

**INSTRUCTIONS FOR ACCOMPLISHING THE REPORT ON COMPUTATION OF THE
ADJUSTED RISK-BASED CAPITAL ADEQUACY RATIO COVERING COMBINED CREDIT
RISK AND MARKET RISK
(For Universal Banks and Commercial Banks with Expanded Derivatives Authority
but Without Options Transactions)
(Appendix to Sec. 125 on Market risk capital requirement)**

General Instructions

1. All UBs and KBs are required to complete this Report both on a solo basis (i.e., head office plus branches) and on a consolidated basis (i.e., parent bank plus subsidiary financial allied undertakings, but excluding insurance companies).
2. The Report should be submitted as follows:
 - (a) Solo report – within fifteen (15) banking days after the end of each reference quarter; and
 - (b) Consolidated report – within thirty (30) banking days after the end of each reference quarter.
3. Current market value should be used for reporting. For leveraged instruments where the apparent notional amount differs from the effective notional amount, the bank should use the effective notional amount in calculating the market value for reporting, e.g., a swap contract with a stated notional amount of PHP1.0 million, the terms of which call for a quarterly settlement of the difference between five percent (5%) and PHIBOR multiplied by 10 has an effective notional amount of PHP10.0 million.
4. Securities transactions are to be reported on a “trade date” basis.

Definitions and Clarifications

5. Market risk is defined as the risk of losses in on- and off-balance sheet positions arising from movements in market prices. The risks subject to this reporting requirement are:
 - (a) the risks pertaining to interest rate- related instruments and equities in the bank’s trading book; and
 - (b) foreign exchange risk throughout the bank.

The Report should include the reporting bank’s positions in on-balance sheet financial instruments and off-balance sheet derivatives, the latter being defined as financial contracts whose values depend on the values of one or more underlying assets or indices.

6. For the purpose of the Report, the trading book of a bank shall consist of:
- (a) its proprietary positions in financial instruments which are taken on with the intention of short-term resale or benefiting in the short term from actual or expected differences between the buying and selling prices or from other price or interest rate variations;
 - (b) positions which arise from the execution of trade orders from customers and market making;
and
 - (c) positions taken in order to hedge other elements of the trading book.
7. The financial instruments referred to in the preceding paragraph include:
- (a) (i) transferable securities;
(ii) units in collective investment undertakings;
 - (b) certificates of deposit and other similar capital market instruments;
 - (c) financial futures contracts;
 - (d) forward contracts including forward rate agreements; and
 - (e) swaps.
8. Banks are expected to have an established policy for allocating transactions (including internal deals) to the trading or non-trading (i.e., banking) book, as well as procedures to ensure compliance with such policy. There must be a clear audit trail at the time each transaction is entered into and the Bangko Sentral will examine the adequacy of such policy and procedures and their consistent implementation when it is considered necessary. For this purpose, banks which engage in trading activities should submit to the Bangko Sentral a policy statement covering:
- (a) the definition of trading activities;
 - (b) the financial instruments which can be traded or used for hedging the trading book portfolio;
and
 - (c) the principles for transferring positions between the trading and the banking books.
9. In general, the Bangko Sentral will have regard to the bank's intention in entering into a particular transaction when determining whether such transaction should fall into the trading book. Transactions will likely be considered to carry a trading intent on the part of the bank if:
- (a) the positions arising from the transactions are marked to market on a daily basis as part of the internal risk management process;

- (b) the positions are not (or not intended to be) held to maturity; and
 - (c) the positions satisfy other criteria the bank applies to its trading portfolio on a consistent basis.
10. Debt securities include both fixed-rate and floating-rate instruments, negotiable certificates of deposit, non-convertible preference shares, and also convertible bonds (i.e., debt issues or preference shares that are convertible, at a stated price, into common shares of the issuer) which trade like debt securities. Debt related derivatives include bond futures.
 11. Interest rate derivatives include all derivatives contracts and off-balance sheet instruments which react to changes in interest rates, e.g., interest rate futures, forward rate agreements (FRAs), interest rate and cross currency swaps, and forward foreign exchange positions.
 12. Detailed offsetting rules applicable to the reporting of positions are set out in the relevant parts of Specific Instructions. These offsetting rules can be applied on both the solo and consolidated basis, provided that in the latter case there are no obstacles to the quick repatriation of profits from a foreign subsidiary to the Philippines and the bank performs daily management of risks on a consolidated basis. For this purpose, offsetting means the exclusion of matched positions of a bank from reporting and hence exclusion of such positions from the calculation of the adjusted capital adequacy ratio.
 13. For avoidance of doubt, items that are deductible from the qualifying capital of the bank in the calculation of the risk-based capital adequacy ratio pursuant to applicable and existing capital adequacy framework are excluded from market risk capital requirement.
 14. In general, banks are only required to complete Parts I to III and V of the Report. Banks which have obtained the Bangko Sentral's approval to adopt their internal value-at-risk (VaR) models to calculate their market risk capital charge (in all or individual risk categories) should complete Part IV (in lieu of Parts I to III). Where the internal model is used to calculate only selected risk categories, the capital charge for the risk categories measured under the internal models approach should be reported in Part IV while that for the other risk categories measured under the standardized approach should be reported in the relevant sections of Parts I to III. This combination of the standardized approach and the internal models approach is allowed on a transitional basis. Banks which adopt the internal models approach will not be permitted, save in exceptional circumstances, to revert to the standardized approach.

