

o Lending and Investment Activities

- On 2 June 2000, the MB, as a general policy, required that in the grant of loans banks must observe the provisions of Section 76 of R.A. No. 337 to wit: *“Before granting a loan, banks must exercise proper caution to ascertain that the debtor is capable of fulfilling his commitments to the bank. xxx”.* (Circular No. 247 dated 2 June 2000)
- Aside from classifying loans into either current or past due, banks are further required to group loans into unclassified or classified accounts and to set up specific allowance for probable losses on classified loan accounts.
- The MB, in its Resolution No. 833 dated 31 May 2001, approved the adjustment in the definition of medium enterprises from the previous ceiling of P60 million in total assets to P100 million.
- The MB, in its Resolution No. 874 dated 13 June 2002, approved the amendments to Sections X312 (Loans and Other Credit Accommodations Secured by Chattels and Intangible Properties) and X313 (Loans and Other Credit Accommodations Secured by Personal Properties) of the MORB, pursuant to Section 38 of R. A. 8791 (The General Banking Law of 2000). (Circular No. 335 dated 17 June 2002)
- The MB, in its Resolution No. 999 dated 11 July 2002, allowed the excess FCDU/EFCDU funds of UBs and KBs to be lent to RBU to fund its on-balance-sheet foreign exchange trade transactions, subject to certain conditions such as compliance with the prescribed 100% asset cover and 30% liquidity cover on FCDU/EFCDU liabilities; the FCDU/EFCDU lending to RBU shall be capped at the lower of total outstanding balance on RBU’s on-balance sheet foreign currency trade assets or 30% of the level of FCDU/EFCDU deposit liabilities, computed at the average daily balance (using 2-month rolling data) as of end of the second week prior to the reference week. (Circular No. 342 dated 8 August 2002 as amended by Circular No. 366 dated 21 January 2003).
- The rules and regulations on amortization on loans and other credit accommodations to implement Section 44 of R. A. No. 8791 was issued pursuant to MB Resolution No. 1171 dated 8 August 2002. The grace period provisions of Section X349 of the MORB was also amended on agriculture and fisheries projects with long gestation periods. (Circular No. 347 dated 16 August 2002)

- The rules and regulations to implement Section 39 of R. A. No. 8791 (General Banking Law of 2000) on the grant of loans and other credit accommodations was approved pursuant to MB Resolution No. 1241 dated 29 August 2002. *(Circular No. 350 dated 10 September 2002)*
- The rules and regulations to implement Sections 40 and 41 of R. A. No. 8791 (General Banking Law of 2000) amending Section X319 of the MORB and its Subsections on the grant of loans and other credit accommodations except those granted to microfinance and small and medium enterprises was approved by MB in its Resolution No. 811 dated 12 June 2003. *(Circular No. 389 dated 25 June 2003)*
- The MB, in its Resolution No. 890 dated 26 June 2003 approved the amendment to the first paragraph of Section X303 of the MORB so as to incorporate loans fully secured by US Treasury Notes and other securities issued by central government and central banks of foreign countries with the highest credit quality given by any 2 internationally accepted rating agencies among the exclusions from the single borrower's limit (SBL). *(Circular No. 393 dated 29 July 2003)*
- The MB, in its Resolution No. 1060 dated 31 July 2003 amended the provisions of BSP Circular No. 1389 dated 13 April 1993 and the MORB to incorporate provisions on securities lending activities as lender and adding Government Securities lent under a securities lending agreement as eligible asset cover for FCDU/EFCDU liabilities. *(Circular No. 395 dated 19 August 2003)*
- In line with the objective of strengthening risk management in the banking system, the MB, in its Resolution No. 1846 dated 18 December 2003 issued the guidelines for managing large exposures and credit risk concentrations. *(Circular No. 414 dated 13 January 2004)*
 - The 9 principles included 1) proper management of various forms of credit risk concentration, 2) credit risk concentrations arise from excessive exposures to individual counterparties, groups of related counterparties and groups of counterparties with similar characteristics, 3) risk diversification is essential, 4) adoption of proper risk control and diversification strategies, 5) responsibility of the board of directors in establishing and monitoring compliance

with policies governing large exposures and credit risk concentrations, 6) minimum coverage of the policy on large exposures and credit risk concentrations, 7) ensure adequate systems and controls are in place together with the regular review of large exposures, 8) where appropriate, conduct stress testing and scenario analysis on the impact of changes in market conditions or key risk factors, and 9) observe a lower internal single borrower's limit than the prescribed limit of 25%.

