

o Capital Adequacy Framework

- In addition to the prescribed minimum levels of capital, Philippine banks were required to maintain a net worth-to-risk assets (NWRA) ratio of at least 10%. (*Sec. 22 of R. A. No. 337*)
- This prescribed ratio was replaced by a 10% BIS-type risk-weighted capital adequacy ratio effective 1 July 2001. The new framework was approved by the MB on 16 February 2001 and implemented under Circular No. 280 requiring capital charge on credit risk only.
- The MB, in its Resolution No. 1616 dated 7 November 2002, approved the guidelines to incorporate market risk in the risk-based capital adequacy framework for universal and commercial banks. (*Circular No. 360 dated 3 December 2002*)
- The key modifications introduced in the Philippine framework pertain to: (i) the risks covered; (ii) the required minimum ratio; (iii) the qualifying capital; and (iii) the classification used on the risk weighting system.
 - a) ***On the risk covered*** - The framework initially covers only capital requirement for credit risk to facilitate early implementation of the risk-based capital adequacy framework. Supplementary guidelines to cover the more complex market risk will be phased-in as soon as the banking system is ready. For this purpose, assets which otherwise are subject to market risk capital requirement shall in the meantime be subject to credit risk capital requirement.
 - b) ***On the Minimum Required Ratio*** - The threshold value has been set higher than the BIS' 8% capital ratio to provide for risks otherwise not covered under the recently approved framework which focuses mainly on credit risk. At 10%, the newly prescribed capital adequacy ratio is equal to the existing Philippine standard ratio prior to the adoption of the BIS capital ratio.
 - c) ***On the Qualifying Capital*** - The limit on the total amount of lower Tier 2 capital that may be included in Tier 2 capital is reduced from 50% to 25% of Tier 1 capital. Tier 2 includes, among others, loan loss provision that is equivalent to 1.25% of the total risk weighted assets.
 - d) ***On the Risk Weighting System*** – In lieu of the OECD and non-OECD classification for purposes of applying differential risk

weighting, sovereigns and banks with the highest credit quality (based on assessments by any 2 internationally accepted rating agencies, e.g., “Aa3” and above by Moody’s, and/or “AA-“ and above by Standard and Poor’s and/or Fitch IBCA) as against all others are used as the bases for applying differential risk weighting.

Moreover, claims on sovereigns other than those with the highest credit quality are assigned 100% risk weight, regardless of currency denomination. The use of assessments by external rating agencies rather than OECD/non-OECD classification for assigning risk weights is more in conformity with the New Capital Adequacy Framework now being proposed by the Basle Committee to replace the July 1988 Capital Accord.

- The guidelines on the adoption of the risk-based capital adequacy framework (Circular No. 280) was amended by virtue of MB Resolution No. 1823 dated 15 November 2001, which assigned 50% risk weight on local government unit (LGU) bonds which are covered by Deed of Assignment of Internal Revenue Allotment of the LGU and guaranteed by the LGU Guarantee Corporation. *(Circular No. 310 dated 10 December 2001)*
- The risk weight applicable to small and medium enterprises (SMEs) and microfinance loan portfolios that meet prudential standards was reduced to 75% from 100%. *(Circular No. 364 dated 9 January 2003)*
- The guidelines on unsecured subordinated debt (USD) eligible as Tier 2 (supplementary) capital under item b.b.1 (8) and b.b.2(1), Subsection X116.1 of the MORB was issued. *(Memorandum to All Banks/Non-Bank Financial Institutions dated 17 February 2003, as amended on 20 May 2003)*
- Assigned 50% risk weight on securities issued by Special Purpose Vehicles against assignment of receivables arising from future payments of the Philippine National Government (NG) in connection with projects undertaken in pursuance of R.A. No. 6957, provided that such securities obtain and maintain credit ratings of at least one notch below the credit rating of the NG from a BSP recognized rating agency. *(Circular No. 394 dated 6 August 2003, superseded by Circular No. 475 dated 14 February 2005)*
- Amended the conditions set before a bank is allowed to issue redeemable preferred shares as well as the treatment thereof for purposes of capital adequacy ratio computation under Subsections X126.5 and X116.1 of the MORB. *(Circular No. 397 dated 19*

August 2003)

- The MB, in its Resolution No. 1062 dated 31 July 2003, approved the guidelines on the adoption of the risk-based capital adequacy framework by quasi-banks to initially cover only the capital requirements for credit risks pending issuance of the supplementary guidelines to incorporate market risks. The guidelines shall replace the existing provisions of Section 4116Q and its subsections of the MORNBFI's effective 1 January 2004. *(Circular No. 400 dated 1 September 2003)*
- In its Resolution No. 1195 dated 21 August 2003, the MB approved the amendments to the provisions of Subsection X116.2 of the MORB to expand the coverage of on balance sheet assets that are assigned 20% risk weight and 50% risk weight to cover claims on Philippine incorporated banks and to impose 2% and 5% (in lieu of 10%) specific market risk capital charge on trading book debt securities issued by Philippine incorporated banks *(Circular No. 403 dated 19 September 2003, superseded by Circular No. 475 dated 14 February 2005)*
- Clarification was made on the market risk capital treatment for dollar-linked peso notes (DLPNs) under Circular No. 360 dated 3 December 2002. *(MAB dated 2 December 2003)*
- The MB, in its Resolution No. 1843 dated 18 December 2003, approved the amendments to the provisions of Subsection X116.2 of the MORB reducing the risk weight of multilateral development banks from 20% to 0% and removing loans to exporters to the extent guaranteed by the GFSME from the list of 0% risk weighted assets. Further, Subsection X116.3 of the MORB was amended to include the International Finance Corporation (IFC), the Nordic Investment Bank (NIB), the Caribbean Development Bank (CDB) and the Council of Europe Development Bank (CEDB) among the list of multilateral development banks assigned a zero percent risk weight. *(Circular No. 416 dated 21 January 2004)*
- The guidelines for the capital treatment of banks' investment in credit-linked notes (CLNs) and similar credit derivative products such as credit-linked deposits (CLDs) and credit-linked loans (CLLs) was approved by the MB in its Resolution No. 1845 dated 18 December 2003. *(Circular 417 dated 28 January 2004)*
- U/KBs applying for BSP recognition of their own internal Value-at-Risk (VaR) models in lieu of the standardized approach for calculating market risk capital charge are required to: conduct a

