NATIONAL ADMINISTRATIVE REGISTER · MARCH 30, 1998

INVESTMENTS IN DEBTS SECURITIES AND MARKETABLE EQUITY SECURITIES

BSP CIRCULAR NO. 161, March 30, 1998

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The Monetary Board in its Resolution No. 401 dated 18 March 1998, approved the rules and regulations to govern investments in all debts securities and marketable equity securities. Accordingly, Books I, II, and IV of the Manual of Regulations for Banks and Other Financial Intermediaries are amended, as follows:

SECTION 1. Sections 1391 (Book I), 2391 (Book II) and 4391Q (Book IV) are hereby added to the Manual of Regulations for Banks and Other Financial Intermediaries, to read as follows:

> "Section __391. Investments in All Debt Securities and Marketable Equity Securities — Investments in all debt securities and marketable equity securities shall be classified into one of four categories and accounted for as follows:
>
> "a. Investments in Bonds and Other Debt Instruments (IBODI) — These are debt securities where the financial institution has the intention and ability to hold these securities to maturity. Such investments shall be measured at amortized cost where any realized gains or losses shall be included in reported current income. However, if a decline in fair market value below the amortized cost is other than temporary, i.e., full collection of principal and interest is not expected on a debt security, the amortized cost basis of the particular debt security shall be adequately provided with allowance for probable losses. The amount of investment loss provision shall be accounted for as a realized loss and charged to reported current income.
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> The ability to hold to maturity is evidenced by the funding structure of such securities wherein IBODI shall not exceed 50% of adjusted net worth plus 40% of total deposit liabilities. For foreign bank branches, the adjusted net worth shall include "net due to head office/branches/agencies" which shall not exceed the equivalent of four (4) times [three (3) times for foreign bank branches with expanded commercial banking authority] the amount of permanently assigned capital.
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> Sales of debt securities that meet either of the following two conditions may be considered as maturities for purposes of the classification of securities under IBODI:
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> "1. The sale of a debt security occurs near enough to its maturity date (or call date if exercise of the call is probable) that interest rate risk is substantially eliminated as a pricing factor. That is, the date of sale is no near the maturity or call date (for example, within three months) that changes in market interest rates would not have a significant effect on the security's fair market value.
>
> "2. The sale of a debt security occurs after the financial institution has already collected at least eighty five per cent (85%) of the principal outstanding at acquisition due either to prepayments on the debt security or to scheduled payments on a debt security payable in installments (both principal and interest) over its term
>
> "b. Trading Account Securities (TAS) — These are debt securities and equity securities (TAS — equity securities applicable only to expanded commercial banks and to non-bank financial institutions with quasi-banking functions) purchased and held principally with the intention of selling them in the near term.
>
> TAS must have readily determinable fair market values and by their very nature require daily mark-to-market

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where unrealized and realized gains and losses are recognized and booked against "Trading Gain/(Loss)" account.

"c. Available for Sale Securities (ASS) — These are debt securities purchased and held indefinitely, i.e., neither held to maturity nor for trading purposes, where the financial institution anticipates that the securities will be available to be sold in response to liquidity needs and/or to reduction in legal reserves, liquidity reserves, liquidity floor, security deposits and/or allowable alternative investments.

The daily valuations for these securities are, like TAS, at fair market values to account for both upward and downward market movements. However, unrealized gains or losses shall be excluded from reported earnings and reported as a separate component of stockholders' equity until realized.

"d. Underwriting Accounts (UA) — These are available for sale underwritten debt securities and equity securities purchased and held principally with the intention of selling them within a defined short-term period.

The daily valuations for these securities are, like ASS, at fair market values with unrealized gains or losses excluded from reported earnings and reported as a separate component of stockholders' equity until realized. UA account is applicable only to expanded commercial banks and investment houses.

"For TAS, ASS and UA, a financial institution may opt to book the mark-to-market valuation every end of the month: Provided, That an adequate mechanism is in place to determine the daily fair market values of securities.

"Subsection __391.1 Valuation. — The valuation for the mark-to-market of TAS, ASS and UA shall be based on the prices/rates supplied by independent sources such as the PHISIX, T-bills, T-bonds, Reuters, Telerate and Bloomberg. The estimated fair market value of each security is then compared to the book value to measure unrealized profit or loss.

A control officer, who is independent of trading and sales functions and their direct supervision, shall be responsible for reviewing the prices/rates.

"Subsection __391.2 Profit and Loss Reconcilement — A daily reconcilement of profit and loss between the trading function and the independent accounting records for investments in all debt securities and marketable equity securities must be done and all differences must be followed up.

