

## 126 CAPITAL INSTRUMENTS ELIGIBLE AS RISK-BASED CAPITAL

**Unsecured subordinated debt.** The following are the guidelines for the issuance of unsecured subordinated debt (UnSD) eligible as Hybrid Tier 1 (HT1) and Tier 2 capital:

**Minimum features of unsecured subordinated debt.**

a. *Form.* A UnSD that will be publicly distributed may either be scripless in form or evidenced by certificates such as: promissory note, debenture or other appropriate certificate of indebtedness. A UnSD in scripless form shall comply with the provisions of R.A. No. 8792, otherwise known as the “Electronic Commerce Act”, particularly on the existence of an assurance on the integrity, reliability and authenticity of the UnSD in electronic form. An independent third party UnSD Registry shall maintain unissued UnSD certificates and the UnSD Registry Book, which must be electronic if the UnSD is scripless in form. A UnSD that will be issued privately or on a negotiated basis shall be evidenced by certificates.

All UnSD shall be registered in the name of individuals or entities and pre-numbered serially.

b. *Denomination.* The UnSD must be issued in minimum denominations of P500,000 or its equivalent if denominated in a foreign currency.

c. *Mandatory provisions.* If the UnSD is not scripless in form, the following provisions must appear in bolder prints on the face of every note, debenture or other certificate evidencing the same:

(1) This obligation is not a deposit and is not insured by the PDIC;

(2) This obligation is neither secured nor covered by the guarantee of (name of bank) or its subsidiaries and affiliates, or other arrangement that legally or economically enhances the priority of the claim of any holder of the UnSD as against depositors and other creditors (for LT2); depositors, other creditors and holders of LT2 capital instruments (for UT2); and depositors, other creditors and holders of LT2 and UT2 capital instruments (for HT1);

(3) This obligation does not have a priority claim, in respect of principal and coupon payments in the event of winding up of the (name of bank), which is higher than or equal with that of depositors and other creditors (for LT2); depositors, other creditors and holders of LT2 capital instruments (for UT2); and depositors, other creditors, holders of LT2 and UT2 capital instruments (for HT1); and

(4) The obligation is ineligible as collateral for a loan granted by (name of Bank), its subsidiaries

and affiliates.

If the UnSD is scripless in form, the foregoing provisions/information shall be furnished every buyer/investor in a separate written instrument receipt of which must be duly acknowledged by him.

- d. *Term.* The UnSD qualifying under HT1 capital shall be perpetual. The minimum maturity of a UnSD qualifying under UT2 and LT2 capital shall be ten (10) years and five (5) years, respectively.

**Prior Bangko Sentral approval.** No UnSD shall be issued without the prior approval of the Bangko Sentral.

**Pre-qualification requirements of issuing bank.** A bank applying for authority to issue an UnSD shall comply with the following requirements:

- a. It has complied with the minimum amount of capital required under Sec. 121 or its paid-in capital is at least equal to the amount required therein.
- b. It has established a risk management system appropriate to its operations characterized by clear delineation of responsibility for risk management, adequate risk measurement systems, appropriately structured risk limits, effective internal controls and complete, timely and efficient risk reporting system.
- c. It is a locally incorporated bank.

**Public issuance of unsecured subordinated debt.** Public issuance of UnSD is an issuance offered to the general public, which may or may not be qualified investors/buyers as hereinafter defined. The Issuing Bank must be rated by an independent credit rating agency recognized by the Bangko Sentral and a Public Trustee shall be appointed for investor protection.

a. *Application for authority*

- (1) The application shall be signed by the president or officer of equivalent rank of the applicant bank;
- (2) The application for authority on each UnSD issue/issue program shall be filed with the appropriate supervising department of the Bangko Sentral : *Provided*, That the period of an issue program of two (2) or more tranches shall not exceed one (1) year from date of

approval; and

(3) The application shall be accompanied by:

- (a) A certified true copy of the resolution of the Issuing Bank's board of directors authorizing the issuance of the UnSD indicating, among others, the issue size, terms and conditions, offering period, purpose or intended use of proceeds thereof, the names of the Underwriter/Arranger, UnSD Registry, Selling Agent(s) and Market Maker(s), and Public Trustee;
- (b) A certification by the corporate secretary that the issuance of the UnSD has been approved by the stockholders owning or representing at least two-thirds (2/3) of the outstanding capital stock of the Issuing Bank if the UnSD has convertibility feature;
- (c) A written confirmation from the president or officer of equivalent rank of the Issuing Bank stating that all the conditions/eligibility criteria for UnSD to qualify for capital instruments under applicable and existing capital adequacy framework are complied with and that such conditions/eligibility criteria shall be contained in the UnSD Certificates if the UnSD is not in scripless form, in the Information Disclosure and Purchase Advice.
- (d) A written undertaking from the president or officer of equivalent rank of the Issuing Bank not to support, directly or indirectly, by extending loans, issuing payment guarantees or otherwise, the buyer/holder of the UnSD of the Issuing Bank;
- (e) A written confirmation from the president or officer of equivalent rank of the Issuing Bank stating that the designated Underwriter/Arranger, UnSD Registry, Selling Agent(s) and Market Maker(s) were provided with a complete list of subsidiaries and affiliates of the Issuing Bank including their subsidiaries and affiliates;
- (f) A written undertaking from the president or officer of equivalent rank of the Issuing Bank to update the above-mentioned list within three (3) banking days from the date of change in composition thereof;
- (g) Specimen of the UnSD;
- (h) A written external legal opinion that all the conditions/eligibility criteria for UnSD to qualify for capital instruments under applicable and existing capital adequacy framework and loss absorption (for HT1 and UT2) features, have been met; and

- (i) A certification signed by the president (or officer of equivalent rank) and chief compliance officer of the issuing bank stating the compliance of all parties to the UnSD transaction with the respective prequalification requirements prescribed under Item “c” of this Section on Public issuance of unsecured subordinated debt.