- In monitoring large exposures, the bank should: 1) maintain a central liability record, 2) maintain adequate management information and reporting systems that enable management to identify credit risk concentrations on a timely basis, 3) ensure that internal or external auditors conduct at least an annual review of the quality of large exposures and controls to safeguard against credit risk concentrations, 4) take prompt corrective action to address concerns and exceptions, and 5) ensure that all relevant internal and prescribed requirements and limits are complied with through an independent compliance function
 - Non-observance of the preceding principles may be a ground for a finding of unsafe and unsound practice under Section 56 of the GBL of 2000.
 - A bank must inform BSP immediately where it has concerns that its large exposures on credit risk concentrations have the potential to impact materially upon its capital adequacy, along with proposed measures to address these concerns.
- The MB, in its Resolution No. 28 dated 15 January 2004, approved the policy guidelines in the conversion and transfer of foreign currency-denominated loans in the books of the FCDO/EFCDU to peso loans in the books of the Regular Banking Unit (RBU). *(Circular No. 420 dated 10 February 2004)*
 - To implement Section 35 of R.A. 8791 (The General Banking Law of 2000), the MB, in its Resolution No. 299 dated 11 March 2004, approved the amendments to Section X303 and Subsections X303.1 to X303.5 of the MORB on matters pertaining to credit exposure limits to a single borrower which provides that total amount of loans, credit accommodations and guarantees that may be extended by a bank to any person, partnership, association, corporation or other entity shall at no time exceed 25% of the net

worth of such bank. The total credit commitment of the bank to or on behalf of the borrower shall be the basis for determining compliance with the single borrower's limit (SBL). Said loans, credit accommodations and guarantees may be increased by an additional 10% of the bank's net worth subject to certain conditions. Subsection X347.2 of the MORB was also amended so that the total guarantees or similar arrangements, the nature of which requires the guarantor to assume the liabilities/obligations of third parties in case of their inability to pay, that may be issued by a bank and outstanding at any given time, shall not exceed 100% of the bank's qualifying capital. (*Circular No. 425 dated 25 March 2004*)

- The MB in its Resolution No. 841 dated 10 June 2004, added the following provision to the Subsection X303.1f of the Manual of Regulations for Banks (MORB):

“ that commercial or business papers purchased by banks from small and medium enterprises (SMEs) which became past due or the maturities of which have been extended, shall be considered additional loan by the bank to the purchaser of goods or services from the SME and shall be entitled to an increased SBL equivalent to ten percent (10%) of the net worth of the concerned bank if the purchasers are companies with credit ratings of at least "AA - " or equivalent from a BSP-recognized rating agency.” (Circular No. 443 dated 13 August 2004)

- Subsection X304.1 of the MORB was amended by the MB in its Resolution No. 74 dated 20 January 2005. (*Circular No. 472 dated 26 January 2005*).
 - Before granting a loan, a bank in addition to the usual sheet about the borrower, shall require from the credit applicant a statement of his assets and liabilities and of his income and expenses together with the following:
 - a) Copy of the latest Income Tax Return (ITR) of the borrower and his co-maker, if applicable, duly stamped as received by the Bureau of Internal Revenue (BIR).
 - b) Except as otherwise provided by law and in other regulations, if the borrower is engaged in business, a copy of the borrower's latest financial statements as submitted for taxation purposes to the BIR.
 - c) A waiver of confidentiality of client information and/or an authority of the bank to conduct random verification with the BIR in order to establish authenticity of the ITR and accompanying

financial statements submitted by the client.

- Should the document(s) submitted prove to be spurious or incorrect in any material detail, the bank may terminate any loan or other credit accommodation granted on the basis of said document(s) and shall have the right to demand immediate repayment or liquidation of the obligation.
- These shall also apply to all non-bank financial institutions under the supervision of BSP.