Specific Instructions

Part I Interest Rate Exposures

1. Debt securities and debt related derivatives - specific risk

15. Report in this part the long and short positions in debt securities and debt derivatives (e.g., bond futures) in the trading book by category of the issuer. Offsetting will be allowed between long and short positions in identical issues (including positions in derivatives) with exactly the same issuer, coupon, currency and maturity. For items 1.4 to 1.7 of the Report, positions should be slotted into the appropriate time bands according to the residual maturities of the debt securities (or the underlying securities in case of debt derivatives). (Refer to examples (1) and (2) in Annex A).
16. A security, which is the subject of a repurchase agreement, will be treated as if it were still owned by the seller of the security, i.e., to be reported by the seller. This principle applies also in Part 1.2 of the Report. Commitments to buy and sell securities should be reported as long and short positions, respectively.
17. Foreign countries, foreign incorporated banks and Philippine incorporated banks/QBs with the “highest credit quality”, as well as debt securities with the “highest credit quality” refer to ratees/debt securities given the minimum credit ratings as indicated below by any two of the following internationally accepted rating agencies:

<u>Rating Agency</u>	<u>Credit Rating</u>
(a) Moody’s	“Aa3” and above
(b) Standard and Poor’s	“AA-” and above
(c) Fitch IBCA	“AA-” and above

and such other recognized international rating agencies as may be approved by the Monetary Board.

The ratings of domestic rating agencies may likewise be used for this purpose provided that such rating agencies meet the criteria to be prescribed by the Monetary Board.

18. Multilateral development banks refer to the World Bank Group comprised of the International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC), the Asian Development Bank (ADB), the African Development Bank (AfDB), the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IADB), the European Investment Bank (EIB); the Nordic Investment Bank (NIB); the Caribbean Development Bank (CDB), the Council of Europe Development Bank (CEDB) and such others as may be recognized by the Bangko Sentral.
19. Non-central government public sector entities of a foreign country refer to entities which are

regarded as such by a recognized banking supervisory authority in the country in which they are incorporated.

2. Debt securities, debt related derivatives and interest rate derivatives - general market risk

20. Report in this part the long and short trading book positions in debt securities and debt derivatives described above, as well as interest rate derivatives. Report also interest rate exposures arising from futures contracts and forward positions in equities. A Maturity Method is adopted for the reporting of these positions as detailed below. Banks that possess the necessary capability to calculate the duration and price sensitivity of each position separately and wish to adopt such a duration approach for reporting in this part may seek approval from Banko Sentral.
21. Positions should be reported separately for each currency, i.e., banks should use separate sheets (Part I.2 of the Report) to report positions of different currencies. The unadjusted market risk capital charge is then calculated for each currency according to procedures set out in paragraphs 31 to 34 with no offsetting between different currencies.
22. Under the Maturity Method, positions are slotted into the time bands of the maturity ladder (as shown in Part I.2 of the Report) by remaining maturity if fixed rate and by the period to the next repricing date if floating rate. (Refer to examples (1) and (2) in Annex A). Derivatives should be treated as combinations of long and short positions. The maturity of an interest rate future or a forward rate agreement will be the period until delivery or exercise of the contract, plus - where applicable - the life of the underlying instrument. For example, a long position in a June 3-month interest rate future taken in December is to be reported at end of December as a long position in a zero coupon government security in that particular currency with a maturity of 9 months and a short position in a zero coupon government security with a maturity of 6 months. (Refer to examples (5) and (6) in Annex A). The market values of the two positions should be reported. For forward foreign exchange positions in the trading book, they should be treated as long and as short positions in a zero coupon government security of the 2 currencies with the same maturity as the forward contract. (Refer to example (7) in Annex A).
23. For a bond future, where a range of deliverable instruments may be delivered to fulfill the contract, the bank has flexibility to elect which deliverable security goes into the maturity ladder but should take account of any conversion factor defined by the exchange. A two-leg approach will be adopted similar to the above. A long bond future will be taken as a long position in a deliverable bond and a short position in a zero coupon security maturing at the future's delivery date. For example, a long futures contract on a 5 year fixed rate security with delivery 3 months from the reporting date will be reported as a long position in say, a 5.25 year security, i.e., a

