BANGKO SENTRAL NG PILIPINAS

OFFICE OF THE GOVERNOR

CIRCULAR NO. 1079
Series of 2020

Subject: **Amendments to the Risk-Based Capital Adequacy Framework for Stand-Alone Thrift Banks, Rural Banks and Cooperative Banks**

The Monetary Board, in its Resolution No. 128 dated 23 January 2020, approved the amendments to the Risk-Based Capital Adequacy Framework for Stand-Alone Thrift Banks (TBs), Rural Banks (RBs) and Cooperative Banks (Coop Banks) under Section 127 and Appendix 62 of the New Manual of Regulations for Banks (MORB) aimed at improving the quality of regulatory capital of covered banks.

Section 1. Section 127 of the New MORB on the Risk-Based Capital Adequacy Framework for Stand-Alone TBs, RBs and Coop Banks is hereby amended to read, as follows:

Section 127 RISK-BASED CAPITAL ADEQUACY FRAMEWORK FOR STAND-ALONE THRIFT BANKS, RURAL BANKS AND COOPERATIVE BANKS.

The guidelines implementing the risk-based capital adequacy framework for Stand-alone TBs, RBs, and Coop Banks[1] are in *Appendix 62*.

a. *Minimum capital ratios.* The minimum capital ratios shall be expressed as a percentage of capital to risk-weighted assets as shown below:

Minimum Capital Ratio	Capital	% of Risk Weighted Assets
Common Equity Tier 1 (CET1) Ratio	CET1	at least 6.0%
Tier 1 Ratio	Tier 1	at least 7.5%
Capital Adequacy Ratio (CAR)	Qualifying Capital	at least 10.0%

A capital conservation buffer (CCB) of two and a half percent (2.5%), comprised of CET1 capital, shall likewise be imposed.

Stand-alone TBs, RBs and Coop Banks must meet the foregoing minimum capital ratios at all times for both solo basis (head office and branches) and consolidated basis (parent bank and subsidiary financial allied undertakings).

Existing Hybrid Tier 1 capital and Unsecured Subordinated Debt instruments of covered banks shall continue to be recognized as part of Tier 2 capital until maturity/pre-termination/redemption of such capital issuances. In the case of Hybrid Tier 1 capital, no new issuances shall be allowed upon maturity of such instrument.

Capital instruments issued by covered banks starting 1 January 2014 must comply with the criteria for inclusion as capital as provided in *Annexes A to C* and *Annexes E to F* of *Appendix 59*.

[1] These refer to TBs, RBs and Coop Banks that are not subsidiaries of UBs and KBs.

The minimum capital ratios based on the new compositions and the CCB shall take effect starting 1 January 2022.

b. *Reporting requirement*. Banks shall electronically submit a report on their risk-based CAR to the appropriate supervising department of the Bangko Sentral on both solo and consolidated bases using the prescribed forms in accordance with the following timelines:

Reporting Details	Solo	Consolidated
Frequency	Quarterly	Quarterly
Submission deadline	15 banking days from end of reference quarter	30 banking days from end of reference quarter

Only banks with subsidiary financial allied undertakings [i.e., RBs and venture capital corporations (VCCs) for TBs, and RBs for Coop Banks] which under the existing regulations are required to prepare consolidated financial statements on a line-by-line basis shall be required to submit report on a consolidated basis. The abovementioned reports shall be classified as Category A-2 reports.

The submission of the CAR report shall be subject to the provisions of Section 171 on governance process on the quality of bank reporting. Non-compliance with the reporting standards, or non-submission or delayed submission of the CAR report shall be subject to the sanctions provided under Section 171.

c. *Observation period* – Stand-alone TBs, RBs and Coop Banks shall undergo an observation period until 31 December 2021. The observation period intends to ensure that covered banks meet the minimum capital ratios through reasonable measures without disrupting banking activities.