Equity Investments

- Only UBs are allowed to invest in the equities of non-allied undertakings. The equity investment of a UB or of its wholly or majority-owned subsidiaries, in a single non-allied enterprise shall not exceed 35% of the total equity/ voting stock in that enterprise. *(Subsection 1381.2 of the MORB, as amended by Circular No. 438 dated 18 June 2004)*
- The broad category of non-allied undertakings in which a UB may invest shall require prior approval of the MB. The equity investment in the following categories, moreover, shall not require prior MB approval: a) enterprises engaged in physically productive activities in agriculture, mining and quarrying, manufacturing, public utilities, construction, wholesale trade and community and social services; b) industrial park projects and/ or industrial estate development; c) financial and commercial complex projects arising from or in connection with the government's privatization program; and d) such other broad categories as the MB may declare as appropriate. *(Subsection 1381.1 and 1381.2 of the MORB, as amended by Circular No. 438 dated 18 June 2004)*

All banks are allowed to invest in equities of financial allied and non-financial allied undertakings, subject to the following ratios in relation to the total subscribed capital stock/voting stock of the allied undertaking:

	Investing Bank*				
	UB		KB		COOP
Financial Allied Undertakings	Publicly -listed	Not Listed	Publicly -listed	Not Listed	

Universal Banks	100%	49%	100%	49%	49%	49%	49%
Commercial Banks	100%	49%	100%	49%	49%	49%	49%
Thrift Banks	100%		100%	49%	9%		49%
Rural Banks	100%		100%	49%	49%		100%
Coop Banks	N.A.		N.A.	N.A.	N.A.		30%
Insurance companies	100%		N.A.	N.A.	N.A.		49%
VCCs	60%		60%	60%	49%		49%
Others	100%		49%	40%	40%		40%

* Circular No. 323 dated 13 March 2002

Non-Financial Allied Undertaking	Investing Bank*				
	UB	KB	TB	RB	COOP
Warehousing	100%	100%	49%	N.A.	N.A.
Storage	100%	100%	49%	N.A.	N.A.
Safe Deposit Box	100%	100%	49%	N.A.	N.A.
Companies engaged in the management of mutual funds	100%	100%	49%	N.A.	N.A.
Management Corporation	100%	100%	49%	N.A.	N.A.
Corporate Services	100%	100%	49%	N.A.	N.A.
Insurance Agencies/ Brokerage	100%	100%	49%	N.A.	N.A.
Home Building and Home Development	100%	100%	49%	N.A.	N.A.
Drying/ Milling Facilities	100%	100%	49%	N.A.	N.A.
Service Bureaus	100%	100%	49%	N.A.	N.A.
PCHC/ Phil. Central Depository Inc. / Fixed Income Exchange	100%	100%	49%	N.A.	N.A.
Health Maintenance Org. (HMOs)	100%	N.A.	N.A.	N.A.	N.A.
Warehousing and other post-	N.A.	N.A.	49%	49%	49%

harvest facilities					
Fertilizes/ agricultural chemical/ pesticides distribution	N.A.	N.A.	49%	49%	49%
Farm equipment distribution	N.A.	N.A.	49%	49%	49%
Trucking/ transportation of agricultural products	N.A.	N.A.	49%	49%	49%
Marketing of agricultural products	N.A.	N.A.	49%	49%	49%
Leasing	N.A.	N.A.	49%	49%	49%

* Section X380 of the MORB

On 12 May 2000, the definition of the account “Equity Investments” in the Manual of Accounts for UBs and KBs was revised to include “indirect” equity ownership in the computation of total investments that qualify for equity method of accounting. *(Circular No. 243, amending Circular No. 108 dated 6 May 1996, as amended by Circular Nos. 201 and 231, dated 1 May 1999 and 21 March 2000)*

In order to promote competitive conditions, the equity investment of a bank in a single financial allied undertaking shall be within the prescribed limit in relation to its total subscribed capital stock and to the total voting stock of the allied undertaking. The MB may further limit the equity investments in quasi-banks of UBs and KBs up to 40% while publicly listed UBs or KBs may own up to 100% of the voting stock of only one other UB or KB, otherwise, it will be limited to a minority holding. *(Circular No. 323 dated 13 March 2002)*