specific security which is within the range of deliverables under the futures contract (as opposed to a notional/ theoretical security), and a short position in a 3 months zero coupon security. (Refer to example (3) in Annex A).

The amount to be reported in the above example for both legs will be the contract face value divided by the relevant conversion factor and multiplied by the current cash price of the selected deliverable bond. A forward bond transaction (i.e., with a settlement period longer than the market norm) will be treated similarly, i.e., a long bond forward will be reported as long position in the bond and a short position in a zero coupon security up to the forward delivery date. The current market value (at spot price) of the bond should be reported.

24. Swaps will be treated as two positions in securities with the relevant maturities. For example, an interest rate swap under which a bank is receiving floating rate interest and paying fixed will be treated as a long position in a floating rate instrument of maturity equivalent to the period until the next interest fixing and a short position in a fixed-rate instrument of maturity equivalent to the residual life of the swap. The market values of the 2 instruments should be reported. (Refer to example (4) in Annex A). For swaps that pay or receive a fixed or floating interest rate against some other reference price, e.g., an equity price, the interest rate component should be slotted into the appropriate maturity category, with the equity component being included in the equity framework. The separate legs of cross- currency swaps are to be reported in the relevant maturity ladders for the currencies concerned. (Refer to example (10) in Annex A).

25. As with the reporting under Part I.1 of the Report, banks can offset long and short positions in identical instruments with exactly the same issuer, coupon, currency and maturity for general market risk purposes. Similarly, a matched position in a futures or forward contract and its underlying may be fully offset. However, the leg representing the time to expiry of the futures or forward contract should be reported.

For example, a bank has a long position in a particular bond and sells forward (i.e., beyond the normal settlement period for the security) such a bond as at the reporting date. The long and short positions in the bond can be offset but a long position in a (notional) zero coupon security with maturity at the forward delivery date should be reported, at the current market value of the bond. Similarly, if the bank has a short position in a bond future and a long position in the underlying bond, such positions can be offset. A long position up to the future's delivery date should, however, be reported.

When the futures contract comprises a range of deliverable instruments, offsetting of positions in the futures contract and its underlying is only permissible in cases where there is a readily identifiable underlying security which is most profitable for the trader with a short

position to deliver, i.e., the “cheapest to deliver”. This means that offsetting is only permitted between a short future and a long bond, not between a long future and a short bond; and the long bond must be the one that is “cheapest to deliver”. The amount to be reported for the remaining long position up to the futures contract’s delivery date will be the face value of the contract divided by the relevant conversion factor and multiplied by the current spot price of the “cheapest to deliver” bond.

26. Opposite positions in the same category of derivatives instruments can in certain circumstances be regarded as matched and allowed to offset fully. The separate legs of different swaps may also be “matched” subject to the same conditions. To qualify for this treatment, the positions must relate to the same underlying instruments, be of the same nominal value and be denominated in the same currency. In addition:

(a) for futures: offsetting positions in the notional or underlying instruments to which the futures contract relates must be for identical products and mature within 7 days of each other;

(b) for swaps and forward rate agreements (FRAs): the reference rate (for floating rate positions) must be identical and the coupon closely matched (i.e., within 15 basis points); and

(c) for swaps, FRAs and forwards: the next interest fixing date or, for fixed coupon positions or forwards, the residual maturity must correspond within the following limits:

- if either of the instruments for offsetting has an interest fixing date or residual maturity up to 1 month, the interest fixing date or residual maturity must be the same for both instruments;
- if either of the instruments for offsetting has an interest fixing date or residual maturity greater than 1 month and up to 1 year, those dates or residual maturities must be within 7 days of each other; and
- if either of the instruments for offsetting has an interest fixing date or residual maturity over 1 year, those dates or residual maturities must be within 30 days of each other.

