

## 242 DEPOSIT SUBSTITUTE INSTRUMENTS

Any deposit substitute transaction by a bank performing quasi-banking functions shall be limited to its own promissory notes, repurchase agreements, and certificates of assignment/participation with recourse.

**Prohibition against use of acceptances, bills of exchange and trust certificates.** Acceptances, bills of exchange, and trust certificates shall not be used by banks as evidence of deposit substitute liabilities in connection with their quasi-banking functions. This prohibition shall not apply to the acceptance or negotiation of bills of exchange in connection with trade transactions, or to the issuance of trust certificates creating trust relationships.

**Negotiation of promissory notes.** Negotiable promissory notes acquired by banks in connection with their quasi-banking functions shall not be negotiated by mere endorsements and/or delivery, if they do not conform with the minimum features prescribed under this Section. If these notes do not contain the features, their negotiation shall be covered by any of the appropriate deposit substitute instruments abovementioned.

**Minimum features.** Deposit substitute instruments issued by entities performing quasi-banking functions shall have the following minimum features:

- a. The present value and maturity value and/or the principal amount and interest rate and such other information as may be necessary to enable the parties to determine the cost or yield of the borrowing or placement shall be specified.
- b. The date of issuance shall be indicated at the upper right corner of the instrument, and directly below which shall be the maturity period or the word “demand”, if it is a demand instrument.
- c. The payee may be identified by his trust account/deposit account number in both negotiable and non-negotiable instruments.
- d. Securities which are the subject of a repurchase agreement or a certificate of assignment/participation with recourse, shall be particularly described on the face of said instruments or on a separate instrument attached and specifically referred to therein and made an integral part thereof as to the maker, value, maturity, serial number, and such other particulars as shall clearly identify the securities.
- e. The instrument shall provide for the payment of liquidated damages, in addition to stipulated interest, in case of default by the maker or issuer, as well as attorney’s fees and costs of

collection in case of suit.

- f. A conspicuous notice at the lower center margin of the face of the instrument that the transaction is not insured by the PDIC shall be indicated.
- g. The corporate name of the issuer shall be printed at the upper center margin of the instrument and directly below which shall be a designation of the instrument, such as *"Promissory Note"* or *"Repurchase Agreement"*.
- h. The words *"duly authorized officer"* shall be placed directly below the signature of the person signing for the maker or issuer.
- i. Each instrument shall be serially pre-numbered.
- j. The copy delivered to the payee shall bear the word *"Original"* and the copies retained by the issuer shall be identified as *"Duplicate"*, *"File Copy"* or words of similar import.
- k. Only security paper with adequate safeguards against alteration or falsification shall be used.

Borrowings of banks from the loans and discounts window of other banks or non-bank financial intermediaries shall be exempted from the documentation requirements prescribed in this Section: *Provided*, That the exemption from the documentation requirements prescribed in this Section shall not be construed or interpreted as exempting said borrowings from other regulations standardizing deposit substitute instruments and from other Bangko Sentral regulations on deposit substitutes.

Deposit substitute instruments shall conform to the language prescribed by the Bangko Sentral. Any substantial deviation there from or any additional stipulation therein shall be referred to the Bangko Sentral for prior approval. The size and appearance of these instruments shall not be similar to the size and appearance of checks. Rubber stamping, typewriting or handwriting some provisions shall not be considered compliance with said regulations. (Shown in *Appendix 12* are the samples of standardized instruments as evidence of deposit substitute liabilities.)

***Interbank loan transactions.*** Except for interbank borrowings which are settled through the banks' respective DDAs with the Bangko Sentral via PhilPaSS, all interbank borrowings shall be evidenced by deposit substitute instruments containing the minimum features prescribed in this Section.

