed officer has the burden to prove that he/she possesses all the foregoing minimum qualifications and none of the disqualifications by submitting the documentary requirements listed in *Appendix Q-57*. X x x

"The foregoing qualifications for officers shall be in addition to those required or prescribed under R.A. No. 8791 and other applicable laws and regulations."

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:

A handwritten signature in black ink, appearing to read 'Amto', written over a diagonal line that extends from the signature down towards the printed name.

AMANDO M. TETANGCO, JR.
Governor

2 November 2015