*b. Additional requirements for the issuance of UnSD*

After a bank’s application to issue a UnSD has been approved, the applicant shall submit the following additional requirements to the appropriate supervising department of the Bangko Sentral:

(1) At least fifteen (15) banking days before the date of offering:

- (a) A written confirmation from the president or officer of equivalent rank of the Issuing Bank stating that the bank has been rated by an independent credit rating agency duly recognized by the Bangko Sentral;
- (b) Information disclosure of the UnSD issuance prepared by the Underwriter Arranger;
- (c) Promotional materials;
- (d) Specimen of the proposed Purchase Advice and Registry Confirmation; and
- (e) Copy of the agreements between the Issuing Bank and the Underwriter/ Arranger/UnSD Registry/Selling Agent(s)/Market Maker(s), and Public Trustee.

The Bangko Sentral reserves the right to suspend the date of offering, within the fifteen (15) banking day period from submission of the above-mentioned requirements.

(2) Within ten (10) banking days after issuance of the initial and subsequent tranches:

- (a) A written notice of the actual date of issuance/offering of each initial and subsequent tranches.

*c. Requirements for other parties involved*

The issuing bank shall be held accountable for ensuring the continuous compliance by its chosen participant-FIs with the qualification requirements prescribed by the Bangko Sentral.

As such, the issuing bank shall make a careful and diligent evaluation of the parties whom it shall engage to act as underwriter/arranger, UnSD registry, selling agent, market maker and public trustee of its UnSDs.

The following qualification requirements shall be strictly complied with prior to and on a continuing basis by the issuing bank and FIs engaged to act as underwriter/arranger, UnSD registry, selling agent, market maker and public trustee while the UnSDs of the issuing bank remains outstanding:

(1) Underwriter/Arranger

- (a) It is either a UB or an IH: *Provided*, That if an offering is on a best effort basis, the Arranger may also be a KB: *Provided, further*, That if an offering is denominated in foreign currency, the Underwriter/Arranger may also be any reputable international investment bank.
- (b) It must be an independent third party that has no subsidiary/affiliate or any other relationship with the Issuing Bank that would undermine the objective conduct of due diligence.
- (c) If Underwriter, it must have adequate risk management and must be well capitalized, which for a local Underwriter, shall be evidenced by compliance with the risk-based CAR prescribed under applicable and existing capital adequacy framework for the past sixty (60) days immediately preceding the date of application where applicable.

(2) UnSD Registry

- (a) It may be a UB, a KB, or such other specialized entity that may be qualified by the Monetary Board.
- (b) It must be a third party that has no subsidiary/affiliate or any other relationship with the Issuing Bank that would undermine its independence.
- (c) It must not be an Underwriter or a Market Maker of the UnSD.
- (d) It must have adequate facilities and the organization to do the following:
  - (i) Maintain certificates of unissued UnSD and the Registry Book which must be electronic if the UnSD is in scripless form;
  - (ii) Deliver transactions within the agreed trading period; and
  - (iii) Issue Registry Confirmations and UnSD Certificates if they are not in scripless form to buyers/holders of UnSD.
- (e) It must have a CAMELS composite rating of at least "3" in the last regular examination, where applicable.

(3) Selling Agent

- (a) It must be an FI with dealership or brokering license.
- (b) It must be a third party that has no subsidiary/affiliate or any other relationship with the Issuing Bank that would undermine its independence.

(4) Market Maker

- (a) It must be an FI with a dealership or brokering license.
- (b) It must be a third party that has no subsidiary/affiliate or any other relationship with the Issuing Bank that would undermine its independence.
- (c) It must have adequate risk management and must be well capitalized as evidenced by compliance with the risk based CAR prescribed under applicable and existing capital adequacy framework for the past sixty (60) days immediately preceding the date of application where applicable.

There is no need for a Market Maker if the UnSD is to be held on to maturity: *Provided*, That this condition is properly disclosed in the Purchase Advice, Registry Confirmation and Prospectus/Information Disclosure.

(5) Public Trustee

- (a) It must be an FI authorized by the Bangko Sentral to engage in trust and other fiduciary business.
- (b) It must be a third party that has no subsidiary/affiliate or any other relationship with the Issuing Bank that would undermine its independence.
- (c) It must have adequate risk management system and must be well capitalized as evidenced by compliance with the risk-based CAR prescribed under applicable and existing capital adequacy framework for the past sixty (60) days immediately preceding the date of application where applicable. The 60-day compliance period with the risk-based CAR shall be waived in evaluating a bank's eligibility to act as Public Trustee for another bank's UnSD's Tier 2 offering, if the former bank has instituted remedial measure to its CAR deficiency by issuing Tier 2 capital.

(d) It may also be the UnSD Registry.