However, equity investments of UBs and KBs in any single enterprise shall not exceed at any time 25% of the net worth of the investing bank as defined in Section X106 and Subsection X121.5 of the MORB; while the total amount of investment in equities in all enterprises shall not exceed the ratios in relation to the net worth of the investing bank, to wit: *(Circular No. 331 dated 2 May 2002)*

	<u>UB</u>	<u>KB</u>	<u>TB</u>	<u>RB</u>	<u>COOP</u>
LIMIT	50%	35%	25%	25%	25%

With prior approval of the MB and under certain conditions, a bank may render the following services in favor of subsidiaries, affiliates and companies related to it by at least 5% common ownership. *(Circular No. 373 dated 27 February 2003):*

Credit card, bank and loans reconciliation;

Credit card billing;
Time deposit processing;
Merchant settlement and care service;
Collections;
Credit application processing;
Call center support;
Telemarketing of bank and credit card products;
Human resource-related service;
Finance accounting functions;
Documentation;
Cashiering;
Reports preparation; and
Safekeeping of securities.

Banks were allowed to outsource certain front/back office functions, i.e., trade support services and downstream processing activities by parent to a subsidiary or vice-versa subject to certain conditions. (*Circular No. 390 dated 30 June 2003*)

Repurchase Agreements

The MB in its Resolution No. 518 dated 15 April 2004, allowed banks to engage in repurchase agreements involving foreign currency denominated government securities, subject to the following conditions (*Circular No. 433 dated 13 May 2004, as amended by Circular No. 478 dated 22 February 2005*):

The repurchase agreements shall involve government securities held as Trading Account Securities under the foreign currency deposit unit (FCDU)/expanded FCDU (EFCDU) books;

The government securities subject of repurchase agreements are to be booked under the account "Government Securities Sold under Repurchase Agreements - FCDU/EFCDU";

The borrowings shall only be from FCDUs/EFCDUs, non-resident financial institutions and offshore banking units;

For thrift banks, which are granted a certificate of authority to operate an FCDU, the maximum term of the repurchase agreements shall be one (1) year.

The borrowings shall be booked under "Bills Payable" and included in the computation of the total FCDU/EFCDU liabilities subject to the mandatory 100% asset cover and 30% liquidity cover;

The government securities used as collateral of the borrowing and any margin (in the form of cash or securities) that the lender

will collect from the bank anytime the market value of the collateralized securities fall below the amount of the loan shall be considered as eligible asset cover for the 100% cover requirement of the said borrowings. Any excess in the value of the securities or cash used as collateral in a repurchase arrangement cannot be used as cover for the other FCDU/EFCDU liabilities;

The government securities used as collateral of the borrowings and any margin (in the form of cash or securities) that the lender will collect from the bank anytime the market value of the collateralized securities fall below the amount of the loan shall not be eligible for the 30% liquid asset cover requirement;

Banks shall, at all times, comply with the 100% FCDU/EFCDU asset cover and 30% liquidity cover; and

Banks shall monitor and assess the risks inherent in these repurchase transactions.

- Per MB Resolution No. 137 dated 3 February 2005, banks' EFCDUs/FCDUs are allowed to purchase foreign currency denominated securities under resale agreements from other banks' EFCDU/FCDU, non-resident financial institutions and offshore banking units, subject to the following conditions (*Circular No. 478 dated 22 February 2005*):

Government securities purchased shall be limited to those issued by central governments and/or central banks of foreign countries with the highest credit quality given by any two internationally accepted rating agencies (i.e., currently the equivalent of Standard and Poor's AA- or Moody's Aa3 or better);

The maximum term of the resale agreements shall be one (1) year for thrift banks which are granted a certificate of authority to operate an FCDU;

Government securities purchased under resale agreements shall be classified as "Trading Account Securities – Loans" and booked under the sub-account "Government Securities-Purchased under Resale Agreements – EFCDU/FCDU".

