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AMENDMENT OF RISK-BASED CAPITAL ADEQUACY FRAMEWORK TO ALLOW QUALIFICATION OF HYBRID TIER 1 INSTRUMENTS

The Monetary Board in its Resolution No. 1569 dated 8 December 2005, approved the following amendments to the guidelines on the risk-based capital adequacy framework to include Hybrid Tier 1 as part of qualifying capital; and to rationalize the minimum requirements for eligibility of unsecured subordinated debt instruments that qualify as Upper or Lower Tier 2 capital.

SECTION 1. Subsection X116.1 of the Manual of Regulations for Banks is hereby amended to read as follows:

§X116.1 Qualifying Capital. The qualifying capital shall be the sum of --

a. Tier 1 capital -

a.1 Core Tier 1 capital

1. Paid-up common stock;
2. Paid-up perpetual and non-cumulative preferred stock;
3. Common stock dividends distributable;
4. Perpetual and non-cumulative preferred stock dividends distributable;
5. Surplus;
6. Surplus reserves;
7. Undivided profits (for domestic banks only); and
8. Minority interest in the equity of subsidiary financial allied undertakings which are less than wholly-owned: Provided, That a bank shall not use minority interests in the equity accounts of consolidated subsidiaries as avenue for introducing into its capital structure elements that might not otherwise qualify as Tier 1 capital or that would, in effect, result in an excessive reliance on preferred stock within Tier 1:

Provided, further, that the following items shall be deducted from the Tier 1 capital:

1. Common stock treasury shares:
2. Perpetual and non-cumulative preferred stock treasury shares.
3. Net unrealized losses on underwritten listed equity securities purchased (for domestic banks and Philippine branches of foreign banks);
4. Unbooked valuation reserves and other capital adjustments based on the latest report of examination as approved by the Monetary Board;
5. Total outstanding unsecured credit accommodations, both direct and

indirect, to directors, officers, stockholders and their related interests (DOSRI);
6. Deferred income tax; and
7. Goodwill; and

a.2 Hybrid Tier 1 (HT1)

1. With prior BSP approval, perpetual preferred stock and perpetual unsecured subordinated debt, subject to the following conditions:

i. The HT1 must be issued and fully paid-up. Only the net proceeds received from the issuance of HT1 shall be included as capital;

ii. The dividends/coupons on the HT1 must be non-cumulative. It is acceptable to pay dividends/coupons in scrip or shares of stock if a cash dividend/ coupon is withheld: Provided, That this does not result on issuing lower quality capital: Provided, further, That where such dividend/coupon stock settlement feature is included, the bank should ensure that it has an appropriate buffer of authorized capital stock and appropriate stockholders and board authorization, if necessary, to fulfill their potential obligations under such issues;

iii. The HT1 must be available to absorb losses of the bank without it being obliged to cease carrying on business. The agreement governing the issuance of the HT1 should specifically provide for the dividend/coupon and principal to absorb losses where the bank would otherwise be insolvent, or for the holders of the HT1 to be treated as if they were holders of a specified class of share capital in any proceedings commenced for the winding up of the bank. Issue documentation must disclose to prospective investors the manner by which the instrument is to be treated in loss situation.

Alternatively, the agreement governing the issuance of the HT1 can provide for automatic conversion into common shares of perpetual and non-cumulative preferred shares upon occurence of certain trigger events, as follows:

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

The rate of conversion must be fixed at the time of subscription to the instrument. The bank must also ensure that it has appropriate buffer of authorized capital stock and appropriate stockholders and board authorization for conversion/issue to take place anytime;

iv. The holders of the HT1 must not have a priority claim, in respect of principal and dividend/coupon payments of the HT1 in the event of winding up of the bank, which is higher than or equal with that of depositors, other creditors of the bank and holders of LT2 and UT2 capital instruments. The holder of the HT1 must waive his right to set-off any amount he owes the bank against any subordinated amount owed to him due to the HT1;

v. The HT1 must be perpetual;

vi. The HT1 must neither be secured nor covered by a guarantee of the issuer or related party or other arrangement that legally or economically enhances the priority of the claim of any holder of the HT1 as against depositors, other creditors of the bank and holders of LT2 and UT2 capital instruments;

vii. The HT1 must not be redeemable at the initiative of the holder. It must not be repayable prior to maturity without the prior approval of the BSP: Provided, that repayment may be allowed only in connection with call option after a minimum of five (5) years from issue date: Provided, however, That a call option may be exercised within the first five (5) years from issue date when --

- The HT1 was issued for the purpose of a merger with or acquisition by the bank and the merger or acquisition is aborted;
- There is a change in tax status of the HT1 due to changes in the tax law and/or regulations; or
- The HT1 does not qualify as Hybrid Tier 1 capital as determined by the BSP:

Provided, further, That such repayment prior to maturity shall be approved by the BSP only if the preferred share/debt is simultaneously replaced with issues of new capital which is neither smaller in size nor of lower quality than the original issue, unless the bank's capital ratio remains more than adequate after redemption.