(e) A Public Trustee is mandatory if UnSD shall be offered to the general public and optional if

offering will be limited to qualified investors/buyers.

d. *Functions/Responsibilities of other parties involved*

The respective parties shall have, among others, the following functions/responsibilities:

(1) Underwriter/Arranger

- (a) Conducts due diligence on the Issuing Bank and determines the valuation/pricing of the primary issue;
- (b) Prepares the prospectus/information disclosure, including updates for multi- tranche UnSD issues;
- (c) Formulates the distribution/allocation plan for the initial offering and ensures proper and orderly distribution of the primary offering of the UnSD;
- (d) Disseminates information to prospective investors of UnSD on the terms and conditions of the issue (including information of non-pre-termination at the initiative of the holder and the liquidity mechanism in secondary trading) and the rights and obligations of the holder, issuer, Underwriter/Arranger, UnSD Registry, Selling Agent, Market Maker and Public Trustee; and
- (e) When selling to its clients, it must perform the functions/responsibilities of the Selling Agent under Item “d(3)” hereof.

(2) UnSD Registry

- (a) Keeps unissued UnSD certificates and maintains UnSD Registry book, which must be electronic if UnSD is scripless in form;
- (b) Records initial issuance of the UnSD and subsequent transfer of ownership;
- (c) Issues UnSD Certificates for primary offerings if UnSD is not scripless in form;
- (d) Issues Registry Confirmation to buyers/holders;
- (e) Functions as paying agent for periodic interest and principal payments;

- (f) Monitors compliance with the prohibitions on holdings of UnSD, as prescribed under this Section on Prohibitions on holdings of unsecured subordinated debt hereof; and
- (g) Submits within ten (10) banking days from end of reference month, an exception report on this Section on Prohibitions on holdings of unsecured subordinated debt to the appropriate supervising department of the Bangko Sentral. This report shall be classified as a “*Category B*” report.

(3) Selling Agent

- (a) Verifies identity of each investor to ascertain that this Section on Prohibitions on holdings of unsecured subordinated debt is not violated and applies appropriate standards to combat money laundering as required under existing Bangko Sentral regulations;
- (b) Determines the suitability of the investor and ensures that he fully understands the features of the UnSD and the risk involved therein; and
- (c) Issues the Purchase Advice for the primary offering of the UnSD to the buyer and sends a copy thereof to the UnSD Registry.

The sale or distribution of UnSD may also be performed by the issuer through its head office and branches subject to the following conditions:

- (i) The in-house distribution shall not exceed fifty percent (50%) of the total issue;
- (ii) The sale/distribution must be done under the supervision of an officer of the Issuing Bank who is capable of determining the suitability of the investor and ensuring that he fully understands the risk in UnSD;
- (iii) All personnel assigned to distribute sell UnSD must be capable of determining the suitability of the investor and ensuring that he fully understands the risk in UnSD; and
- (iv) It must also perform the functions/responsibilities of the Selling Agent.

(4) Market Maker

- (a) Sets an independent pricing for the secondary trading of UnSD;
- (b) Posts daily the bid and offer prices for the UnSD on the screen of at least one (1) of the

information providers until the operation of a fixed income exchange for UnSD;

- (c) Verifies identity of each investor to ascertain that the provisions of this Section on Prohibitions on holdings of unsecured subordinated debt is not violated and applies appropriate standards to combat money laundering as required under existing Bangko Sentral regulations;
- (d) Determines the suitability of the buyer and ensures that he fully understands the risk involved in a UnSD;
- (e) Issues the Purchase Advice for the secondary trading of the UnSD to the buyer and sends a copy thereof to the UnSD Registry; and
- (f) Ensures secondary market transfers and registration in coordination with the UnSD Registry.

(5) Public Trustee

- (a) Monitors compliance of the Issuing Bank with the terms and conditions of the UnSD;
  - (b) Monitors compliance of the other parties with their functions and responsibilities prescribed under this Section;
  - (c) Reports regularly to UnSD holders non-compliance of the Issuing Bank with the terms and conditions of the UnSD and such other developments that adversely affect their interest and advise them of the course of action they should take to protect their interest; and
  - (d) Act on behalf of the UnSD holders in case of bankruptcy of the Issuing Bank.
- e. *Change of underwriter/arranger, UnSD registry, selling agent(s), market maker(s).* After an application for authority to issue a UnSD has been approved by the Bangko Sentral, the Issuing Bank cannot change its Underwriter/Arranger, UnSD Registry, Selling Agent(s), Market Maker(s) and Public Trustee without prior Bangko Sentral approval.
- f. *Agreements between issuing bank and other parties involved.* The agreements between the Issuing Bank and the UnSD Registry/Selling Agent(s)/Market Maker(s)/Public Trustee shall comply with the provisions of Sec. 112 (*Definition*) on bank service contracts. The Issuing Bank shall be liable to investors for any damages caused by actions of the UnSD Registry, Selling Agent(s) and Market Maker(s), which are contrary to the agreements entered into.

g. *Purchase advice and registry confirmation.* The Purchase Advice and Registry Confirmation shall contain all the terms and conditions on the issuance of UnSD and shall conspicuously state the following caveat:

- (1) This UnSD is not a deposit and is not insured by the PDIC.
- (2) This UnSD is neither secured nor covered by a guarantee of the Issuer/ Underwriter/Arranger or related party of the Issuer/Underwriter/Arranger or other arrangement that legally or economically enhances the priority of the claim of any holder of the UnSD as against depositors and other creditors (for LT2); depositors, other creditors and holders of LT2 capital instruments (for UT2); and depositors, other creditors and holders of LT2 and UT2 capital instruments (for HT1);
- (3) This UnSD does not have a priority claim, in respect of principal and coupon payments in the event of winding-up of the Issuing Bank, which is higher than or equal with that of depositors and other creditors (for LT2); depositors, other creditors and holders of LT2 capital instruments (for UT2); and depositors, other creditors, holders of LT2 and UT2 capital instruments (for HT1);
- (4) This UnSD is ineligible as collateral for a loan granted by the Issuing Bank, its subsidiaries or affiliates;
- (5) This UnSD cannot be terminated by the holder nor by the Issuing Bank (for HT1). This UnSD cannot be terminated by the holder nor by the Issuing Bank before (maturity date) (for UT2 and LT2).

