[BSP CIRCULAR NO. 360, DECEMBER 3, 2002, December 03, 2002]

GUIDELINES TO INCORPORATE MARKET RISK IN THE RISK-BASED CAPITAL ADEQUACY FRAMEWORK

Pursuant to Monetary Board Resolution No. 1616 dated November 7, 2002, approving the guidelines to incorporate market risk in the risk-based capital adequacy framework for universal banks and commercial banks, the provisions of the Manual of Regulations for Banks are amended as follows:

1. A new subsection is hereby added after Subsection X116.4 of the Manual to read as follows:

   "§ I116.5. **Market Risk Capital Requirement**. Universal banks (UBs)/commercial banks (KBs) shall also measure and apply capital charges for market risk, in addition to the credit risk capital requirement described above, in accordance with the Guidelines to Incorporate Market Risk in the Risk-Based Capital Adequacy Framework (Appendix __)."

2. Subsections X116.5 and X116.6 of the Manual are hereby renumbered as Subsections X116.6 and X116.7, respectively.

3. Subsection X116.6 of the Manual (formerly Subsection X116.5) is hereby amended to read as follows:

   "§ X116.6. Sanctions. Whenever the capital accounts of a bank are deficient with respect to the prescribed risk-based capital adequacy ratio (which for UBs/KBs shall pertain to adjusted capital adequacy ratio covering combined credit risk and market risk), the Monetary Board after considering a report of the appropriate supervising and examining department of the BSP on the state of solvency of the institution concerned, shall limit or prohibit the distribution of the net profits and shall require that part or all of net profits be used to increase the capital accounts of the bank until the minimum requirement has been met. The Monetary Board may restrict or prohibit the making of new investments of any sort by the bank, with the exception of purchases of readily marketable evidences of indebtedness issued by the Philippine national government and BSP included in Item a(2)i of Subsec. X116.2, until the minimum required capital ratio has been restored."

This Circular shall take effect on July 1, 2003: Provided, That covered banks shall submit trial reports (solo basis and consolidated basis) using the prescribed new report forms commencing with the end-March 2003 reports.

Adopted: 3 Dec. 2002

(SGD.) AMANDO M. TETANGCO, JR.
Deputy Governor

Appendix I

GUIDELINES TO INCORPORATE MARKET RISK IN THE RISK-BASED CAPITAL ADEQUACY FRAMEWORK

Introduction

1. These guidelines describe the approach to be used by the BSP to determine the minimum level of capital to be held by a bank against its market risk. The guidelines are broadly consistent with the recommendations of the Basel Committee on Banking Supervision in a document entitled "Amendment to the Capital Accord to Incorporate Market Risks" issued in January 1996.

2. Under these guidelines, banks shall be required to measure and apply capital charges against their market risk, in addition to their credit risk.

3. Market risk is defined as the risk of losses in on and off balance sheet positions arising from movements in market prices. The risks addressed by these guidelines are:

- The risks pertaining to *interest rate-related instruments* and *equities* in the trading book; and

- Foreign exchange risk throughout the bank.

Coverage of capital requirement for market risk

4. The capital requirement for market risk shall apply to all universal banks and commercial banks.

5. The minimum capital adequacy ratio covering combined credit risk and market risk shall apply to banks which are subject to market risk capital requirement on both solo basis (i.e., head office plus branches) and consolidated basis (i.e., parent bank plus subsidiary financial allied undertakings, but excluding insurance companies).

Methods of measuring market risk

6. There are two alternative methods recognized for the measurement of market risk, as follows:

(a) The standardized approach shall be used by all banks which are subject to market risk capital requirement, except by those which may be allowed by BSP to use the alternative method described in paragraph (b) below. The method of measuring market risk under the standardized approach is set out in the