Requirements during the observation period. For monitoring purposes, covered banks shall submit the risk-based CAR reports using the existing and new frameworks, on both solo and consolidated bases, following the submission deadlines set out in Item *"b"*. Non-submission or delayed submission of the risk-based CAR reports using the new framework during the observation period shall be subject to the sanctions provided under Section 171.

d. ***Board and senior management oversight.*** It shall be the responsibility of the banks' board of directors and senior management to institute an appropriate system that would ensure compliance with the minimum capital ratios, accuracy of their calculations and integrity of the related monitoring and reporting systems. It is, likewise, the responsibility of the senior management to cause the immediate reporting of breaches in their minimum capital ratios to the board and to the Bangko Sentral, through the appropriate supervising department, within three (3) banking days from the date of breach in the minimum capital ratios.

e. *Supervisory enforcement action.* Consistent with the provisions of Section 002, the Bangko Sentral reserves the right to deploy its range of supervisory tools to promote adherence to the requirements set forth in the foregoing guidelines and bring about timely corrective actions and compliance with the Bangko Sentral directives.

In this regard, the Bangko Sentral may issue directives to or impose sanctions on the bank and/or responsible persons which may include, among others, prohibition on the distribution of net profits, restrictions from certain activities (e.g., acquisition of major assets), and issuance of a reprimand to, or the suspension, removal or disqualification of a bank's directors, officers or employees concerned. Moreover, the Bangko Sentral is not precluded from requiring a TB, RB and Coop Bank that is non-compliant with the minimum capital ratios to develop a capital build-up plan, which must be approved by the board of directors and stockholders of the bank concerned.

In case, however, of a bank merger, or consolidation, or when a bank is under rehabilitation program approved by the Bangko Sentral, the Monetary Board may temporarily relieve the surviving bank, consolidated bank, or constituent bank or corporations under rehabilitation from full compliance with the required capital ratios under such conditions as it may prescribe.

Section 2. Parts I (Risk-Based Capital Adequacy Ratio) and II (Qualifying Capital) of Appendix 62 of the MORB are hereby amended while Parts VII (Required Reports) and VIII (Sanctions) are hereby deleted. The amended guidelines are attached as Annex A of this Circular.

Section 3. Section 003 and Appendix 68/Q-40 of the MORB/Manual of Regulations for Non-Bank Financial Institutions (MORNBFI) on the Prompt Corrective Action (PCA) Framework is hereby amended to read, as follows:

Section 003 PROMPT CORRECTIVE ACTION FRAMEWORK

Prompt Corrective Action Framework. A bank may be subject to PCA whenever any or all of the following conditions obtain:

(1) When either of the Total CAR or Tier 1 capital ratio as defined under Sections 125 and 127 or leverage ratio[2] falls below ten percent (10%), seven and a half percent (7.5%)[3] and five percent (5%), respectively, or such other minimum levels that may be prescribed for the said ratios under relevant regulations, and/or the combined capital account falls below the minimum capital requirement prescribed under Section 121;

x x x

[2] For universal and commercial banks and their subsidiary banks and quasi-banks, this refers to the Basel III Leverage Ratio. For stand-alone TBs, RBs and Coop Banks, this is derived as Total Capital /Total Assets.

[3] This shall take effect on 01 January 2022 for stand-alone thrift, rural, and cooperative banks. Pending effectivity of the new risk-based capital adequacy ratio framework for stand-alone thrift banks, rural banks and cooperative banks, the covered banks shall refer to the existing six percent (6%) as the minimum threshold for Tier 1 capital.

Appendix 68/Q-40

Prompt Corrective Action Framework
(Appendix to Section 003/Section 003-Q/S and 002-N)

In carrying out its primary objective of maintaining price stability x x x

x x x

Corporate governance reforms – x x x

A bank may be subject to PCA whenever any or all of the following conditions obtain:

(1) When either of the Total Capital Adequacy Ratio (CAR) or Tier 1 Capital Ratio as defined under Sections 125 and 127 or Leverage Ratio[4] falls below ten percent (10%), seven and a half percent (7.5%)[5] and five percent (5%), respectively, or such other minimum levels that may be prescribed for the said ratios under relevant regulations, and/or the combined capital account falls below the minimum capital requirement prescribed under Section 121/ 121-Q;

x x x

Section 4. Section 124 and Appendix 120 of the MORB on the requirements on the declaration of dividends is hereby amended to read, as follows:

Section 124 DIVIDENDS

The following rules and regulations shall govern the declaration of dividends on shares of stock, regardless of feature, as well as interest payments on unsecured subordinated debt which meet the qualification requirements of Additional Tier 1 or other capital instruments[6] as defined under existing risk-based capital adequacy framework.

x x x

Requirements on the declaration of dividends. At the time of declaration, banks shall have complied with the following:

x x x

d. The combined requirement for capital conservation buffer and countercyclical capital buffer as defined in *Appendix 59*, Part III, for universal and commercial banks (UBs/KBs) and their subsidiary banks and QBs or capital conservation buffer requirement as defined in Appendix 62, Part II.C for stand-alone TBs, RBs and Coop Banks[7];

x x x

[4] For universal and commercial banks and their subsidiary banks and quasi-banks, this refers to the Basel III Leverage Ratio. For stand-alone TBs, RBs and Coop Banks, this is derived as Total Capital /Total Assets.