self-assessment of its compliance with the requirements for the use of such models as prescribed under Circular 360; and submit a written application together with the required documents to the appropriate supervising and examination department. (MAB dated 26 January 2004)

- The revised report form for the Computation of the Risk-Based Capital Adequacy Ratio Covering Credit Risks for Rural and Cooperative Banks under Circular No. 416 dated 21 January 2004 shall be used for the quarter ending 31 March 2004 and thereafter. (Memorandum to All RBs and Coop Banks dated 3 February 2004)
- The guidelines for the capital treatment of banks' investment in securities overlying securitization structures was approved by the MB in its Resolution No. 13 dated 6 January 2005. (Circular No. 468 dated 12 January 2005)

➤ The assignment of risk weights corresponding to agency ratings shall be as follows:

Risk weight	Moody's	Standard & Poor's	Fitch IBCA	PhilRatings
20%	Aaa to Aa3	AAA to AA-	AAA to AA-	Aaa to Aa
50%	A1 to A3	A+ to A-	A+ to A-	A
100%	Baa1 to Baa3	BBB+ to BBB-	BBB+ to BBB-	Baa
Deduction from total of Tier 1 and Tier 2 capital	Below Baa3	Below BBB-	Below BBB-	Below Baa
	Unrated			

- The guidelines for the capital treatment of banks' investment in structured products was approved by the MB in its Resolution No. 1791 dated 9 December 2004. (Circular No. 469 dated 13 January 2005)

➤ The mapping of ratings to the corresponding risk weights shall be as follows:

Risk weight	Moody's	Standard & Poor's	Fitch Ratings
50%	Aaa to Aa3	AAA to AA-	AAA to AA-
100%	A1 to A3	A+ to A-	A+ to A-
150%	Baa1 to Baa3	BBB+ to BBB-	BBB+ to BBB-
Deduction from total of Tier 1 and Tier 2 capital	Below Baa3	Below BBB-	Below BBB-
	Unrated		

- The guidelines on the adoption of the risk-based capital adequacy framework (Circular No. 280) and incorporation of market risk (Circular 360) was amended by virtue of MB Resolution No. 140 dated 3 February 2005 (*Circular No. 475 dated 14 February 2005*):

a) Risk weights applicable for claims on foreign incorporated and Philippine incorporated private enterprises, and past due claims were amended as follows:

➤ 20% risk weight on claims on Philippine and foreign incorporated private enterprises with the highest credit quality as defined in Subsec. X116.3;

➤ 50% risk weight on loans for housing purposes, fully secured by first mortgage on residential property that is or will be occupied or leased out by the borrower, which are not classified as non-performing;

➤ 75% risk weight on non-performing loans for housing purposes, fully secured by first mortgage on residential property that is or will be occupied or leased out by the borrower; provided that risk weighting for such loans shall be increased to 100% in 2007;

➤ 100% risk weight on claims on Philippine incorporated private enterprises and claims on foreign incorporated private enterprises other than those with the highest credit quality;

➤ 125% risk weight on all non-performing loans (except non-performing loans for housing purpose, fully secured by first mortgage on residential property that is or will be occupied or leased out by the borrower) and all non-performing debt securities; provided, that risk weighting for such exposures shall be increased to 150% in 2007;

b) Subsection X116.3 of the MORB is hereby amended to include the definition of a non-performing debt security, a private enterprise, a private enterprise with a highest credit quality, and to clarify the use of credit ratings for regulatory capital purposes.

- Implementation Plans for Basel 2 (*Memorandum to All Banks Dated 13 December 2004*)

➤ The MB, in its Resolution No. 1516 dated 14 October 2004, approved the implementation plans for Basel 2 accord, or the International Convergence of Capital Measurement and Capital Standards.

➤ U/KBs are expected to comply with the standardized approach for credit risk, and the basic indicator or standardized approaches for operational risk by 2007. By 2010, these banks may move to the foundation

internal rating based (IRB) or advanced IRB approaches for credit risk, and advanced measurement approaches for operational risk.

- Thrift banks on the other hand, are classified into two. Small TBs are expected to be subject to an enhanced Base-1 type approach by 2007. However, TBs affiliated with U/KBs should use the same approach used by U/KBs.
- Rural Banks are expected to be subject to an enhanced Basel 1-type approach.