The MB in its Resolution No. 1181 dated 19 August 2004, allowed banks to use IBODI holdings under the foreign currency deposit unit (FCDU)/expanded FCDU (EFCDU) books in engaging in repurchase agreements. (*Circular No. 448 dated 3 September 2004*)

To implement Circular No. 448 dated 3 September 2004, the

Manual of Accounts of universal, commercial and thrift banks was amended so as to create a subsidiary ledger accounts under the general ledger "Investment in Bonds and Other Debt Instruments", namely: "Investments in Bonds and Other Debt Instruments Lent Under Securities Lending Agreements (Foreign Regular and FCDU/EFCDU Books)" and Investment in Bonds and Other Debt Instruments Sold Under Repurchase Agreements (Foreign Regular and FCDU/EFCDU Books). The revised General ledger and Consolidated Statement of Condition (CSOC) will be implemented effective reports ending 28 February 2005 (*Memorandum to All U/KBs and TBs dated 14 February 2005*).

The rules and regulations on repurchase agreements covering government securities or instruments of banks and NBQBs as well as sale on a without recourse basis of said securities by banks, NBQBs and other financial institutions were approved by the MB un its resolution No. 1871 dated 23 December 2004, as amended by MB resolution No. 12 dated 6 January 2005 (*Circular No. 467 dated 10 January 2005*).

Repurchase agreements covering government securities, commercial papers and other negotiable instruments must be properly recorded and documented in accordance with existing BSP regulations. All sales of government securities, commercial papers and other negotiable and non-negotiable securities or instruments that are not documented in accordance with existing BSP regulations shall be deemed to be deposit substitutes subject to regular reserves.

The Chief Executive Officer (CEO) or the Officer of Equivalent Rank should:

- Institute policies and procedures to prevent undocumented or improperly documented repurchase agreements covering government securities, commercial papers and other negotiable and non-negotiable securities or instruments;
- Submit a notarized certification at the end of every semester that the bank/NBFI did not enter into any repurchase agreement covering government securities, commercial papers and other negotiable and non-negotiable securities or instruments that are not documented in accordance with existing BSP regulations and that the bank/NBFI has strictly complied with the pertinent rules of the SEC and the BSP on the proper sale of securities to the public and performed the

necessary representations and disclosures on the securities.

- Inform the client of the provisions in the BSP Circular No. 392 dated 23 July 2003
- Clearly state to the client that:

The bank/NBFI does not guarantee the payment of the security sold on a “without recourse basis” and in the event of default by the issuer, the sole credit risk shall be borne by the client; and

The bank/NBFI is not performing any advisory or fiduciary function.

- Report to the appropriate supervising and examining department of the BSP any undocumented repurchase agreement within seventy-two (72) hours from knowledge of such transactions.

Accounting Guidelines for Investments (Circular No. 476 dated 16 February 2005)

- BSP promotes full transparency of the financial statements of banks and other supervised institutions in order to strengthen market discipline, encourage sound risk management practices, and stimulate the domestic capital market. BSP also desires to align local financial accounting standards with international accounting standards.
- All investments in debt and equity securities are covered except for the following:

Those that are part of hedging relationship;

Those that are hybrid financial instruments

Those financial liabilities that are held for trading

Those financial assets and financial liabilities which, upon initial recognition, are designated by the financial institutions as at fair value through profit or loss; and

Those that are classified as loans and receivables.

Depending on the intent, investments in debt and equity securities shall be classified into one of four categories and accounted for as follows:

- a) Held to Maturity Securities (HTM) — These are debt securities with fixed or determinable

payments and fixed maturity that a financial institution has the positive intention and ability to hold to maturity other than:

- Those that meet the definition of Securities at Fair Value Through Profit or Loss; and
- Those that the financial institution designates as Available-for-Sale Securities (AFS).

b) Securities at Fair Value through Profit or Loss consist initially of HFT Securities. HFT are debt and equity securities that are:

- Acquired principally for the purpose of selling or repurchasing them in the near term; or
- Part of a portfolio of identified securities that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking.

c) Available-for-Sale Securities (AFS). are debt or equity securities that are designated as Available-for-Sale Securities (AFS) or are not classified/designated as:

- HTM
- Securities at Fair Value through Profit or Loss
- Investment in Non-Marketable Equity Securities (INMES).
- Underwriting Accounts (UA) which are applicable to UBs and IHs, shall be a sub-account under AFS.

d) Investments in Non-Marketable Equity Securities (INMES) are equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured.