It must not contain any clause which requires acceleration of payment of principal, except in the event of insolvency. The agreement governing the issuance of the HT1 must not contain any provision that mandates or creates an incentive for the bank to repay the outstanding principal of the instrument, e.g., a cross-default or negative pledge or a restrictive covenant, other than a call option which may be exercised by the bank;

viii. The main features of the HT1 must be publicly disclosed by annotating the same on the instrument and in a manner that is easily understood by the investor;

ix. The proceeds of the HT1 must be immediately available without limitation to the bank;

x. The bank must have full discretion over the amount and timing of dividends/coupons under the HT1 where the 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.

The bank must have full control and access to waived payments;

xi. Any dividend/coupon to be paid under the HT1 must be paid only to the extent that the bank has profits distributable determined in accordance with existing BSP regulations. The dividend/coupon rate, or the formulation for calculating dividend/coupon payments must be fixed at the time of issuance of the HT1and must not be linked to the credit standing of the bank;

xii. The HT1 may allow only one (1) moderate step-up in the dividend/coupon rate in conjunction with a call option, only if the step-up occurs at a minimum of ten (10) years after the issue date and if it results in an increase over the initial rate that is not 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 should be fixed as of 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 (Refer to Annex A for computation of dividend/coupon rate step-up);

xiii. The HT1 must be underwritten or purchased by a third party not related to the issuer bank nor acting in reciprocity for and in behalf of the issuer bank;

xiv. The HT1 must be issued in minimum denominations of at least five hundred thousand pesos (P500,000.00) or its equivalent;

xv. The HT1 must clearly state on its face that it is not a deposit and is not insured by the Philippine Deposit Insurance Corporation (PDIC); and

xvi. The bank must submit a written external legal opinion that the above-mentioned requirements, including the subordination and loss absorption features, have been met:

Provided, That for purposes of reserve requirement regulation, the HT1 shall not be treated as time deposit liability, deposit substitute liability or other forms of borrowings: *Provided, further*, That the total amount HT1 that may be included in the Tier 1 capital shall be limited to a maximum of 15% of total Tier 1 capital (net of deductions therefrom). To determine the allowable amount of HT1, the amount of total Tier 1 capital (net of deductions therefrom) excluding the HT1 should be multiplied by 17.65%, the number derived from the proportion of 15% to 85% (i.e 15%/85% = 17.65%);

b. Tier 2 (supplementary) capital which shall be the sum of --

b.1 Upper Tier 2 capital -

1. Paid-up perpetual and cumulative preferred stock;
2. Paid-up limited life redeemable preferred stock issued with the condition that redemption thereof shall be allowed only if the shares redeemed are replaced with at least an equivalent amount of newly paid-in shares so that the total paid-in capital stock is maintained at the same level prior to redemption;
3. Perpetual and cumulative preferred stock dividends distributable;

4. Limited redeemable preferred stock with the replacement requirement upon redemption dividends distributable;
5. Appraisal increment reserve - bank premises, as authorized by the Monetary Board;
6. Net unrealized gains on underwritten listed equity securities purchased: Provided, That the amount thereof that may be included in upper Tier 2 capital shall be subject to a 55% discount (for domestic banks and Philippine branches of foreign banks);
7. General loan loss provision: Provided, That the amount thereof that may be included in upper Tier 2 capital shall be limited to a maximum of 1.25% of gross risk-weighted assets, and any amount in excess thereof shall be deducted from the total risk-weighted assets in computing the denominator of the risk-based capital ratio;
8. With prior BSP approval, unsecured subordinated debt with a minimum original maturity of at least ten (10) years, hereinafter referred to as "UT2" subject to the following conditions:

i. The UT2 must be issued and fully paid-up. Only the net proceeds received from the issuance of UT2 shall be included as capital;

ii. The UT2 must be available to absorb losses of the bank without it being obliged to cease carrying on business. The agreement governing the issuance of the UT2 should specifically provide for the coupon and principal to absorb losses where the bank would otherwise be insolvent, or for the holders of the UT2 to be treated as if they were holder of a specified class of share capital in any proceedings commenced for the winding up of the bank. Issue documentation must disclose to prospective investors the manner by which the instrument is to be treated in loss situation.

Alternatively, the agreement governing the issuance of the UT2 can provide for automatic conversion into common shares or perpetual and non-cumulative shares or perpetual and cumulative preferred shares upon occurrence of certain trigger events, as follows:

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

The rate of conversion must be fixed at the time of subscription to the instrument. The bank must also ensure that it has appropriate buffer of authorized capital stock and appropriate stockholders and board authorization for con- version/issue to take place anytime;

iii. The holders of the UT2 must not have a priority claim, in respect of principal and coupon payments of the UT2 in the event of winding up of the bank, which is higher than or equal with that of depositors, other creditors of the bank, and holders of LT2 capital instruments. The holder of the UT2 must waive his right to set-off any amount he owes the bank against any subordinated amount owed to him due to the UT2;

iv. The UT2 must neither be secured nor covered by a guarantee of the issuer or related party or other arrangement that legally or economically enhances