GUIDELINES FOR THE TREATMENT OF NON-DELIVERABLE FORWARDS INVOLVING THE PHILIPPINE PESO

(Appendix to Sec. 622 on Non-deliverable Forward Contracts Involving the Philippine Peso)

Statement of Policy. The Bangko Sentral ng Pilipinas is cognizant that Non-Deliverable Forwards (NDFs) may, directly or indirectly, create system-wide risks even if there is no delivery of principal amounts and even when NDFs are used as a hedge. To mitigate the buildup of systemic risks and protect against undue concentration in market usage, the following prudential guidelines are set in place.

Definition of Terms. As used in this Appendix, the following terms are defined accordingly:

a) *Peso Non-Deliverable Forwards (Peso NDFs)* – refers to a forward foreign exchange (FX) contract involving the value of the Philippine peso against a foreign currency at a specified maturity date on an agreed notional amount. Only the net difference between the contracted forward exchange rate and the spot exchange rate between the Philippine peso and the foreign currency at the fixing date shall be settled. NDFs may be transacted by a bank with offshore or onshore counterparties.

b) *Peso NDF Purchase with Non-Residents* – refers to an NDF contract undertaken by the bank with a non-resident counterparty to receive foreign currency at an agreed forward exchange rate with the Philippine peso over a specified tenor.

c) *Peso NDF Sale with Non-Residents* – refers to an NDF contract undertaken by the bank with a non-resident counterparty to deliver foreign currency at an agreed forward exchange rate with the Philippine peso over a specified tenor.

d) *Onshore Non-Deliverable Forward* – refers to an NDF contract undertaken by the bank with a resident counterparty. It may be an NDF purchase or an NDF sale. All NDF contracts with residents shall be settled in Philippine pesos.

e) *Fixing Date* – refers to the date at which the difference between the prevailing market exchange rate and the agreed upon exchange rate or the reference rate is calculated. NDF contracts shall not be pre- terminated before their fixing date.

f) *Settlement Date* – refers to the date by which the payment of the difference is due to the party receiving payment.

Licensing Requirement. A bank must secure a Type 2 derivatives license before it can act as a dealer and/or broker of any NDF contract. The bank must likewise continuously comply with the provisions in *Appendix 25* (Risk Management Guidelines for Derivatives) and *Appendix 22* (Sales and Marketing Guidelines for Derivatives).

A bank duly authorized to transact in and has outstanding exposures of NDF contracts but subsequently has been found to be in breach of:

a) the requirements of a Type 2 derivatives license;

b) the provisions of *Appendix 22* (Risk Management Guidelines for Derivatives);

c) the provisions of *Appendix 26* (Sales and Marketing Guidelines for Derivatives) is immediately prohibited from entering into further NDF transactions. Within five (5) banking days, the bank shall present to the appropriate supervising department of the Bangko Sentral a formal plan that will remedy the cited deficiencies and achieve the plan's objectives within a reasonable period. If the remedial plan is deemed unacceptable by the appropriate supervising department of the Bangko Sentral, the bank shall be directed to close all of its outstanding positions within two (2) months.

Bank Limits on Peso NDF Exposures. To mitigate any potential build-up of systemic risks, bank's total gross exposures to all forms of Peso NDF transactions, *i.e., the sum of sales and purchases for both onshore and offshore transactions,* shall be limited to a fixed percentage of the bank's capital base. Unless otherwise amended, the said limit is twenty percent (20%) of unimpaired capital for domestic banks. Foreign bank branches shall have a limit equal to 100 percent of their unimpaired capital as defined under Sec. 103 (*Capital Requirements*).

Bilateral Netting. A bank which has purchase and sell positions against counterparty which are maturing at the same fixing date may consolidate said positions for the purpose of bilateral net settlement.

Reportorial Requirements. All NDF transactions shall be covered by the appropriate reports prescribed by the supervising sector of the Bangko Sentral.

Sanctions. Any violation of the foregoing provisions shall constitute grounds for the imposition on the bank of the following:

a. *First Offense*

i. Reprimand for the directors/officers responsible for the violation with a warning that subsequent violations will be subject to more severe sanctions.

ii. Banks in breach of the limits shall be required to submit remedial plan to comply with the limits.

b. *Subsequent Offense* – Bank will be subject to any or all of the following, as may be recommended by the SES to the Monetary Board:

i. Restriction or prohibition on the bank from requesting new authority and/or licenses of any sort;

ii. Restriction or prohibition on the bank from declaring dividends; and

iii. Issuance of an order requiring the bank to cease and desist from conducting business in an unsafe and unsound manner and may further order that immediate action be taken to correct the conditions resulting from such unsafe or unsound banking.

Transitory Provisions. Banks which are in excess of the NDF exposure limits shall be given two (2) months from 26 March 2013 to comply with the prescribed limits.

However, banks with Peso NDF exposures as of 26 March 2013 but do not have at least a Type 2 derivatives license are not allowed to enter into further Peso NDF exposures except to close out said positions. Banks must demonstrate to the appropriate supervising department of the Bangko Sentral that transactions under this situation are meant to directly square existing positions.