However, negotiations/transfers from one (1) holder to another do not constitute pre-termination.

For tax purposes, negotiations/transfers from one (1) holder to another shall be subject to the pertinent provisions of the National Internal Revenue Code of 1997, as amended, and BIR regulations.

(Item “g(5)” above shall apply if the Issuing Bank commits no pre-termination of the UnSD. Otherwise, it shall read as follows):

This UnSD cannot be terminated by the holder (for HT1). This UnSD cannot be terminated by the holder before (maturity date) (for UT2 and LT2).

However, it may be pre-terminated at the instance of the Issuing Bank upon:

(a) Prior approval of the Bangko Sentral subject to the following conditions:

(i) The repayment is in connection with call option after a minimum of five (5) years from issue date, or even within the first five (5) years from issue date when:

- (aa) The UnSD was issued for the purpose of a merger with or acquisition by the Issuing Bank and the merger or acquisition is aborted;
- (bb) There is a change in tax status of the UnSD due to changes in the tax laws and/or regulations; or
- (cc) The UnSD does not qualify as HT1, UT2 or LT2 capital, as the case may be, as determined by the Bangko Sentral; and

(ii) The debt is simultaneously replaced with the issues of new capital which is neither smaller in size nor of lower quality than the original issue, unless the Issuing Bank's capital adequacy ratio remains more than adequate after redemption; and

(b) Prior notice to holders on record. Negotiations/transfers from one (1) holder to another do not constitute pre- termination.

However, for tax purposes, negotiations/ transfers from one (1) holder to another shall be subject to the pertinent provisions of the National Internal Revenue Code of 1997, as amended, and BIR regulations.

In case there is a feature allowing one-time step-up in the coupon rate in conjunction with a call option, the step-up shall be after a minimum of ten (10) years for HT1 and UT2 and five (5) years for LT2 after the issue date, and shall not result in an increase over the initial rate that is more than:

- (i) 100 basis points less the swap spread between the initial index basis and the stepped-up index basis; or
- (ii) Fifty percent (50%) of the initial credit spread less the swap spread between the initial index basis and the stepped-up index basis.

The swap spread shall be fixed at the pricing date and reflect the differential in pricing on that date between the initial reference security or rate and the stepped- up reference security or rate;

- (6) The holders/owners of this UnSD cannot set off any amount they owe to the Issuing Bank against this UnSD.
- (7) All negotiations/transfers of this UnSD prior to maturity must be coursed through a Market Maker until the operation of a fixed income exchange.
- (8) The payment of principal may be accelerated on this UnSD only in the event of insolvency of the Issuing Bank.
- (9) The coupon rate, or the formulation for calculating coupon payments shall be fixed at the time of the issuance of the UnSD and may not be linked to the credit standing of the Issuing Bank;
- (10) The payment of principal and coupon due on this UnSD shall not be made to the extent that such payment will cause the Issuing Bank to become insolvent (for HT1 and UT2);
- (11) The holders of the UnSD shall be treated as if they were holders of a specified class of share capital in any proceedings commenced for the winding-up of the Issuing Bank (for HT1 and UT2);

(Item “g(11)” above shall apply if such is the manner by which the UnSD is to be treated in loss situation. Otherwise, it shall read as follows):

This UnSD shall be automatically converted into common shares or perpetual and non-cumulative preferred shares (for HT1) or into common shares or perpetual and non-cumulative preferred shares or perpetual and cumulative preferred shares (for UT2) upon occurrence of certain trigger events as follows:

- (a) Breach of minimum capital ratio;
- (b) Commencement of proceedings for winding-up of the Issuing Bank; or
- (c) Upon appointment of receiver for the Issuing Bank.

The rate of conversion shall be fixed at the time of the subscription of this UnSD.

- (12) The amount and timing of coupons on this UnSD shall be discretionary on the Issuing Bank where the Issuing Bank has not paid or declared a dividend on its common shares in the preceding financial year, or determines that no dividend is to be paid on such shares in the current financial year; and the Issuing Bank shall have full control and access to waived payments (for HT1). The coupon payment on this UnSD shall be deferred where the Issuing

Bank has not paid or declared a dividend on its common shares in the preceding financial year, or determines that no dividend is to be paid on such shares in the current financial year (for UT2);

(13) The coupon on this UnSD shall be non-cumulative. In case there is a feature allowing withheld cash coupon to be payable in scrip or shares of stock, the shares of stock to be issued shall not be of lower quality capital than the UnSD (for HT1); and

(14) The coupon to be paid on this UnSD shall be paid only to the extent that the Issuing Bank has profit distributable determined in accordance with existing Bangko Sentral regulations (for HT1).

N.B.: The last five (5) items (i.e., "10", "11", "12", "13" and "14") are applicable only to UnSD qualifying under HT1 and UT2 capital, as the case may be. The foregoing information shall also be shown in the Prospectus/ Information Disclosure.

*h. Pre-termination by the Issuer*

(1) The Issuing Bank may pre-terminate the UnSD subject to the following conditions:

- (a) The Information Disclosure, Purchase Advice and Registry Confirmation shall include the information that the Issuing Bank has the option to pre-terminate the UnSD;
- (b) Compliance with Items "a(2)(a)vii", "b(1)(h)v" or "b(2)(c)iv" as may be applicable;
- (c) Prior notification of thirty (30) banking days or more to holders of record; and
- (d) Notwithstanding any agreement to the contrary, the Issuer shall shoulder the tax due, if any, on the interest income already earned by the holders.