[5] This shall take effect on 01 January 2022 for stand-alone thrift, rural, and cooperative banks. Pending effectivity of the new risk-based capital adequacy ratio framework for stand-alone thrift banks, rural banks and cooperative banks, the covered banks shall refer to the existing six percent (6%) as the minimum threshold for Tier 1 capital.

[6] This shall include existing issuances of Hybrid Tier 1 capital until maturity/pre-termination/redemption.

[7] The capital conservation buffer requirement for stand-alone TBs, RBs and Coop Banks, shall take effect on 01 January 2022.

Appendix 120

FORMAT CERTIFICATION ON COMPLIANCE WITH REQUIREMENTS ON DIVIDEND DECLATION (Appendix to Section 124 on Reporting and Verification)

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Name of Bank

We, (Name of Officer), President (or Officer of Equivalent Rank) and (Name of Officer), Chief Compliance Officer, in behalf of (Name of Bank), with office address at (Head/Principal Office), after having been duly sworn to in accordance with law, hereby certify that the bank's dividend declaration as of (date of dividend declaration), as approved by the board of directors (state resolution number and date), to the bank's stockholders of record as of (record date) amounting to (amount of cash/stock/property dividend declaration) complies with the provisions of Section 124.

We further certify that at the time of dividend declaration, the bank has complied with the following:

x x x

d. The combined requirement for capital conservation buffer and countercyclical capital buffer as defined in *Appendix 59*, Part III for universal and commercial banks (UBs/KBs) and their subsidiary banks and QBs and capital conservation buffer requirement as defined in Appendix 62, Part II.C for stand-alone TBs, RBs and Coop Banks[8];

x x x

Section 5. Section 363-B of the MORB on the limits on real estate exposures and other real estate property of TBs is hereby amended to read, as follows:

Section 363-B LIMITS ON REAL ESTATE EXPOSURES AND OTHER REAL ESTATE PROPERTY OF TBS

A prudential limit is set for real estate exposures as defined under Item "b" of Section 363-A and other real estate property of TBs. Other real estate property shall include those recorded under Real and Other Properties Acquired and Non-Current Assets Held for Sale. For this purpose, a stress test will be undertaken on a TBs' REEs and other real estate property under an assumed write-off rate of twenty-five percent (25%).

The prudential REST limits which shall be complied with at all times by TBs are:

a. six percent (6%) of CET1 capital ratio, for TBs that are subsidiaries of UBs/KBs;
b. six percent (6%) of Tier 1 capital ratio, for stand-alone TBs[9]; and

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[8] The capital conservation buffer requirement for stand-alone TBs, RBs and Coop Banks, shall take effect on 01 January 2022.

[9] TBs that are not subsidiaries of universal and commercial banks. The required six percent (6%) Tier 1 capital ratio shall be replaced by the six percent (6%) CET1 capital ratio by 1 January 2022.

c. ten percent (10%) of risk-based CAR for all TBs.

x x x

Section 6. This Circular will 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:

BENJAMIN E. DIOKNO
Governor

09 March 2020

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05/06/2020
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Annex A
Appendix 62

RISK-BASED CAPITAL ADEQUACY FRAMEWORK FOR STAND-ALONE THRIFT BANKS, RURAL BANKS, AND COOPERATIVE BANKS[1]
(Appendix to Section 127)

Introduction

This Appendix contains the Bangko Sentral's implementing guidelines of the risk-based capital adequacy framework for stand-alone TBs, RBs and Coop Banks. The framework largely conforms with the Basel capital adequacy standards.