- The financial institution shall maintain an operations manual for booking and valuation of HTM, Securities at Fair Value through Profit or Loss, AFS and INMES.
- Penalties and sanctions shall be imposed on financial institutions and concerned officers found to violate the provisions of the regulations

Securities Trading

Marking-to-Market

As a general rule, to the extent a credible market pricing mechanism as determined by the BSP exists for a given security, that market price shall be the basis of mark-to-market. However, in the absence of a market price, a calculated price shall be used as prescribed in Circular Letter dated 29 December 2000.

A financial institution may also be allowed, subject to the approval of the Deputy Governor of the Supervision and Examination Sector (SES) of the BSP, to use its own system for marking-to-market its securities holdings provided that this can be shown to be sufficient, transparent, objective, reliable, and consistent. This system should be:

- a) Approved by the financial institution's risk management group (or equivalent management committee in the case of foreign bank branches)
- b) Vetted by the financial institution's risk management group, internal audit group and systems group, and properly documented (such documentation should be made available for review by external auditors and BSP).

Benchmarks/Reference Prices

On 29 December 2000, the BSP prescribed the market benchmarks/reference prices as well as the computation method that will be used to mark-to-market debt and marketable equity securities as required under BSP Circular No. 161, Series of 1998. *(Circular Letter dated 29 December 2000)*

Delivery of Securities

Subsec. X235.5 and X238.1 of the MORB was amended to include book-entry transfer for dematerialized securities apart from the physical delivery of securities subject of deposit substitute and without recourse transactions and requiring that an entity cannot be the custodian of securities issued or owned by said entity, its subsidiaries/affiliates or of securities in bearer form. *(Circular No. 392 dated 23 July 2003, per Memorandum to All Banks and NBFIs dated 10 September 2003 and 27 January 2004, Circular Letter dated 2 April 2004, Circular No. 453 dated 24 September 2004 and Circular No. 460 dated 12 November 2004 effectivity date deferred to 1 January 2004, 1 April 2004, 30 June 2004, 16 November 2004 and 1 January 2005, respectively)*

The MB, in its Resolution No. 1179 dated 19 August 2004, extended the applicability of the provision of Circular 392 dated 23 July 2003 to non-bank financial institutions (NBFIs) under BSP supervision, thus amending some sections of the MORNBFI. *(Circular No. 450 dated 6 September 2004)*

Securities sold on a without recourse basis shall be delivered to the purchaser or to his designated custodian duly accredited by the BSP. However, the bank/other entity authorized by the BSP to perform custodianship function may not be allowed to be custodian of securities issued or sold on a without recourse basis by said bank/entity, its subsidiaries or affiliates, or of securities in bearer form. Existing securities being held under custodianship by banks/other entities under BSP supervision, which are not in accordance with said regulation, must therefore, be delivered to a BSP accredited third party custodian. However, banks and other financial institutions under BSP supervision may maintain custody of existing securities of their clients who are unable or unwilling to take delivery pursuant to the provisions of Circular No. 392 but who declined to deliver their existing securities to a BSP accredited third party custodian. *(Circular No. 457 date 14 October 2004)*

Securities Custodianship/Registry

(Circular No. 428 dated 27 April 2004, Circular No. 457 dated 14 October 2004 and Circular No. 458 dated 2 November 2004)

Banks and NBFIs under BSP supervision may act as securities custodian and/or registry only upon prior MB approval.

A BSP-accredited securities registry must be a third party with no subsidiary/affiliate relationship with the issuer of securities while a BSP-accredited custodian must be a third party with no subsidiary/affiliate relationship with the issuer or seller of securities. Subject to certain conditions a BSP accredited securities custodian may hold securities it sold from a related purchaser/ entity, a non-resident with global custody agreement and an insurance company with global custody agreements.