(2) Within ten (10) banking days after the completion of the pre-termination transaction, the Issuing Bank must submit a written notice to the appropriate supervising department of the Bangko Sentral of the following:

- (a) Actual pre-termination date; and
- (b) New capital composition.

*i. Primary offering/secondary trading*

(1) The primary offering of a UnSD shall be executed through an Underwriter under a firm commitment or through an Arranger on a best effort basis. Initial sale/distribution of UnSD shall be made by a Selling Agent, the Underwriter/Arranger or, to a limited extent, the Issuing

Bank itself. Subsequent negotiations in secondary trading must be executed through authorized Market Maker(s) until the operation of a fixed income exchange.

The primary offering as well as the secondary trading of a UnSD must be supported by Purchase Advice to be issued by the Selling Agent or the Market Maker, as the case may be, with the original given to the buyer and a second copy to the UnSD Registry. Upon presentation by the buyer of the original copy of Purchase Advice, the UnSD Registry shall:

- (a) record the primary issuance in the Registry Book and issue a Registry Confirmation and the corresponding UnSD certificate to the buyer if it is not scripless in form; and
- (b) register the transfer of ownership in the UnSD Registry Book and issue a Registry Confirmation to the buyer, in the case of secondary trading.

***Private or negotiated issuance of unsecured subordinated debt.***

a. *Private or negotiated issuance of UnSD* is the issuance of UnSD to qualified investors/buyers, whether individuals or institutions as defined under Sec. 126 (*Qualified investors/buyers*). There is no limit on the number of qualified investors/buyers and on the sale or negotiation of the UnSD: *Provided*, That such sale or negotiation shall only be made to another qualified investor/buyer.

b. *Application for authority of the Issuing Bank*

- (1) The application shall be signed by the president or officer of equivalent rank of the Issuing Bank.
- (2) The application for authority on each negotiated UnSD issue shall be filed with the appropriate supervising department of the Bangko Sentral.
- (3) The application shall be accompanied by:
  - (a) A certified true copy of the resolution of the Issuing Bank's board of directors authorizing the private/negotiated issuance of UnSD indicating, among others, the amount, duration/maturity, interest rate, purpose or intended use of proceeds of the UnSD;
  - (b) A Certification by the corporate secretary that the issuance of the UnSD has been approved by the stockholders owning or representing at least two-thirds (2/3) of the outstanding capital stock of the Issuing Bank if the UnSD has convertibility feature;
  - (c) A written confirmation from the president or officer of equivalent rank of the Issuing Bank stating that all the conditions/eligibility criteria for UnSD to qualify for capital instruments under applicable and existing capital adequacy framework are complied with and that

such conditions/eligibility criteria shall be contained in the UnSD Certificates, Prospectus/Information Disclosure and Debt Agreement/Contract.

- (d) An undertaking from the president or officer of equivalent rank of the Issuing Bank that the UnSD shall be issued only to qualified investors/buyers;
  - (e) A certification from the president or officer of equivalent rank of the Issuing Bank that the investor/buyer shall not be among those prohibited to hold UnSD under this Section on Prohibitions on holdings of unsecured subordinated debt and that the Issuing Bank has applied appropriate standards to combat money laundering as required under existing Bangko Sentral regulations;
  - (f) A written undertaking from the president or officer of equivalent rank of the Issuing Bank not to support, directly nor indirectly, by extending loans, issuing payment guarantees or otherwise, the buyer/holder of the UnSD of the Issuing Bank;
  - (g) Specimen of the proposed Debt Agreement/Contract containing the terms and conditions of the UnSD issuance; and
  - (h) A written external legal opinion that all the conditions for UnSD under applicable and existing capital adequacy framework including the subordination (for HT1, UT2 and LT2) and loss absorption (for HT1 and UT2) features, have been met.
- c. *Additional requirements for the private issuance of UnSD.* Within ten (10) banking days after issuance of the UnSD, the Issuing Bank shall submit the following additional requirements to the appropriate supervising department of the Bangko Sentral:
- (1) A written notice of the actual date of full receipt of proceeds, accompanied by a certification from the president or officer of equivalent rank of the Issuing Bank stating that the pre-qualification requirements under this Section have been complied with up to the time of full receipt of proceeds;
  - (2) A copy of each of the duly signed Debt Agreements/Contracts between the Issuing Bank and the investor/buyer as specified in the application for authority to issue negotiated UnSD; and
  - (3) A copy of the income tax return of the investor/buyer in case of a natural person.

d. *Debt agreement/contract*

The Debt Agreement/Contract shall contain all the terms and conditions on the issuance of UnSD and shall conspicuously state the following caveat:

- (1) This UnSD is not a deposit and is not insured by the PDIC.
- (2) This UnSD is neither secured nor covered by a guarantee of the Issuer or related party of the Issuer or other arrangement that legally or economically enhances the priority of the claim of any holder of the UnSD as against depositors and other creditors (for LT2); depositors, other creditors and holders of LT2 capital instruments (for UT2); and depositors, other creditors and holders of LT2 and UT2 capital instruments (for HT1).
- (3) This UnSD does not have a priority claim, in respect of principal and coupon payments in the event of winding-up of the Issuing Bank, which is higher than or equal with that of depositors and other creditors (for LT2); depositors, other creditors and holders of LT2 capital instruments (for UT2); and depositors, other creditors, holders of LT2 and UT2 capital instruments (for HT1);
- (4) This UnSD is ineligible as collateral for a loan made by the Issuing Bank, its subsidiaries or affiliates.
- (5) This UnSD cannot be terminated by the holder nor by the Issuing Bank (for HT1). This UnSD cannot be terminated by the holder nor by the Issuing Bank before (maturity date) (for UT2 and LT2).