For example, a bought and a sold FRA in the same currency with the same face value and settlement date as well as notional deposit maturity date can be offset against each other and excluded from reporting if the contract rates are within 15 basis points of each other. Similarly, opposite swap positions in the same currency with the same face value and reference dates can be offset if, say, the floating rate in both cases is 6 months PHIBOR and the fixed rates are within 15 basis points of each other. The positions can still be offset if the reference dates (i. e., the

next interest fixing date or remaining maturity) of the opposite positions are different but within the range as set out in (c) above. Opposite bond futures can, for example, be offset against each other if the deliverable bonds are of the same type and mature within 7 days of each other.

27. Banks with the necessary expertise and systems may use alternative formulae (the so called “pre-processing” techniques) to calculate the positions to be included in the maturity ladder. This applies to all interest rate sensitive positions, arising from both physical and derivative instruments.

One method is to first convert the payments required under each transaction into their present values. For that purpose, each cash flow should be discounted using zero- coupon yields. A single net figure of all of the cash flows within each time band may be reported. Banks wishing to adopt this or other methods for reporting should seek the Bangko Sentral’s prior approval. The “pre- processing” models would be subject to review by the Bangko Sentral.

Calculation of capital charges for interest rate exposures reported in Part I

28. The unadjusted minimum capital requirement is expressed in terms of two separately calculated charges, one applying to the “specific risk” of each trading book position in debt securities or debt derivatives, whether it is a short or long position, and the other to the overall interest rate risk in the trading book portfolio (termed “general market risk”) where long and short positions in different securities or derivatives can be offset subject to certain “disallowances”.

Specific risk

29. The unadjusted specific risk charge is graduated into five broad categories by types of issuer, as follows:

Government and multilateral development banks ¹	0.00%
Qualifying ²	0.25% (residual maturity of 6 months or less)
	1.00% (residual maturity of over 6 months to 24 months)
	1.60% (residual maturity of over 24 months)
LGU bonds ³	4.00%
Others	8.00%

30. Interest rate and currency swaps, FRAs, forward foreign exchange contracts and interest rate futures will not be subject to a specific risk charge. In the case of futures contracts where the

underlying is a debt security, a specific risk charge will apply according to the issuer (and the remaining maturity) as set out in the above paragraph.

General market risk

31. General market risk applies to positions in all debt securities, debt derivatives and interest rate derivatives, subject only to an exemption for fully or very closely matched positions in identical instruments as described in paragraphs 25 to 26 above. The unadjusted capital charge is the sum of the following components:

- (a) the net short or long weighted position in the whole trading book;
- (b) a small proportion of the matched positions in each time band (the “vertical disallowance”);
and
- (c) a larger proportion of the matched positions across different time-bands (the “horizontal disallowance”).

32. In the maturity ladder, first calculate the weighted positions by multiplying the positions reported in each time band by a risk-factor according to the following table:

Table 1

Maturity method: time bands and weights

Coupon 3% or more	Coupon less than 3%	Risk Weight
1 month or less	1 month or less	0.00%
Over 1 month to 3 months	Over 1 month to 3 months	0.20%
Over 3 months to 6 months	Over 3 months to 6 months	0.40%
Over 6 months to 12 months	Over 6 months to 12 months	0.70%
Over 1 year to 2 years	Over 1 year to 1.9 years	1.25%
Over 2 years to 3 years	Over 1.9 years to 2.8 years	1.75%
Over 3 years to 4 years	Over 2.8 years to 3.6 years	2.25%
Over 4 years to 5 years	Over 3.6 years to 4.3 years	2.75%
Over 5 years to 7 years	Over 4.3 years to 5.7 years	3.25%
Over 7 years to 10 years	Over 5.7 years to 7.3 years	3.75%
Over 10 years to 15 years	Over 7.3 years to 9.3 years	4.50%
Over 15 years to 20 years	Over 9.3 years to 10.6 years	5.25%

Over 20 years	Over 10.6 years to 12 years	6.00%
	Over 12 years to 20 years	8.00%
	Over 20 years	12.50%

Maturity method: time bands and weights

33. The weighted longs and shorts in each time band will be offset resulting in a single short or long position for each band. A 10% capital charge (“vertical disallowance”) will be levied on the smaller of the offsetting positions, be it long or short. Thus, if the sum of the weighted longs in a time band is P100.0 million and the sum of the weighted shorts is P90.0 million, the vertical disallowance would be 10% of P90.0 million (i.e., P9.0 million).
34. Two rounds of “horizontal offsetting” will then be conducted, first between the net positions in each of 3 zones (zero to 1 year, over 1 year to 4 years and over 4 years), and subsequently between the net positions in the 3 different zones. The offsetting will be subject to a scale of disallowances expressed as a fraction of the matched positions, as set out in Table 2 below. The weighted long and short positions in each of 3 zones may be offset, subject to the matched portion attracting a disallowance factor that is part of the capital charge. The residual net position in each zone may be carried over and offset against opposite positions in other zones, subject to a second set of disallowance factors.