A BSP-accredited custodian may rely on referral by the seller/issuer of securities provided that it maintains a record of such referral together with the minimum identification, information/documents required under the law and its implementing rules and regulations. It must also maintain accounts only in the true and full name of the owners of the security.

Violation of provisions under these Circulars shall be subjected to

penal and administrative sanctions provided for under Sections 36 and 37, respectively of R.A. No. 7653 (The New Central Bank Act).

Accredited custodian financial institutions:

1. HSBC
 2. Citibank, N.A.
- Deutsche Bank
BPI
Standard Chartered
Philippine Depository and Trust Corporation (PDTC)

New Financial Products

Securitization Structures (Circular No. 468 dated 12 January 2005)

- Securitization structures refer to:
 - *Traditional Securitization* - structures where the cash flow from an underlying pool of exposures is used to service at least two different stratified risk positions or tranches reflecting different degrees of credit risk.
 - *Synthetic Securitization* - structures with at least two different stratified risk positions or tranches that reflect different degrees of credit risk, where credit risk of an underlying pool of exposures is transferred, in whole or in part, through the use of credit derivatives or guarantees that serve to hedge the credit risk of the portfolio.
- All U/KBs with expanded derivatives authority may invest in securities overlying any tranche of securitization structures. U/KBs without expanded derivatives authority may also invest but only in securities overlying tranches of securitization structures that are rated at least A, or its equivalent, by a BSP-recognized credit rating agency.
- Capital Treatment:
 - Capital charge for investments in securitization structures held in the banking book shall be based on the *latest* rating given by any of the BSP-recognized credit rating agencies.
 - Capital charge for securities overlying securitization structures held in the trading book shall be determined in accordance with BSP Circular No. 360 dated 3 December 2002, as amended, and the use of agency ratings for such purpose shall be

consistent with the above principles.

Structured Products * (*Circular No. 469 dated 13 January 2005*)

- A structured product refers to a financial instrument where the return is a function of one or more underlying indices, such as interest rates, equities and exchange rates. There may also be embedded derivatives such as swaps, forwards, options, caps, and floors that reshape the risk-return pattern.
- U/KBs with expanded derivatives license may obtain exposures in structures products while those without expanded derivatives license may only invest in structured products approved by BSP.
- Capital Treatment:
 - Capital charge for structured products held in the banking book shall depend on the rating of the issuing entity, or rating of the collateral in case of structured products issued by special purpose vehicle (SPVs), given by BSP-recognized international credit rating agencies.
 - In cases where there are two or more types of collateral, capital charge shall depend on the lowest rated collateral.
 - Capital charge for structured products held in the trading book shall be determined according to Circular No. 360 dated 3 December 2002, as amended.

Foreign Currency Denominated Structured Products (*Circular No. 466 dated 5 January 2005*)

Statement of Policy

- The BSP encourages banks to diversify their expanded foreign currency deposit unit (EFCDU) investment portfolios in order to stabilize earnings, control maturity mismatches and minimize overconcentration of exposures.

Scope

- EFCDUs of U/KBs without expanded derivatives authority may invest, for their own account, in foreign currency-denominated structured products issued by banks and SPVs of high credit

* Structured products do not include asset-backed securities, credit-linked notes and other similar instruments.

quality; Provided, that the revenue streams of such products may only be linked to interest rate indices and/or foreign exchange rates other than those that involve the Philippine Peso; Provided, further, that the minimum all-in return of such investments may not be lower than zero.

Other Conditions

- The maximum contractual maturity of any investment in structured products shall be 5 years.
- Acceptable issuers are banks and SPVs collateralized by securities rated at least “A” or its equivalent by an international rating agency acceptable to the MB.
- Investments in structured products as herein defined shall be booked under the account *Investment in Bonds and Debt Instruments (IBODI)*, except for instruments with put options which shall be booked under the account *Available for Sale Securities (ASS)*.
- The total carrying value of all investments in structured products as defined herein at any given points in time must not exceed 20% of the total investment portfolio of the EFCDU (combined amount of Trading Account Securities (TAS), ASS and IBODI).
- Investment banks must have an established risk management processes.

Investments in structured notes shall qualify as asset cover, but not as part of the 30% liquidity cover for EFCDU liabilities.