Part I. Risk-based Minimum Capital Ratios

1. The minimum capital ratios shall be expressed as a percentage of capital to risk-weighted assets as shown below:

Minimum Capital Ratio	Capital	% of Risk Weighted Assets
Common Equity Tier 1 (CET1) Ratio	CET1	at least 6.0%
Tier 1 Ratio	Tier 1	at least 7.5%
Capital Adequacy Ratio (CAR)	Qualifying Capital	at least 10.0%

A capital conservation buffer (CCB) of two and a half percent (2.5%), comprised of CET1 capital, shall likewise be imposed.

Stand-alone TBs, RBs and Coop Banks must meet the foregoing minimum capital ratios at all times, for both solo basis (head office and branches) and consolidated basis (parent bank and subsidiary financial allied undertakings).

The minimum capital ratios based on the new compositions and the CCB shall take effect starting 1 January 2022.

2. CET1 capital, Tier 1 capital and Qualifying capital are computed in accordance with the provisions set out under Part II.

Risk weighted assets is the sum of (a) credit risk-weighted assets (Part III), and (b) operational risk-weighted assets (Part IV): *Provided,* That banks that shall engage in trading activities, including derivatives activities as end-user for hedging purpose and/or under a Type 3-Limited User Authority shall likewise include counterparty credit risk-weighted assets and/or market risk-weighted assets relative to such exposures, which shall be computed based on the relevant provisions of the Risk-Based Capital Adequacy Framework for the Philippine Banking System under *Appendix 59*.

[1] These refer to TBs, RBs and Coop Banks that are not subsidiaries of universal and commercial banks.

3. The minimum capital ratio shall apply to all stand-alone TBs, RBs and Coop Banks on both solo and consolidated bases, as applicable. xxx

xxx

5. Banks shall comply with the minimum capital ratios at all times notwithstanding that supervisory reporting shall only be on quarterly basis. Any breach, even if only temporary, shall be reported to the bank's board of directors and to the appropriate supervising department of the Bangko Sentral within three (3) banking days from the date of breach in the minimum capital ratios. For this purpose, these banks shall develop an appropriate system to properly monitor their compliance.

Part II. Qualifying Capital

1. Qualifying capital consists of the following elements, net of required deductions:

   a) Tier 1 capital is composed of:

      i. CET1 capital; and
      ii. Additional Tier 1 (AT1) capital; and

   b) Tier 2 capital.

2. Banks must ensure that all capital instruments which form part of the qualifying capital comply with the eligibility criteria prescribed for a particular category of capital where such instrument belongs.

A. Tier 1 Capital

3. Tier 1 capital is the sum of CET1 capital and AT1 capital.

CET1 Capital

4. CET1 capital consists of:

   a) Paid-up common stock issued by the bank that meet the eligibility criteria in Annex A of *Appendix 59*;
   b) Deposit for common stock subscription recognized as equity pursuant to Sec. 123;
   c) Common stock dividends distributable;
   d) Additional paid-in capital resulting from the issuance of common stock included in CET1 capital;
   e) Retained earnings[2];
   f) Undivided profits;
   g) Other Comprehensive Income;
      i. Net unrealized Gains/(Losses) on Available for Sale (AFS) Securities[3];

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[2] This shall exclude the portion appropriated for general provision.

[3] Under PFRS 9, this account shall refer to "Net Unrealized Gains/(Losses) on Financial Assets at Fair Value Through Other Comprehensive Income (FVOCI)"; In view of the continuing evaluation by the Basel Committee on the appropriate treatment of unrealized gains/losses with respect to the evolution of the accounting

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ii. Cumulative foreign currency translation;
iii. Net Gains/(Losses) on Fair Value Adjustments of Hedging Instruments in a cash flow hedge; and
iv. Other[4]

h) Minority interest in subsidiary bank which are less than wholly-owned[5]: *Provided,* That the minority interest arises from issuances of common stock which, if issued by the bank itself, would meet all of the criteria as CET1 capital: *Provided, further,* That the amount to be included as minority interest shall be reduced by the surplus CET1 capital of the subsidiary attributable to minority shareholders computed as the available CET1 capital minus six percent(6%)[6] of the subsidiary's total risk-weighted assets multiplied by the percentage of CET1 held by minority shareholders.