Item “d(5)” above shall apply if the Issuing Bank commits no pre-termination of the UnSD. Otherwise, it shall read as follows:

This UnSD cannot be terminated by the holder (for HT1). This UnSD cannot be terminated by the holder before (maturity date) (for UT2 and LT2).

However, it may be pre-terminated at the instance of the Issuing Bank upon:

- (a) Prior approval of the Bangko Sentral subject to the following conditions:
  - (i) The repayment is in connection with call option after a minimum of five (5) years from issue date, or even within the first five (5) years from issue date when:
    - (aa) The UnSD was issued for the purpose of a merger with or acquisition by the Issuing Bank and the merger or acquisition is aborted;

- (bb) There is a change in tax status of the UnSD due to changes in the tax laws and/or regulations; or
  - (cc) The UnSD does not qualify as HT1, UT2 or LT2 capital, as the case may be, as determined by the Banko Sentral; and
- (ii) The debt is simultaneously replaced with the issues of new capital which is neither smaller in size nor of lower quality than the original issue, unless the Issuing Bank's capital adequacy ratio remains more than adequate after redemption; and
- (b) Prior notice to investors/buyers.

In case there is a feature allowing one-time step-up in the coupon rate in conjunction with a call option, the step-up shall be after a minimum of ten (10) years (for HT1 and UT2) and five (5) years (for LT2) after the issue date, and shall not result in an increase over the initial rate that is more than:

- (i) 100 basis points less the swap spread between the initial index basis and the stepped-up index basis; or
- (ii) Fifty percent (50%) of the initial credit spread less the swap spread between the initial index basis and the stepped-up index basis.

The swap spread shall be fixed at the pricing date and reflect the differential in pricing on that date between the initial reference security or rate and the stepped-up reference security or rate;

- (6) This UnSD may only be sold, transferred or negotiated to another qualified investor/buyer;
- (7) The holders/owners of this UnSD cannot set off any amount they owe to the Issuing Bank against this UnSD.
- (8) The payment of principal may be accelerated on this UnSD only in the event of insolvency of the Issuing Bank.
- (9) The coupon rate, or the formulation for calculating coupon payments shall be fixed at the time of the issuance of the UnSD and may not be linked to the credit standing of the Issuing Bank;
- (10) The payment of principal and coupon due on this UnSD shall not be made to the extent that such payment will cause the Issuing Bank to become insolvent (for HT1 and UT2);

- (11) The holders of the UnSD shall be treated as if they were holders of a specified class of share capital in any proceedings commenced for the winding up of the Issuing Bank (for HT1 and UT2);

(Item “d(11)” above shall apply if such is the manner by which the UnSD is to be treated in loss situation. Otherwise it shall read as follows):

This UnSD shall be automatically converted into common shares or perpetual and non-cumulative preferred shares (for HT1), or into common shares or perpetual and non-cumulative preferred shares or perpetual and cumulative preferred shares (for UT2) upon occurrence of certain trigger events as follows:

- (a) Breach of minimum capital ratio;
- (b) Commencement of proceedings for winding up of the Issuing Bank; or
- (c) Upon appointment of receiver for the Issuing Bank.

The rate of conversion shall be fixed at the time of the subscription of this UnSD.

- (12) The amount and timing of coupons on this UnSD shall be discretionary on the Issuing Bank where the Issuing Bank has not paid or declared a dividend on its common shares in the preceding financial year, or determines that no dividend is to be paid on such shares in the current financial year; and the Issuing Bank shall have full control and access to waived payments (for HT1). The coupon payment on this UnSD shall be deferred where the Issuing Bank has not paid or declared a dividend on its common shares in the preceding financial year, or determines that no dividend is to be paid on such shares in the current financial year (for UT2);
- (13) The coupon on this UnSD shall be non-cumulative. In case there is a feature allowing withheld cash coupon to be payable in scrip or shares of stock, the shares of stock to be issued shall not be of lower quality capital than the UnSD (for HT1); and
- (14) The coupon to be paid on this UnSD shall be paid only to the extent that the Issuing Bank has profit distributable determined in accordance with existing Bangko Sentral regulations (for HT1).

N.B.: The last five (5) items (i.e., “10”, “11”, “12”, “13” and “14”) are applicable only to UnSD qualifying under HT1 and UT2 capital, as the case may be.

*e. Pre-termination by the Issuer*

- (1) The Issuing Bank may preterminate the negotiated UnSD subject to the following conditions:
  - (a) The Debt Agreement/Contract shall include the information that the Issuing Bank has the option to pre-terminate the UnSD;
  - (b) Compliance with call options as provided in applicable and existing capital adequacy framework;
  - (c) Prior notification of thirty (30) banking days or more to lender/investor; and
  - (d) Notwithstanding any agreement to the contrary, the Issuer shall shoulder the tax due, if any, on the interest income already earned by the holders.
  
- (2) Within ten (10) banking days after the completion of the pre-termination transaction, the Issuing Bank must submit a written notice to the appropriate supervising department of the Bangko Sentral of the following:
  - (a) Actual pre-termination date; and
  - (b) New capital composition.