#### ***Delivery of securities***

- a. Securities, warehouse receipts, quedans and other documents of title which are the subject of

quasi-banking functions, such as repurchase agreements, shall be delivered to a Bangko Sentral accredited securities custodian or an SEC authorized central securities depository in accordance with the guidelines set forth in *Appendix 73*. The securities custodian shall hold the securities in the name of the borrower/seller, but shall keep said securities segregated from the proprietary securities account of the borrower/seller if the borrower/seller has an existing securities account with the custodian: *Provided*, That a bank authorized by the Bangko Sentral to perform custodianship function may not be allowed to be custodian of securities issued or owned by said bank, its subsidiaries or affiliates, or of securities in bearer form.

The delivery shall be effected upon payment and shall be evidenced by a securities delivery receipt duly signed by authorized officers of the custodian and delivered to both the lender/purchaser and seller/borrower.

*Sanctions*. Violation of any provision of Item “a” shall be subject to the following sanctions/penalties:

(1) *Monetary penalties*

*First offense* – Fine of P10,000 a day for each violation reckoned from the date the violation was committed up to the date it was corrected.

*Subsequent offenses* – Fine of P20,000 a day for each violation reckoned from the date the violation was committed up to the date it was corrected.

(2) *Other sanctions*

*First offense* – Reprimand for the directors/officers responsible for the violation.

*Subsequent offense* –

- (a) Suspension for ninety (90) days without pay of directors/officers responsible for the violation;
- (b) Suspension or revocation of the accreditation to perform custodianship function;
- (c) Suspension or revocation of the authority to engage in quasi-banking function; and/or
- (d) Suspension or revocation of the authority to engage in trust and other fiduciary business.

- b. The guidelines to implement the delivery by the seller of securities to the buyer or to his designated securities custodian or central securities depository are shown in *Appendix 73*.

The guidelines on the delivery of government securities to the investor's principal securities account with the Registry of Scripless Securities (RoSS) are in *Appendix 74*.

**Sanctions.** Without prejudice to the penal and administrative sanctions provided for under Sections 36 and 37, respectively of R.A. No. 7653 (The New Central Bank Act), violation of any provision of the guidelines in *Appendix 73* shall be subject to the following sanctions/penalties depending on the gravity of the offense:

a. *First offense*

- (1) Fine of up to P10,000 a day for the institution for each violation reckoned from the date the violation was committed up to the date it was corrected; and
- (2) Reprimand for the directors/officers responsible for the violation.

b. *Second offense*

- (1) Fine of up to P20,000 a day for the institution for each violation reckoned from the date the violation was committed up to the date it was corrected; and
- (2) Suspension for ninety (90) days without pay of directors/officers responsible for the violation.

c. *Subsequent offenses*

- (1) Fine of up to P30,000 a day for the institution for each violation from the date the violation was committed up to the date it was corrected;
- (2) Suspension or revocation of the authority to act as securities custodian and/or registry; and
- (3) Suspension for 120 days without pay of the directors/officers responsible for the violation.

***Other rules and regulations governing the issuance and treatment of deposit substitute instruments***

- a. If there is any stipulation that payment of the deposit substitute shall be chargeable against a particular deposit account, it shall further provide that the liability of the maker or issuer of the instrument shall not be limited to the outstanding balance of said account.
- b. Any agreement allowing the issuer or maker to substitute the underlying securities shall further provide that the actual substitution shall be with the prior written consent of the payee.
- c. Automatic renewal upon maturity of the instrument may be effected only under terms and conditions previously stipulated by the parties.

- d. Stipulations between the maker or issuer and the payee which are embodied in separate instruments shall be specifically referred to in the deposit substitute instruments and made an integral part thereof.
- e. In the case of repurchase agreements and certificates of assignment/participation with recourse, the stipulation shall clearly state either (1) that the underlying securities are being delivered to the buyer or assignee as collaterals or (2) that the ownership thereof is being transferred to the buyer or assignee.
- f. The regulations on interbank loan transactions prescribed in Sec. 315 shall also apply to interbank borrowings.

**Repurchase agreements covering government securities, commercial papers and other negotiable and non-negotiable securities or instruments.** The following regulations shall govern repurchase agreements covering government securities, commercial papers and other negotiable and non-negotiable securities or instruments of banks as well as sale on a without recourse basis of said securities by banks.