Regulatory Adjustments to CET1 capital

5. The following must be deducted from/(added to) CET1 capital:

a) Common stock treasury shares[7], including shares that the bank could be contractually obliged to purchase;
b) Unbooked allowance for credit losses and other capital adjustments based on the latest report of examination as approved by the Monetary Board;
c) Total outstanding unsecured credit accommodations, both direct and indirect, to directors, officers, stockholders and their related interests (DOSRI), net of allowances for credit losses;
d) Total outstanding unsecured loans, other credit accommodations and guarantees granted to subsidiaries, net of allowances for credit losses;
e) Total outstanding loans, other credit accommodations and guarantees granted to related parties that are not at arm's length terms as determined by the appropriate supervising department of the Bangko Sentral, net of allowances for credit losses;
f) Deferred tax asset, net of allowance for impairment and associated deferred tax liability: *Provided,* That the conditions to offset under Philippine Accounting Standards (PAS) 12 are met: *Provided, further,* That any excess of deferred tax liability over deferred tax asset (i.e., net deferred tax liability) shall not be added to CET1 capital;
g) Goodwill, net of allowance for impairment and any associated deferred tax liability which would be extinguished upon impairment or derecognition, including that relating to unconsolidated subsidiary RBs and VCCs for TBs, and RBs for Coop Banks (on solo basis) and unconsolidated non-financial allied undertakings (on solo and consolidated bases);

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framework, the Bangko Sentral will revise its relevant regulation once the treatment of fair value adjustments in the calculation of CET1 capital has been determined.

[4] This shall be equal to OCI – Others as reflected in the FRP Balance Sheet.

[5] Minority interest in a subsidiary that is a bank is strictly excluded from the parent bank's common equity if the parent bank or affiliate has entered into any arrangements to fund directly or indirectly minority investment in the subsidiary whether through an SPV or through another vehicle or arrangement. The treatment of minority interest set out above is strictly available where all minority investments in the bank subsidiary solely represent genuine third party common equity contributions to the subsidiary.

[6] This represents the minimum CET1 ratio.

[7] This also includes shares of the parent bank held by a subsidiary financial allied undertaking in a consolidated statement of condition.

h) Other intangible assets, net of any allowance for impairment and any associated deferred tax liability which would be extinguished upon impairment or derecognition;
i) Defined benefit pension fund assets (liabilities)[8];
j) Investments in equity of unconsolidated subsidiary RBs and VCCs for TBs, and RBs for Coop Banks after deducting related goodwill, if any (for solo basis);
k) Investments in equity of unconsolidated subsidiary non-financial allied undertakings after deducting related goodwill, if any (for both solo and consolidated bases);
l) Significant minority investments (10%-50% of voting stock) in RBs and VCCs for TBs, and RBs for Coop Banks after deducting related goodwill, if any (for both solo and consolidated bases);
m) Significant minority investments (10%-50% of voting stock) in unconsolidated subsidiary non-financial allied undertakings after deducting related goodwill, if any (for both solo and consolidated bases);
n) Minority investments [below ten percent (10%) of voting stock] in RBs and VCCs for TBs, and RBs for Coop Banks after deducting related goodwill, if any (for both solo and consolidated bases);
o) Minority investments [below ten percent (10%) of voting stock] in unconsolidated subsidiary non-financial allied undertakings after deducting related goodwill, if any (for both solo and consolidated bases);

For equity investments in financial and non-financial entities (Items "*j*" to "*o*"), total investments include common equity exposures in both the banking and trading books.

In case the instrument of the entity in which the bank has invested does not meet the criteria for CET1 capital of the bank, the capital is to be considered common shares and thus deducted from CET1.

p) Other equity investments in non-financial allied undertakings; and
q) Reciprocal investments in common stock of other banks/enterprises, after deducting related goodwill, if any (for both solo and consolidated bases).

Additional Tier 1 (AT1) Capital

6. AT1 capital consists of the following:

a) Paid up perpetual and non-cumulative preferred stock;
b) Other instruments issued by the bank that are not included in CET1 capital that meet the following:
    i. Criteria for inclusion in AT1 capital as set out in Annex B of *Appendix 59*;
    ii. Required loss absorbency features for instruments classified as liabilities for accounting purposes to ensure that the capital instrument absorbs losses and minimize public sector support. The loss absorbency requirements are enumerated in Annex E of *Appendix 59*: *Provided*, That the applicable trigger

[8] The adjustment pertains to the defined benefit asset or liability that is recognized in the balance sheet. Such that CET1 cannot be increased by derecognizing the liabilities, in the same manner, any asset recognized in the balance sheet should be deducted from CET1 capital.