Table 2: Horizontal disallowance

Zones	Time-band	Within the zone	Between adjacent zones	Between zones 1 and 3
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Zone 1	1 month or less	40%	40%	100%				
	Over 1 month to 3 months							
	Over 3 month to 6 months							
	Over 6 months to 12 months							
Zone 2	Over 1 year to 2 years	30%			40%			
	Over 2 years to 3 years							
	Over 3 years to 4 years							
Zone 3	Over 4 years to 5 years	30%					40%	
	Over 5 years to 6 years							
	Over 6 years to 7 years							
	Over 7 years to 10 years							
	Over 10 years to 15 years							
	Over 15 years to 20 years							
	Over 20 years							

Part II Equity Exposures

35. Report in this part the long and short positions in equities and equity derivatives in the trading book, including instruments that exhibit market behavior similar to equities. The instruments covered include common stock (whether voting or non-voting), convertible bonds (i.e., debt issues or preference shares that are convertible, at a stated price, into common shares of the issuer) which trade like equities and commitments to buy or sell equity securities. For non-convertible preference shares and those convertible bonds which trade like debt securities, they should be reported under Part I. Equity derivatives include forwards, futures and swaps on both individual equities and or stock indices. Long and short positions in the same issue may be reported on a net basis.

36. The positions are to be reported on a market-by-market basis, i.e., under separate columns to

indicate the exchange where the reported equities are listed/traded. For foreign markets, banks should indicate the country where the market is located. (Refer to example (8) in Annex A) Equities with listing in more than one market should be reported as positions in the market of their primary listing.

37. Equity derivatives are to be converted into positions in the relevant underlying. Futures and forward contracts relating to an individual equity should be reported at current market values. Futures relating to equity indices can be reported either as the current index value times the monetary value of one index point set by the exchange, i.e., the “tick” value, or the marked-to-market value of the notional underlying equity portfolio. (Refer to example (9) in Annex A).
38. Matched positions in each identical equity or index (same delivery months) in each market may be fully offset, resulting in a single net short or long position. A future in a given equity may be offset against an opposite cash position in the same equity but the interest rate exposure arising out of the equity futures should be reported in Part I. For example, a short futures contract on a specific stock with delivery 3 months from the reporting date can be offset against a long position in the underlying stock. However, the interest rate exposure arising out of the equity futures should be reported as a long position in the “1 to 3 months” time band of the stock denominated currency in Part I. The position should be reported as the current market value of the stock.
39. An equity swap obligates a bank to receive an amount based on the change in value of a particular equity or equity index and also to pay an amount based on the change in value of a different equity or equity index. Accordingly, the receipt side and the payment side of an equity swap contract should be reported as a long and a short position, respectively. For an equity swap contract which involves a leg relating to a financial instrument other than equities or equity derivatives, for example, receiving/paying a fixed or floating interest rate, the exposure should be slotted into the appropriate maturity band in Part I. Where equities are part of a forward contract (equities to be received or to be delivered), any interest rate exposure from the other leg of the contract should be reported in Part I. The treatment is similar to that set out in paragraph 38. The same arrangement applies for index futures. (Refer to example (9) in Annex A).
40. As with interest rate exposures, the capital charge is levied to separately cover both the specific risk and the general market risk. Calculation is done on an individual market basis. The unadjusted capital charge for specific risk will be 8% on the gross (i.e., long plus short) positions. The unadjusted general market risk charge will be 8% on the net position. Net long and short positions in different markets cannot be offset for the purpose of calculating general market risk

charge.

Part III Foreign Exchange Exposures

41. Report in this part the amount in US dollars (USD) of net long or net short position in each currency. In addition, structural positions taken deliberately to hedge against the effects of exchange rate movements on the capital adequacy of the reporting bank may be excluded. This should be cleared with the Bangko Sentral prior to reporting.
42. Net long/ (short) position shall refer to FX assets (excluding FX items allowed under existing regulations to be excluded from FX assets in the computation of a bank's net FX position limits) less FX liabilities (excluding FX items allowed under existing regulations to be excluded from FX liabilities in the computation of a bank's net FX position limits), plus contingent FX assets less contingent FX liabilities.
43. Banks which base their normal management accounting of forward currency positions on net present values shall use the net present values of each position, discounted using current interest rates, for measuring their positions. Otherwise, forward currency positions shall be measured based on notional amount.
44. The total USD amount of net long or net short position in each currency should then be converted at spot rates into Philippine peso. The overall net open position is the greater of the absolute value of the sum of net long position or sum of net short position.
45. The unadjusted capital charge will be 8% of the overall net open position.