*a. Proper recording and documentation of repurchase agreements.*

Banks shall have a true and accurate account, record or statement of their daily transactions. As such, repurchase agreements covering government securities, commercial papers and other negotiable and non-negotiable securities or instruments must be properly recorded and documented in accordance with existing Bangko Sentral regulations.

The absence of proper documentation for repurchase agreements is tantamount to willful omission of entries relevant to any transaction, which shall be a ground for the imposition of administrative sanctions and the disqualification from office of any director or officer responsible therefor under existing laws and regulations.

*b. Responsibilities of the chief executive officer (CEO) or officer of equivalent rank*

It shall be the responsibility of the CEO or the officer of equivalent rank in a bank to:

- (1) Institute policies and procedures to prevent undocumented or improperly documented repurchase agreements covering government securities, commercial papers and other negotiable and non-negotiable securities or instruments;
- (2) Ascertain and ensure that the bank did not enter into a repurchase agreement covering

government securities, commercial papers and other negotiable and non-negotiable securities or instruments that are not documented in accordance with existing Bangko Sentral regulations and that the bank has strictly complied with the pertinent rules of the SEC and the Bangko Sentral on the proper sale of securities to the public and performed the necessary representations and disclosures on the securities particularly the following:

- (a) Informed the clients that such securities are not deposits and as such, do not benefit from any insurance otherwise applicable to deposits such as, but not limited to, R.A. No. 3591, as amended, otherwise known as the PDIC law;
- (b) Informed and explained to the client all the basic features of the security being sold on a without recourse basis, such as but not limited to:
  - (i) issuer and its financial conditions;
  - (ii) term and maturity date;
  - (iii) applicable interest rate and its computation;
  - (iv) tax features (whether taxable, tax paid or tax-exempt);
  - (v) risk factors and investment considerations;
  - (vi) liquidity feature of the instrument:
    - (aa) procedures for selling the security in the secondary market (e.g., OTC or exchange);
    - (bb) authorized selling agents; and
    - (cc) minimum selling lots.
  - (vii) disposition of the security:
    - (aa) registry (address and contact numbers);
    - (bb) functions of the registry; and
    - (cc) pertinent registry rules and procedures.
  - (viii) collecting and paying agent of the interest and principal; and
  - (ix) other pertinent terms and conditions of the security and if possible, a copy of the prospectus or information sheet of the security.
- (c) Informed the client that pursuant to Secs. 242 (*Delivery of securities*) and 245 (*Delivery of securities*):
  - (i) Securities sold under repurchase agreements shall be delivered in accordance with the guidelines set forth in *Appendix 73*; and

(ii) Securities sold on a without recourse basis are required to be delivered in accordance with the guidelines set forth in *Appendix 73*.

(d) Clearly stated to the client that:

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

(ii) The bank is not performing any advisory or fiduciary function.

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

c. *Treatment as Deposit Substitutes*. All sales of government securities, commercial papers and other negotiable and non-negotiable securities or instruments that are not documented in accordance with existing Bangko Sentral regulations shall be deemed to be deposit substitutes subject to regular reserves.

d. *Sanctions*. The Monetary Board may, at its evaluation and discretion, impose any or all of the following sanctions to a bank or the director/s or officer/s found to be responsible for repurchase agreements covering government securities, commercial papers and other negotiable and non-negotiable securities or instruments that are not documented in accordance with existing Bangko Sentral regulations:

- (1) Fine of up to P30,000 a day to the concerned entity for each violation from the date the violation was committed up to the date it was corrected;
- (2) Suspension of interbank clearing privileges/immediate exclusion from clearing;
- (3) Suspension of access to Bangko Sentral rediscounting facilities;
- (4) Suspension of lending or foreign exchange operations or authority to accept new deposits or make new investments;
- (5) Revocation of quasi-banking license;
- (6) Revocation of authority to perform trust operations; and
- (7) Suspension for 120 days without pay of the directors/officers responsible for the violation.

*(Circular Nos. 873 dated 25 March 2015 and 870 dated 20 February 2015)*