point for stand-alone TBs, RBs and Coop Banks is set at CET1 ratio of seven percent (7%) or below as determined by Bangko Sentral; and

iii. Required loss absorbency feature at point of non-viability as set out in Annex F of *Appendix 59*.

c) Deposit for subscription of perpetual and non-cumulative preferred stock and other AT1 capital instruments recognized as equity pursuant to Sec. 123;
d) Additional paid-in capital resulting from the issuance of instruments included in AT1 capital; and
e) Minority interest in subsidiary financial allied undertakings (e.g., VCCs for TBs) which are less than wholly-owned:[9] Provided, That the minority interest from issuances of Tier 1 instruments, if issued by the bank itself, would meet all of the criteria as Tier 1 capital: Provided, further, That the amount to be included as minority interest shall be reduced by the surplus Tier 1 capital of the subsidiary attributable to minority shareholders computed as the available Tier 1 capital minus the seven and a half percent(7.5%)[10] of the subsidiary's total risk-weighted assets multiplied by the percentage of Tier 1 held by minority shareholders: *Provided, furthermore,* That the amount of Tier 1 Capital to be recognized in AT1 capital will exclude amounts recognized in CET1 capital.

Regulatory Adjustments to AT1 capital

7. The following are the adjustments to AT1 capital:

a) Perpetual and non-cumulative preferred stock and other AT1 instruments treasury shares[11], including shares that the bank could be contractually obliged to purchase;
b) Investments in equity of unconsolidated subsidiary RBs and VCCs for TBs, and RBs for Coop Banks after deducting related goodwill, if any (for solo basis);
c) Investments in equity of unconsolidated subsidiary non-financial allied undertakings after deducting related goodwill, if any (for both solo and consolidated bases);
d) Significant minority investments (10%-50% of voting stock) in RBs and VCCs for TBs, and RBs for Coop Banks after deducting related goodwill, if any (for both solo and consolidated bases);
e) Significant minority investments (10%-50% of voting stock) in unconsolidated subsidiary non-financial allied undertakings after deducting related goodwill, if any (for both solo and consolidated bases);
f) Minority investments [below ten percent (10%) of voting stock] in RBs and VCCs for TBs, and RBs for Coop Banks after deducting related goodwill, if any (for both solo and consolidated bases);
g) Minority investments [below ten percent (10%) of voting stock] in unconsolidated subsidiary non-financial allied undertakings after deducting related goodwill, if any (for both solo and consolidated bases);

For equity investments in financial and non-financial entities (Items "*b*" to "*g*"), total investments include other capital instruments in both the banking and trading books.

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[9] Please refer to Footnote No. 5.

[10] This represents the minimum Tier 1 ratio.

[11] Please refer to Footnote No. 7.

In case the instrument of the entity in which the bank has invested does not meet the criteria for AT1 capital of the bank, the capital is to be considered common shares and thus deducted from CET1; and

h) Reciprocal investments in AT1 capital instruments of other banks/ enterprises, after deducting related goodwill, if any (for both solo and consolidated bases).

B. Tier 2 Capital

8. Tier 2 capital is composed of the following:

a) Paid-up perpetual and cumulative preferred stock;
b) Deposit for perpetual and cumulative preferred stock subscription recognized as equity pursuant to Sec. 123;
c) 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;
d) Deposit for limited life redeemable preferred stock subscription with the replacement requirement upon redemption recognized as equity pursuant to Sec. 123;
e) Paid-up limited life redeemable preferred stock without the replacement requirement upon redemption in an amount equivalent to its carrying amount discounted by the following rates:

Remaining maturity	Discount factor
5 years & above	0%
4 years to <5 years	20%
3 years to <4 years	40%
2 years to <3 years	60%
1 year to <2 years	80%
<1 year	100%

f) Deposit for limited life redeemable preferred stock subscription without the replacement requirement upon redemption recognized as equity pursuant to Sec. 123;
g) Other instruments issued by the bank (and are not included in AT1 capital)[12] that meet the following:

i. criteria for inclusion in Tier 2 capital as set out in Annex C of *Appendix 59*; and
ii. Required loss absorbency feature at point of non-viability to ensure that the capital instrument absorbs losses and minimize public sector support as set out in Annex F of *Appendix 59 Provided*, That the applicable trigger point for stand-alone TBs, RBs and Coop Banks is set at CET1 ratio of seven percent (7%) or below as determined by Bangko Sentral: *Provided further*, That the conversion of Tier 2