*f. Functions/Responsibilities of the Issuing Bank*

- (1) Prepares the Prospectus/Information Disclosure on the UnSD issues;
- (2) Disseminates to prospective investors/buyers information on the terms and conditions of the UnSD (including information on no pre-termination at the initiative of the holder, and where applicable, the liquidity mechanism in secondary trading) and the rights and obligations of the holder and the issuer;
- (3) Keeps unissued UnSD certificates and maintains UnSD Register;
- (4) Records initial issuance of UnSD and subsequent transfer of ownership;
- (5) Issues UnSD Certificates and Registry Confirmation to original investors/buyers;
- (6) Issues Registry Confirmation to subsequent buyers/holders where applicable;
- (7) Ensures compliance with this Section on Prohibitions on holdings of unsecured subordinated debt and applies appropriate standards to combat money laundering as required under existing Bangko Sentral regulations; and
- (8) Determines suitability of the investors/buyers (original or subsequent) and assures that he

fully understands the risk involved in a UnSD.

**Issuance abroad of unsecured subordinated debt.** The overseas issuance of UnSD shall also be subject to the provisions under this Section on Unsecured subordinated debt except for the following:

- a. Overseas issuance of UnSD may be allowed to be governed by the laws and applicable rules and regulations of the country where the UnSD is to be issued with respect to form, qualified investors/buyers and subsequent sale or negotiation;
- b. The requirements under Item “c(1)” on Minimum features of unsecured subordinated debt, Item “g(1)” on Public issuance of unsecured subordinated debt, and Items “d(1)” and “d(6)” on Private or negotiated issuance of unsecured subordinated debt of this Section may be allowed to be dispensed with in cases of overseas issuance of UnSD; and
- c. The subsequent sale/negotiation in the Philippines of the UnSDs originally issued overseas shall not be allowed unless all the requirements for domestic issuance are complied with.

It is however understood that the applicant/issuer shall also secure the approval of the International Department (ID) of the Bangko Sentral for the overseas issuance of foreign currency denominated UnSD.

**Qualified investors/buyers.** Qualified buyers of, or suitable investors in, a UnSD can be any of the following:

- a. Banks;
- b. Investment house (IH);
- c. Insurance company;
- d. Pension or retirement fund of other entities which have no subsidiary/affiliate or any other relationship with the Issuing Bank;
- e. Investment company;
- f. Funds managed by another bank or other entities duly authorized to engage in trust or other fiduciary business;
- g. Domestic corporate or institutional investors with total assets of at least P100.0 million;

- h. Foreign multilateral organizations such as, the ADB and IFC;
- i. High net-worth individual investor/buyer who is sophisticated enough to understand and appreciate the significance of and the risk involved in UnSD as may be indicated by his/her educational background and/or employment/business experience; and
- j. Stockholder, director or officer with the rank of at least a vice-president of the Issuing Bank.

**Prohibitions on holdings of unsecured subordinated debt.** The following persons and entities are prohibited from purchasing/holding UnSD of the Issuing Bank:

- a. Subsidiaries and affiliates of the Issuing Bank including their subsidiaries and affiliates; and
- b. Common trust funds (CTFs) managed by the Trust Department of the Issuing Bank, its subsidiaries and affiliates or other related entities: *Provided*, That other funds being managed by the Trust Department of the Issuing Bank, its subsidiaries and affiliates or other related entities are allowed to purchase or invest in UnSD of the Issuing Bank subject to the following conditions:
  - (1) That the fund owners give prior authority/instruction to the Trust Department to purchase or invest in the UnSD of the Issuing Bank; and
  - (2) That the authority/instruction of the fund owner and his understanding of the risk involved in purchasing or investing in UnSD are fully documented.

For purposes of this Section, an *affiliate* refers to a related entity linked by means of ownership of at least twenty percent (20%) to not more than fifty percent (50%) of its outstanding voting stock.

**Accounting treatment.** Obligations arising from the issuance of UnSD (including the portion exceeding the allowable ceiling for purposes of determining the qualifying capital as provided in applicable and existing capital adequacy framework shall be booked under the following General Ledger account titles:

- a. "Other Equity Instruments - Others" for HT1 capital which shall be presented in the equity accounts section of the Balance Sheet which shall be accounted for in accordance with the provisions of PAS 32; and
- b. "Unsecured Subordinated Debt" for UT2 and LT2 capital, which shall be presented in the liability accounts section of the balance sheet.

However, only the proceeds actually received from the UnSD issues, (i.e., net of discounts, if any, and transaction costs) shall be considered as HT1, UT2 or LT2 capital.

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The proceeds actually received from the UnSD issues, (i.e., net of discounts, if any, and transaction costs) eligible as UT2 or LT2 capital shall be considered in the computation of loanable funds for purposes of determining compliance with the mandatory allocation of funds for agri-agra credit required under P.D. No. 717, as amended.

A UnSD eligible as HT1, UT2 or LT2 capital shall be accounted for in accordance with PAS 32 and PFRS 9.

A UnSD denominated in foreign currency eligible as HT1, UT2 or LT2 may be recorded in the regular banking unit (RBU) or foreign currency deposit unit (FCDU/EFCDU) of the issuing bank: *Provided*, That if booked in the FCDU/EFCDU, the following conditions shall be strictly observed:

- a. The issuing bank shall indicate in its application that the UnSD shall be booked in its FCDU/EFCDU;
- b. The UnSD shall remain in the FCDU/EFCDU books until full settlement; and
- c. The UnSD shall be issued only to non-residents and offshore banking units (OBUs) in accordance with Section 72.2.e of CB Circular No. 1389, as amended.

A UnSD eligible as HT1, UT2 or LT2 capital shall be accounted for in accordance with PAS 32 and PFRS 9.