Part IV Internal Models Approach

46. Only those banks which have obtained the Bangko Sentral's approval to adopt their internal value-at-risk (VaR) models to calculate their market risk capital charges in lieu of the standardized methodology are required to report in this part.

1. Value-at-risk results

47. Report in this part the value-at-risk (VaR) results as at the last trading day of the reference quarter in column (a) and the average VaR over the most recent 60 trading days of the reference quarter in column (b), both for each individual market risk category using internal models approach, i.e., item 1.1 to 1.3, and for the aggregate of these risk categories, i.e., item 1.4.

48. Provided that the Bangko Sentral is satisfied with the bank's system for measuring correlations, recognition of empirical correlations across broad risk categories (e.g., interest rates, equity prices and exchange rates) may be allowed. The VaR for the aggregate of all risk categories will therefore not necessarily be equal to an arithmetic sum of the VaR for the individual risk category.
49. Report also in this part the number of backtesting exceptions for the past 250 trading days (from the reference quarter-end going backwards), based on:
- actual daily changes in portfolio value, in item 1.4. column (c), and
 - hypothetical changes in portfolio value that would occur were end-of-day positions to remain unchanged during the 1 day holding period, in item 1.4 column (d), for the aggregate of the broad risk categories.
50. The multiplication factor to be reported in item 1.4 column (e) is the summation of the following 3 elements:
- (a) the minimum multiplication factor of 3;
 - (b) the "plus" factor ranging from 0 to 1 based on the number of backtesting exceptions (i.e., the larger of item 1.4 column (c) or item column (d)) for the past 250 trading days as set out in Table 3 below: and
 - (c) any additional "plus" factor as may be prescribed by the Bangko Sentral.

Table 3
"Plus" factor based on the number of backtesting exceptions for the past 250 trading days

Zone	Number of exceptions	"Plus" factor
Green zone	0	0.00
	1	0.00
	2	0.00
	3	0.00
	4	0.00
Yellow zone	5	0.40
	6	0.50
	7	0.65
	8	0.75
	9	0.85
Red zone	10 or more	1.00

51. Capital charge for general market risk calculated by internal models reported in item 1.6 is larger of:

- (a) Item 1.4 column (a), i.e., VaR for the aggregate of all risk categories, as at the last trading day of the reference quarter; or
- (b) Item 1.5, i.e., the average VaR for the last 60 trading days of the reference quarter (item 1.4 column (b)) times the multiplication factor (item 1.4 column (e)) set out in paragraph 50 above.

2. Specific risk

52. Capital charge for the specific risk of debt securities and other debt related derivatives, and equities and equity derivatives is to be reported using either of the following two methods:

- (a) For banks which incorporate the specific risk into their models, report the capital charge for the total specific risk calculated by the models in item 1.7 of Part IV.1; or
- (b) For banks which do not incorporate the specific risk into their models, report the specific risk of debt securities and other debt related derivatives in Part I.1 according to the instructions in paragraphs 15-19 and 29-30. For equities and equity derivatives, report the specific risk in Part II according to the instructions in paragraphs 35 to 40.

3. Largest daily losses over the quarter

53. Report in this part in descending order (i.e., the largest loss first) the 5 largest daily losses over the reference quarter and their respective VaRs for the risk exposures which are measured by the internal models approach. If the number of daily losses during the quarter is less than 5, report only all such daily losses.

Part V Adjusted Capital Adequacy Ratio

54. The market risk capital charges should be aggregated and converted to a market risk-weighted exposure. The total market risk capital charges is the sum of the capital charges for individual market risk categories computed using either (a) the standardized approach, or (b) the internal models approach. The total capital charges for individual market risk categories using the standardized approach should be multiplied by 125% (to be consistent with the higher capital charge for credit risk, i.e., 10% as opposed to the BIS recommended 8%.)

55. The total market risk-weighted exposures is computed by multiplying the total market risk

capital charges by 10. (The multiplier 10 is the reciprocal of the Bangko Sentral required minimum capital ratio for credit risk of 10%.) The qualifying capital and total credit risk weighted exposures are extracted from Part V.A and Part V.B, respectively, of the Report on the Computation of Risk-Based Capital Adequacy Ratio covering credit risk.