[12] This shall include existing issuances of Hybrid Tier 1 capital and Unsecured Subordinated Debt by covered banks. Such instruments shall continue to be recognized as part of Tier 2 capital until maturity/pre-termination/redemption. In the case of Hybrid Tier 1 capital, no new issuances shall be allowed upon maturity of such capital instruments.

capital should be in compliance with the Revised Corporation Code of the Philippines.

h) Appraisal increment reserve – bank premises, as authorized by the Monetary Board;
i) General loan loss provision[13], limited to a maximum of one percent (1%) of total credit risk-weighted assets, and any amount in excess thereof shall be deducted from the total credit risk weighted assets in computing the denominator of the risk-based capital ratio; and
j) Minority interest in subsidiary financial allied undertakings (e.g., VCCs for TBs) which are less than wholly-owned:[14] *Provided*, That the minority interest from issuances of capital instruments, if issued by the bank itself, would meet all of the criteria as Tier 1 or Tier 2 capital: *Provided, further,* That the amount to be included as minority interest shall be reduced by the surplus total capital of the subsidiary attributable to minority shareholders computed as the available total capital minus the ten percent (10%)[15] of the subsidiary's total risk-weighted assets multiplied by the percentage of total capital held by minority shareholders: *Provided, furthermore,* That the total capital that will be recognized in Tier 2 capital will exclude amounts recognized in CET1 and AT1 capital.

Regulatory Adjustments to Tier 2 capital

9. The following adjustments shall be charged against Tier 2 capital:

a) Perpetual and cumulative preferred stock treasury shares[16];
b) Limited life redeemable preferred stock treasury shares with the replacement requirement upon redemption[16];
c) Limited life redeemable preferred stock treasury shares without the replacement requirement upon redemption[16];
d) Tier 2 capital instruments treasury shares[16], including shares that the bank could be contractually obliged to purchase;
e) Sinking fund for redemption of limited life redeemable preferred stock with the replacement requirement upon redemption;
f) Sinking fund for redemption of limited life redeemable preferred stock without the replacement requirement upon redemption up to the extent of the balance of redeemable preferred stock after applying the cumulative discount factor;
g) Investments in equity of unconsolidated subsidiary RBs and VCCs for TBs, and RBs for Coop Banks after deducting related goodwill, if any (for solo basis);
h) Investments in equity of unconsolidated subsidiary non-financial allied undertakings after deducting related goodwill, if any (for both solo and consolidated bases);
i) Significant minority investments (10%-50% of voting stock) in RBs and VCCs for TBs, and RBs for Coop Banks after deducting related goodwill, if any (for both solo and consolidated bases);
j) Significant minority investments (10%-50% of voting stock) in unconsolidated

[13] This shall include the General Provision appropriated in the Retained Earnings
[14] Please refer to footnote No.5.
[15] This represents the minimum CAR.
[16] Please refer to Footnote No. 7.

subsidiary non-financial allied undertakings after deducting related goodwill, if any (for both solo and consolidated bases);

k) Minority investments [below ten percent (10%) of voting stock] in RBs and VCCs for TBs, and RBs for Coop Banks after deducting related goodwill, if any (for both solo and consolidated bases);

l) Minority investments [below ten percent (10%) of voting stock] in unconsolidated subsidiary non-financial allied undertakings after deducting related goodwill, if any (for both solo and consolidated bases);

For equity investments in financial and non-financial entities (Items *"g"* to *"l"*), total investments include other capital instruments in both the banking and trading books.

In case the instrument of the entity in which the bank has invested does not meet the criteria for Tier 2 capital of the bank, the capital is to be considered common shares and thus deducted from CET1; and

m) Reciprocal investments in Tier 2 capital of other banks/ enterprises, after deducting related goodwill, if any (for both solo and consolidated bases).

10. Any asset deducted from qualifying capital in computing the numerator of the risk-based capital ratio shall not be included in the total risk-weighted assets in computing the denominator of the ratio.

C. Capital Conservation Buffer

11. Stand-alone TBs, RBs and Coop Banks shall be required to set a Capital Conservation Buffer (CCB) of two and a half percent (2.5%) of risk-weighted assets in the form of CET1 capital.