**Sanctions.** Without prejudice to the other sanctions prescribed under Sections 36 and 37 of R.A. No. 7653 and the provisions of Section 16 of R.A. No. 8791, sanctions shall be imposed on Bangko Sentral-supervised FIs for failure to comply with the provisions of this Section and for non-disclosure or misrepresentation of information, as follows:

a. *On the issuing bank*

- (1) Suspension of its authority to issue remaining tranches, if any;
- (2) Disqualification from future issuance of UnSD;
- (3) Disqualification of all outstanding issues as eligible Tier 2 capital; and
- (4) Monetary penalty of P30,000 for each violation.

b. *On the underwriter/arranger*

- (1) Disqualification from being underwriter/arranger for three (3) years; and
- (2) Monetary penalty of P30,000 for each violation.

c. *On the UnSD registry*

- (1) Disqualification from being appointed as UnSD Registry for three (3) years; and
- (2) Monetary penalty of P30,000 for each violation.

d. *On the selling agent/market maker*

- (1) Disqualification from being appointed as selling agent or market maker for three (3) years; and
- and
- (2) Monetary penalty of P30,000 for each violation.

e. *On the public trustee*

- (1) Disqualification from being appointed as public trustee for three (3) years; and
- (2) Monetary penalty of P30,000 for each violation.

f. *On the certifying officer* - A fine of P5,000 per day from the time of required disclosure up to the time disclosure was made, or from the time misrepresentation was made up to the time the information was corrected, and a possible disqualification if warranted by the gravity of the offense committed.

g. *On the responsible officer* - A fine of P30,000 for participating in or tolerating the non-disclosure or misrepresentation of information, and a possible disqualification if warranted by the gravity of the offense committed.

FIs not supervised by the Bangko Sentral acting as selling agent and/or market maker of UnSDs and/or its concerned directors/officers that are found to violate rules and regulations in the performance of their functions/responsibilities shall be subject to the provisions of Section 36 of R.A. No. 7653 and shall, likewise, be referred to the SEC for appropriate action.

***Interim Tier 1 capital for banks under rehabilitation.*** The following are the guidelines on the issuance of capital notes that will qualify as interim Tier 1 capital for banks under rehabilitation:

a. Banks under rehabilitation shall be allowed, upon prior Bangko Sentral approval, to issue capital notes that shall qualify as interim Tier 1 capital: *Provided*, That the PDIC shall be the holder of the said capital notes: *Provided, further*, That any transfer from PDIC of said capital notes shall require prior Bangko Sentral approval.

b. The interim Tier 1 capital notes shall have the following minimum features:

- (1) It must be perpetual, unsecured and subordinated;

- (2) It must be issued and fully paid-up. Only the net proceeds received from the issuance shall be included as Tier 1 capital. The proceeds of the issuance must be immediately available without limitation to the bank;
- (3) It must neither be secured nor covered by a guarantee of the issuer or related party or other arrangement that legally or economically enhances the priority of the claim of the PDIC as against depositors, other creditors of the bank and holders of LT2 and UT2 capital instruments;
- (4) The PDIC, as holder of the interim capital notes must not have a priority claim, in respect of its principal and coupon payments of the interim Tier 1 capital notes in the event of winding up of the bank, which is higher than or equal with that of depositors, other creditors of the bank and holders of LT2 (e.g., limited life redeemable preferred stock) and UT2 (e.g., perpetual and cumulative preferred stock) capital instruments. The PDIC must waive its right to set-off any amount it owes the bank against any subordinated amount owed to it due to the interim Tier 1 capital notes;
- (5) It must not be repayable without the prior approval of the Bangko Sentral: *Provided*, That repayment may be allowed only in connection with a call option after a minimum of five (5) years from issue date: *Provided, however*, That a call option may be exercised within the first five (5) years from issue date upon entry of new investors: *Provided, further*, That such repayment prior to maturity shall be approved by the Bangko Sentral only if it is simultaneously replaced with issues of new capital which is neither smaller in size nor of lower quality than the original issue, unless the bank's capital ratio remains more than adequate after redemption.

It must not contain any clause, which requires acceleration of payment of principal, except in the event of insolvency. The agreement governing its issuance must not contain any provision that mandates or creates an incentive for the bank to repay the outstanding principal of the interim Tier 1 capital notes, e.g., a cross-default or negative pledge or a restrictive covenant, other than a call option, which may be exercised by the bank;

- (6) The PDIC, as holder of the interim Tier 1 capital notes, shall have the right to convert, upon prior notice to the Bangko Sentral, the interim Tier 1 capital notes into perpetual and non-cumulative preferred shares convertible into common shares which may be sold to new investors: *Provided*, That the rate of conversion shall be fixed at the time of subscription of the interim Tier 1 capital notes;
- (7) The coupons must be non-cumulative;

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- (8) The bank must have full discretion over the amount and timing of coupon payments and it must have full control and access to waived payments;
  - (9) Any coupon to be paid must be paid only to the extent that the bank has profits distributable determined in accordance with existing Bangko Sentral regulations. The coupon rate, or the formulation for calculating coupon payments must be fixed at the time of issuance of the interim Tier 1 capital notes and must not be linked to the credit standing of the bank;
  - (10) It must not have step-up provisions in the coupon rate in conjunction with the call option;
  - (11) other transactions involving the capital notes shall require prior Bangko Sentral approval.
- c. The bank must submit a written opinion from its external auditor that the features of the interim Tier 1 capital notes shall be accounted for as equity instruments in accordance with PAS 32.

*(Circular No. 1011 dated 14 August 2018)*