56. For on-balance-sheet debt securities and equities in the trading book included in Parts I, II and IV of this Report, the credit risk- weighted exposures reported in Part II of the Report on the Computation of the Risk-Based Capital Adequacy Ratio covering credit risk should be excluded in calculating the adjusted ratio covering combined credit risk and market risk. The market risk capital charges for these positions calculated in this Report cover all the capital requirements for absorbing potential losses arising from carrying such positions.

(Circular Nos. 890 dated 02 November 2015 and 827 dated 28 February 2014)

Annex A

Suppose as at 31 December, 200X, ABC Bank Corporation has the following trading book positions:

- (1) Long position in US Treasury Bond (7.5% annual coupon) with face value equivalent to PHP507.000MM and residual maturity of 8 years.

Market value based on quoted price: PHP518.914MM equivalent

- (2) Long position in an unrated floating rate note (6.25% current annual coupon) issued by a US corporate with face value equivalent of PHP260.000MM and next repricing nine (9) months after.

Market value based on quoted price: PHP264.758MM equivalent

- (3) Long ten (10) futures contracts involving 5- year US Treasury Note (face value USD0.100MM per contract) for delivery three (3) months after.

Selected deliverable: US Treasury Note (coupon 6.375%) maturing 5.25 years, current price at 100.0625, conversion factor 0.9423.

- (4) Single currency interest rate swap with face value PHP975.000MM and residual maturity of 2.5 years, bank receives annual floating rate interest and pays fixed at 8% per annum. The current floating rate is fixed at 5.5% with next repricing after 6 months.

- (5) Long ten (10) futures contracts involving 3- month LIBOR interest rate (face value GBP6.500MM per contract) for delivery six (6) months after.
- (6) An FRA sold on 6-month PHIBOR with nominal amount PHP130.000MM and settlement date nine (9) months after.
- (7) Forward foreign exchange position of EUR5.000MM (long) against PHP250.000MM equivalent maturing in three (3) months.
- (8) Long 1000 shares of a US listed company with current market price of PHP715.000MM equivalent.
- (9) Short one Hang Seng Index Futures for delivery three (3) months after, current index at 10,000.
- (10) Currency swap with residual maturity of six (6) months. Bank receives USD19.500MM at 9.5% per annum and pays PHP975.000MM at 11% per annum.

Treatments:

- (1) Report market value (PHP518.914MM) of the long position in Part I.1, item I.2 and Part I.2, USD ladder, seven (7) to ten (10) years time band.
- (2) Report market value (PHP264.758MM) of the long position in Part I.1, item 1.9' and Part I.2, USD ladder, six (6) to twelve (12) months time band.
- (3) Report selected Treasury Note (long position) in Part I.1, item I.2 and Part I.2, USD ladder, five (5) to seven (7) year time band. Report the same amount in short position, one (1) to three (3) months time band.

Assume spot exchange rate PHP50.00

Amount to be reported:

$USD0.100MM \times 10 \times 100.0625\% / 0.9423 = USD1.062MM$

=P53.095MM

- (4) Report the fixed rate leg as a short 2.5- year bond in Part I.2, Peso ladder, two (2) to three (3) years time band. Report the floating rate leg as a long six (6) months security in the three (3) to

six (6) months time band.

Assume the Peso zero coupon yields are as follows:

<u>Period</u>	<u>Zero coupon</u>
1M	5.31
3M	5.63
6M	5.81
1Y	6.16
2Y	6.69
3Y	7.07

(Zero coupon yields within one (1) year can be taken as cash rates, i.e., PHIBOR, zero coupon yields beyond one (1) year can be constructed from, say, swap rates.)

Cash flows of Peso swap: two (2) legs

Pay – fixed rate bond

8% of PHP975.000MM in 6 months

8% of PHP975.000MM in 18 months

108% of PHP975.000MM in 30 months Receive – floating rate paper

105.5% of PHP975.000MM in 6 months

Zero-coupon rates at eighteen (18) months can be obtained from the linear interpolation between the 1Y and 2Y zero coupon rates.

$$\text{ZC (18 months)} = (6.16\% + 6.69\%)/2 = 6.425\%$$

Similarly,

$$\text{ZC (30 months)} = (6.69\% + 7.07\%)/2 = 6.88\%$$

PV of the fixed leg (i.e., pay side)

$$= \text{Php975.000MM} \times \frac{0.08}{(1+0.0581 \times 0.5)} + \frac{0.08}{(1+0.06425)^{1.5}} + \frac{1.08}{(1+0.0688)^{2.5}}$$

$$= \text{PHP1, 038.479MM}$$

PV of the floating leg (i.e. receive side)

$$= \text{PhP}975.000\text{MM} \quad \times \quad \frac{1.055}{(1+0.0581 \times 0.5)}$$

$$= \text{PHP}999.587\text{MM}$$

- (5) Report a long nine (9) months zero coupon security in Part I.2, GBP ladder, six (6) to twelve (12) months time band and a short six (6) months zero coupon security in three (3) to six (6) months time band.