12. The CCB is meant to promote the conservation of capital and build-up of adequate cushion above the minimum level that can be drawn down by banks to absorb losses during periods of financial and economic stress.

13. The buffer is on top of the minimum capital requirements. The capital must first be used to meet the minimum CET1 ratio, before the remainder can contribute to the CCB.

14. Where a bank does not have positive earnings, has CET1 ratio of lower than eight and a half percent (8.5%) [CET1 ratio of six percent (6%) plus conservation buffer of two and a half percent (2.5%)] and has not complied with other minimum capital ratios, the bank would then be restricted from making distribution of earnings, as illustrated below:

CET 1 capital ratio	**Restriction on Distribution of earnings**
<6.0%-7.25%	No distribution until more than 7.25% CET1 capital is met
>7.25%-8.5%	50% of earnings may be distributed
>8.5%	No restriction on distribution

15. Elements subject to the restriction on distributions include dividends, share buybacks, discretionary payments on other Tier 1 capital instruments, and discretionary bonus payments to staff.

16. Payments that do not result in the depletion of CET1 capital are not considered distributions.

17. Earnings refer to distributable profits calculated prior to the deduction of elements subject to the restriction on distributions. The earnings are computed after the tax which would have been reported had none of the distributable items been paid.

18. Drawdowns on the capital conservation buffers are generally not prohibited. However, banks should not choose in normal times to operate in the buffer range. If buffer is drawn down, banks shall ensure to rebuild buffers over an appropriate timeframe.

19. If the bank wants to make payments or distribute earnings in excess of the restrictions, the bank may raise capital in the private sector equal to the amount above the constraints which it wishes to distribute. The bank's options may be discussed with the Bangko Sentral and should be included in the capital planning process.

Part III. Credit Risk-Weighted Assets

x x x

g) 100% risk weight -

x x x

xii. Foreign currency checks and other cash items x x x, except those which are deducted from capital as follows:

(1) x x x

x x x

(4) Deferred tax asset, net of allowance for impairment and associated deferred tax liability: *Provided,* That the conditions to offset under Philippine Accounting Standards (PAS) 12 are met: *Provided, further,* That any excess of deferred tax liability over deferred tax asset (i.e., net deferred tax liability) shall not be added to CET1 capital;

(5) Goodwill, net of allowance for impairment and any associated deferred tax liability which would be extinguished upon impairment or derecognition, including that relating to unconsolidated subsidiary RBs and VCCs for TBs, and RBs for Coop Banks (on solo basis) and unconsolidated non-financial allied undertakings (on solo and consolidated bases);

(6) Other intangible assets, net of any allowance for impairment and any associated deferred tax liability which would be extinguished upon impairment or derecognition;

(7) Defined benefit pension fund assets (liabilities);

(8) Investments in equity of unconsolidated subsidiary RBs and VCCs for TBs, and RBs for Coop Banks after deducting related goodwill, if any (for solo basis)

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(9) Investments in equity of unconsolidated subsidiary non-financial allied undertakings, after deducting related goodwill, if any (for both solo and consolidated bases);
(10) Significant minority investments (10%-50% of voting stock) in RBs and VCCs for TBs, and RBs for Coop Banks after deducting related goodwill, if any (for both solo and consolidated bases);
(11) Significant minority investments (10%-50% of voting stock) in unconsolidated subsidiary non-financial allied undertakings after deducting related goodwill, if any (for both solo and consolidated bases);
(12) Minority investments [below ten percent (10%) of voting stock] in RBs and VCCs for TBs, and RBs for Coop Banks after deducting related goodwill, if any (for both solo and consolidated bases);
(13) Minority investments [below ten percent (10%) of voting stock] in unconsolidated subsidiary non-financial allied undertakings after deducting related goodwill, if any (for both solo and consolidated bases);
(14) Other equity investments in non-financial allied undertakings;
(15) Reciprocal investments in common stock, AT1 capital or Tier 2 capital of other banks/enterprises after deducting related goodwill, if any (for both solo and consolidated bases);
(16) Sinking fund for redemption of limited life redeemable preferred stock with the replacement requirement upon redemption;
(17) Sinking fund for redemption of limited life redeemable preferred stock without the replacement requirement upon redemption (limited to the balance of redeemable preferred stock after applying the cumulative discount factor).

B. Off Balance Sheet Assets

x x x

x x x

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