"Subsection __391.3 Sales and Transfers Between Categories —

"a.The following circumstances, may cause the financial institution to change its intention to hold a certain IBODI to maturity without calling into question its intent to hold other debt securities to maturity in the future. Thus, the sale or transfer of an IBODI security due to one of the following changes in circumstances shall not be considered to be inconsistent with its original classification:

"1. Evidence of a significant deterioration in the issuer's credit-worthiness

"2. A change in tax law that eliminates or reduces the tax-exempt status of interest on the debt security (but not a change in tax law that revises the marginal tax rates applicable to interest income)

"3. A major business combination or major disposition (such as sale of a segment) that necessitates the sale or transfer of IBODI securities to maintain the financial institution's existing interest rate risk position or credit risk policy

"4. A change in statutory or regulatory requirements significantly modifying either what constitutes a permissible investment or the maximum level of investment in certain kinds of securities, thereby causing the financial institution to dispose of an IBODI security

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"5. Unusual and unforeseen liquidity needs including occasional changes in the IBODI duration in consideration of projected liquidity and/or price risk.

"In addition to the foregoing changes in circumstances, other events that are isolated, nonrecurring, and unusual for the reporting financial institution that could not have been reasonably anticipated may cause the financial institution to sell or transfer an IBODI security without necessarily calling into question its intent to hold the debt securities to maturity.

"b. The transfer of a security between categories of investments shall be accounted for at fair market value. At the date of the transfer, the security's unrealized holding gain or loss shall be accounted for as follows:

"1. For a security transferred from TAS, the unrealized holding gain or loss at the date of the transfer will have already been recognized in earnings and shall not be reversed.

"2. For a security transferred into TAS, the unrealized holding gain or loss at the date of the transfer shall be recognized in earnings immediately

"3. For a debt security transferred into ASS from IBODI, the unrealized holding gain or loss at the date of transfer shall be excluded from reported earnings and reported as a separate component of stockholders' equity until realized

"4. For a debt security transferred into IBODI from ASS and UA, the unrealized holding gain or loss at the date of the transfer shall continue to be reported in a separate component of stockholders' equity but shall be amortized over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount. The amortization of an unrealized holding gain or loss reported in equity will offset or mitigate the effect on interest income of the amortization of the premium or discount for that security

"c. The transfer of the same type of securities between categories shall be rare and shall in no case be made within a period of six (6) months reckoned from the original transaction date or as transfer date.

"Subsection __391.4 Operations Manual — Where applicable, the financial institution shall maintain an operations manual for booking and valuation of IBODI, TAX, ASS and UA with the following minimum contents:

"a. Criteria for lodging purchased securities to IBODI, TAS, ASS and UA

"b. Valuation procedures

> "1. Independent sources of prices/rates
> "2. Sample computations and booking

"c. Sales procedures

> "1. Sample computations and booking

"d. Transfers between categories

> "1. Criteria
> "2. Recognition of unrealized gain or loss in income
> "3. Sample computations and booking

"A copy of the operations manual shall be submitted to the appropriate supervision and examination department of the Bangko Sentral ng Pilipinas within thirty (30) banking days from effectivity date of this Circular. Subsequent amendments thereto shall be submitted within fifteen (15) banking days prior to its implementation. A penalty of five hundred pesos (P 500.00) per banking day shall be imposed for delay or non-submission."

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SECTION 2. Item 1 of Subsections 1306.4, 2306.4 and 4306Q.4 of Books I, II and IV, respectively, of the Manual of Regulations for Banks and Other Financial Intermediaries, is hereby amended to read as follows:

"Subsection ___306.4 Investments and other risk assets

"1. Investments in All Debt Securities and Marketable Equity Securities

"a. Investments in bonds and other debt instruments (IBODI) shall be valued at cost adjusted for discount or premium through periodic amortization charges or credits to income. When the decline in fair market value below the amortized cost is other than temporary, i.e., full collection of principal and interest is not expected on a debt security, the amortized cost basis of the particular debt security shall be adequately provided with allowance for probable losses. The amount of investment loss provision shall be accounted for as a realized loss and charged to reported current income.

"b. Trading account securities (TAS) shall initially be booked at cost and subsequently valued at fair market values. Unrealized gains and losses are recognized and booked against "Trading Gain/(Loss)" account.

"c. Available for sale securities (ASS) shall initially be booked at cost and subsequently valued at fair market values. Unrealized gains and losses are excluded from reported income and reported as a separate component of stockholders' equity [Net Unrealized Gains/(Losses) on Securities Available for Sale] until realized.

"d. Underwriting Accounts (UA) shall initially be booked at cost and subsequently valued at fair market values. Unrealized gains and losses are excluded from reported income and reported as a separate component of stockholders' equity [Net Unrealized Gains/(Losses) on Securities Available for Sale] until realized. UA account is applicable only to expanded commercial banks and investment houses."

This shall take effect six (6) months from date of this Circular.

Adopted: 30 Mar. 1998

(SGD.) GABRIEL C. SINGSON
Governor

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