Assume the GBP six (6) months zero-coupon yield is 6.74% while the interpolated 9 months zero-coupon yield is 6.87%. Assume spot exchange rate is PHP75.00.

Amount to be reported:

$$\begin{aligned} \text{9 months} &= \text{GBP}65.000\text{MM} / (1+0.0687 \times 0.75) \\ &= \text{GBP}65.000\text{MM} \times 0.951 \\ &= \text{PHP}4,636.124\text{MM equivalent} \end{aligned}$$

$$\begin{aligned} \text{6 months} &= \text{GBP}65.000\text{MM} / (1+0.0674 \times 0.5) \\ &= \text{GBP}65.000\text{MM} \times 0.9674 \\ &= \text{PHP}4,716.069\text{MM equivalent} \end{aligned}$$

- (6) Report a long 15 months zero coupon security in Part I.2, Peso ladder, 1.0 to 1.9 years time band and a short 9 months zero coupon security in 6 to 12 months time band.

Calculations similar to (4) above,

$$\begin{aligned} \text{ZC (15 months)} &= 6.16 \% + (6.69\% - 6.16\%) \times 0.25 \\ &= 6.2925\% \end{aligned}$$

$$\begin{aligned} \text{15 months} &= \text{PHP}130.000\text{MM} (1+0.062925)^{1.25} \\ &= \text{PHP}121.000\text{MM} \end{aligned}$$

$$\begin{aligned} \text{9 months} &= \text{PHP}130.000\text{MM} \times 0.957 \\ &= \text{PHP}124.410\text{MM} \end{aligned}$$

- (7) Report a long three (3) months zero coupon security in Part I.2, EUR ladder, one (1) to three (3) months time band and a short three (3) months zero coupon security in the Peso ladder, one (1) to three (3) months time band.

Calculation similar to (4) above and assume three (3) months EUR cash rate at 3.25% and spot exchange rate is PHP46.00.

$$\begin{aligned} \text{EUR} &= \text{EUR}5.000\text{MM} / (1 + 0.0325 \times 0.25) \\ &= \text{PHP}228.146\text{MM equivalent} \end{aligned}$$

$$\begin{aligned} \text{PHP} &= \text{PHP}250.000\text{MM}/(1+ 0.0563 \times 0.25) \\ &= \text{PHP}246.530\text{MM} \end{aligned}$$

(For simplicity, Part III of the report is not presented in this example.)

(8) Report market value in Part II, item 1 (US column).

(9) Report as a short position the market value for futures (HKD50.00 per index point) in Part II, Item 5 (HKD column) and as a long position in Part I.2, HKD ladder, one (1) to three (3) months time band. Assume HKD to PHP exchange rate is PHP6.50.

(10) Report the USD leg as a long 6-month zero coupon security in Part I.2, USD ladder, three (3) to six (6) months time band. Report the PHP leg as a short 6-month zero coupon security in Part I.2, PHP ladder, 3 to 6 months time band.

Assume the 6-month Peso and Dollar zero coupon yields are 5.81% and 4%, respectively, and the spot exchange rate is PHP50.00.

Cash flows of currency swap: two legs Pay – PHP
111% of PHP975.000MM in 6 months

PV of PHP leg

$$= \frac{\text{PHP}975.000\text{MM} \times (1.11)}{(1 + 0.0581 \times 0.5)}$$

$$= \text{PHP}1,051.700\text{MM}$$

Receive – USD

109.5% of USD19.500MM in 6 months

PV of USD leg

$$= \frac{\text{USD}19.500\text{MM} \times (1.095)}{(1 + 0.04 \times 0.5)}$$

$$= \text{PHP}1,046.700\text{MM equivalent}$$

(For simplicity, Part III of the report is not presented in this example.)

Footnotes

1. "Government and multilateral development banks" refers to the issuers as described under items 1.1 and 1.3 in Part I.1 of the Report.
2. "Qualifying" refers to the issuers/issues as described under items 1.4 to 1.7 in Part I.1 of the Report.
3. "LGU bonds" refers to bonds issued by local government units (LGUs), covered by Deed of Assignment of Internal Revenue Allotment of the LGU and guaranteed by LGU Guarantee Corporation.