

FINANCIAL DERIVATIVES ACTIVITIES

BSP CIRCULAR NO. 102, December 29, 1995

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The Monetary Board, in its Resolution No. 1416 dated December 13, 1995 approved the following rules and regulations on financial derivatives activities of banks, non-bank financial intermediaries performing quasi-banking functions (NBQBs) and/or its subsidiaries/affiliates engaged in financial allied activities.

SECTION 1. Statement of Policy. — It is the policy of the Bangko Sentral ng Pilipinas (BSP) to help deepen the Philippine financial markets. In line therewith, alternative instruments for risk management, including financial derivatives products, shall be allowed under a properly regulated environment for the protection of market participants.

SECTION 2. General Authority. — Any bank, NBQB, and/or its subsidiaries/affiliates may engage in financial derivatives activities upon prior approval of the BSP.

A bank may engage in derivatives activities both in its regular banking unit and foreign currency deposit unit/expanded foreign currency deposit unit (FCDU/EFCDU).

SECTION 3. Pre-Qualification Requirements. — Approval by the BSP of an application to engage in derivatives activities shall be granted upon compliance with the following requirements, whenever applicable and/or appropriate:

- a. Required minimum capital for the specific category of banks/non-bank financial intermediaries or net worth of P200 million, whichever is higher;
- b. Required net worth-to-risk assets ratio for the last sixty (60) days immediately preceding the date of application;
- c. Required reserves against deposit liabilities, deposit substitutes and common trust funds for the last eight (8) weeks immediately preceding the date of application;
- d. Required liquidity floor for government deposits for the last six (6) months immediately preceding the date of application;
- e. Required FCDU/EFCDU foreign currency asset cover on FCDU/EFCDU foreign currency liabilities for the last six (6) months immediately preceding the date of application;
- f. Limits on bank's allowable open foreign exchange position for the last six (6) months immediately preceding the date of application;
- g. No losses from operations for a period of six (6) months prior to the date of application; or in lieu thereof, the bank shall infuse additional capital over and above the basic minimum unimpaired capital required, equivalent to an amount computed by multiplying the average rate of return on net worth of normally operating banks/NBQBs and/or its subsidiaries/affiliates, as the case may be, during the preceding year, by the basic minimum capital required for the applicant.

- h. Electronic data processing capability including the appropriate computer hardware and software;
- i. Adequate internal control system and procedures including record keeping;
- j. Key officers/traders responsible for derivatives must have a minimum experience of two (2) years as office/trader in treasury, international operations and/or risk management; and
- k. Compliance with banking laws, orders, instructions and regulations issued by the Monetary Board and/or orders, instructions and rulings by the BSP Governor.

The application to engage in derivatives activities shall be submitted to the Foreign Exchange Department of the BSP.

SECTION 4. Authorized Transactions. — Any bank, NBQB and/or its subsidiaries/affiliates authorized to engage in derivatives activities under this Circular may enter into any derivatives contract, whether as end-user or in the capacity of dealer/trader or as agent/broker, provided, that when such contract is entered as end-user or in the capacity of dealer/trader, either party to said contract enters into the same for hedging purposes, provided, further, that in the case of commodity- or equity-based contracts, the bank, NBQB, and/or its subsidiary/affiliate shall not take an open position at any time.

SECTION 5. Risk Management Guidelines. — A bank, NBQB and/or its subsidiaries/affiliates authorized to engage in derivatives activities shall adopt a policy manual that contains the minimum features and principles embodied in the Risk Management Guidelines for Derivatives attached hereto as Annex "A"[*].

Risk disclosure statements, which should at least contain the disclosure statements in the attached Annex "B"[*], shall be provided to the clients/customers of a bank, NBQB and/or its subsidiaries/affiliates in order to advise the former of the risks involved in derivatives activities.

A detailed statement on the position of the clients/customers must be sent to them periodically.

SECTION 6. Accounting Guidelines. — In recording derivatives activities in the books, a bank, NBQB and/or its subsidiaries/affiliates shall observe the guidelines enumerated in the attached Annex "C"[*].

SECTION 7. Reportorial Requirements. — A monthly report on derivatives activities shall be submitted to the BSP by a bank, NBQB and/or its subsidiaries/affiliates authorized to engage in such activities. The report and annexes thereto, prepared in the format prescribed in Annex "D", shall be submitted to the Foreign Exchange Department (original copy) and the appropriate supervising and examining department (duplicate copy) of the Supervision and Examination Sector of the BSP, within five (5) banking days after the end of every reference month. Such report shall be considered as a major report for purposes of implementing fines in the submission of required reports pursuant to existing regulations.

SECTION 8. Sanctions. — In addition to the penalties prescribed in Sections 36 and 37 of Republic Act No. 7653, any bank, NBQB and/or its subsidiaries/affiliates may be liable to the following sanctions:

- a. Suspension or revocation of the authority to engage in derivatives activities if after due investigation, the BSP finds that the bank, NBQB and/or its subsidiaries/affiliates: (i) has violated any provision of this Circular; or (ii) is in imminent danger of insolvency, or (iii) will probably incur continuous losses if it does not stop/suspend its derivatives activities.
- b. Imposition of a fine in accordance with existing regulations for any delay in the submission of major reports required under this Circular or when such reports are incomplete or erroneous in any material respect.

SECTION 9. Transitory Provisions. — Any bank previously authorized to engage in certain types of derivatives

activities may continue engaging in such activities for a period of ninety (90) days from the effectivity of this Circular: Provided, That in the case of foreign exchange swaps and forwards, the bank may continue to engage in such transactions for a period of six (6) months from said effectivity date.

Upon the expiration of the aforesaid periods, such bank shall not enter into new derivatives contracts unless it has secured the prior authority of the BSP pursuant to this Circular: Provided, however, that if such previously-authorized bank has a net worth of at least P200 million, it shall continue to be so authorized until such time that its application for authority to engage in derivatives activities under this Circular shall have been acted upon and such action is that of denial. It is understood that even upon expiration of aforesaid periods, the bank may consummate derivatives contracts executed during the ninety (90) day period, or during the six (6) month period in the case of foreign exchange swaps and forwards.

SECTION 10. Repealing Clause. — All provisions of existing circulars, rules and regulations of the BSP which are inconsistent with this Circular are hereby amended, modified or repealed accordingly.

SECTION 11. Effectivity. — This Circular shall take effect fifteen (15) days after its publication in a newspaper of general circulation.

Adopted: 29 Dec. 1995

(SGD.) GABRIEL C. SINGSON
Governor

[*] Text available at Office of the National Administrative Register, U.P. Law Complex, Diliman, Quezon City.

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