

GUIDELINES FOR THE ESTABLISHMENT AND ADMINISTRATION/MANAGEMENT OF SINKING FUND FOR THE REDEMPTION OF REDEEMABLE PRIVATE PREFERRED SHARES

(Appendix to Sec. 122 on Issuance of redeemable shares: conditions; certification and report; sanctions)

Sinking fund shall refer to a fund set aside in order to accumulate the amount necessary for the redemption of redeemable preferred shares.

A. Establishment and Composition

1. Documentation

- a. A resolution by the bank's board of directors authorizing the Chief Executive Officer/President of the bank to establish a sinking fund equal to the reserve for retirement of preferred shares for the sole purpose of redemption of redeemable preferred shares at their maturity dates.
- b. Investment Plan. The plan shall be approved by the board of directors and should indicate the types/classes of investments for the sinking fund. The amount of initial/periodic contributions set forth in the Investment Plan shall be in accordance with Section B par. 1 below. A copy of the Plan shall be submitted to the Bangko Sentral within thirty (30) calendar days from approval thereof by the bank's board of directors.

2. Eligible Securities and Investments

The sinking fund may be invested in the following:

- a. Evidence of indebtedness of the Republic of the Philippines and/or the Bangko Sentral, or any other evidence of indebtedness or obligations the servicing and repayment of which are fully guaranteed by the Republic of the Philippines;
- b. Evidence of indebtedness or obligation of the central monetary authority of a foreign country, denominated in the national currency of the issuing country, the servicing and repayment of which are fully guaranteed by the government of such country;
- c. Deposits with private and/or government banks to the extent covered by deposit insurance; and
- d. Such other securities as the Monetary Board may designate from time to time.

Banks shall refrain from investing sinking fund resources in highly volatile, high-risk commercial instruments.

B. Operation

1. Amount of Annual Investment

The annual contribution to the sinking fund shall be equal to the reserve for retirement set up for the year, equivalent to the amount of redeemable shares issued divided by their respective terms, i.e., number of years from date of issue to date of maturity.

2. Accounting Entries – please refer to Annex “A”.

3. Administration

- a. Responsible Officer. The sinking fund shall be administered by the Chief Executive Officer or his duly authorized representative, who shall be an employee of the bank with a rank not lower than manager or its equivalent, preferably with experience in treasury operations. The administrator shall be responsible for investment decisions and the maintenance of records of the sinking fund. He shall be responsible for the execution of the Investment Plan, and may deviate from the Plan only upon the approval of the board of directors.

In the case of RBs/Coop Banks, the bank president or the general manager or the officer-in-charge shall be designated as the administrator of the sinking fund.

- b. Sinking Fund Manager. The board of directors shall delegate the management of the fund to an independent fund manager, e.g., trust company, where the amount of the fund is equivalent to five percent (5%) or more of the authorized redeemable private preferred shares, in case of UBs and KBs, or when such fund amounts to P1.0 million or more in the case of TBs and RBs/Coop Banks: *Provided*, That the sinking fund manager shall invest only in such securities as are prescribed in these guidelines: *Provided, further*, That a bank/financial institution acting as sinking fund manager may not designate the owner of the fund it manages as the sinking fund manager of its own sinking fund established for the same purpose.
- c. Reports. The administrator shall submit to the Board a quarterly report on the status of the Fund. The report shall include the to-date balance of the fund, its composition, income earned for the period, a reasonable forecast for the various financial instruments into which the fund has been placed, and the administrator’s/ fund manager’s recommendations or proposals regarding the fund. In its evaluation of the report the Board shall ascertain the degree of risk that the sinking fund is exposed to and prescribe the appropriate corrective actions.

The report of the administrator/fund manager shall be under oath and made available for examination by the Bangko Sentral.

- d. Review of the Investment Plan. The Board shall conduct an annual evaluation of the Investment Plan and the performance of the administrator/fund manager, and may introduce amendments to or revisions of the Plan, a copy of which shall be submitted to the Bangko Sentral.
4. Sanctions. Failure to comply with the guidelines shall subject the bank and its directors and officers to the sanctions prescribed Item "c" of Sec. 122 (*Issuance of redeemable shares; conditions; certification and report; sanctions*) and Sections 36 and 37 of R.A. No. 7653.

Annex A

Summary of Pro-Forma Journal Entries to Record Sinking Fund Transactions

- a. Setting up the sinking fund. The initial contribution to the sinking fund shall be recorded as follows:

1. To set up Reserve for Retirement of Preferred Stock

Undivided Profits/Surplus Free	xxx	
Other Surplus Reserves - Reserve for Retirement of Preferred Stock		xxx

To transfer from free to restricted Surplus the amount set up as reserve for redemption of preferred shares.

2. To set up the subsidiary account - Sinking Fund (classified as Other Non-Current Assets)

IBODI/Others - Sinking Fund for Redemption of Preferred Shares	xxx	
Cash/Due from Banks		xxx

To set up the Sinking Fund for the Redemption of Preferred Shares.

- b. Contributions to the sinking fund

1. To set up the periodic Reserve for Retirement

Undivided Profits/Surplus Free	xxx	
Other Surplus Reserves - Reserve for Retirement of Preferred Stock		xxx

To transfer from free to restricted Surplus reserve for redemption of preferred shares.

- c. Income/loss from the sinking fund. The recognition of income/loss from the investments shall follow the existing accounting treatment/procedures prescribed in the Manual of Accounts for Banks

1. To record receipt or accrual of income due to the sinking fund

Cash/Due from Banks/ Accrued Other Income Receivable	xxx	
Other Income/Accrued Other Income		xxx

To record income earned from sinking fund assets.

- d. Redemption

1. Liquidation of sinking fund. Any gain or loss realized/incurred from liquidation of the sinking fund investments shall be credited/charged to operations.

Undivided Profits/ Surplus Free

Cash	xxx	
IBODI/Others - Sinking Fund for Redemption of Preferred Shares		xxx
Other Income - Gain on Sale of Sinking Fund Securities		xxx

To record the liquidation of sinking fund assets and recognize income therefrom.

or:

Cash	xxx	
Loss from Sale of Sinking Fund Securities		xxx
IBODI/Others - Sinking Fund for Redemption of Preferred Shares		xxx

To record the liquidation of sinking fund assets and loss incurred therefrom.

2. Transfer to Undivided Profits/Surplus Free of the balance of the Restricted Surplus account

Other Surplus Reserves - Reserve for Retirement of Preferred Stock	xxx	
Undivided Profits/ Surplus Free		xxx

To close the restricted surplus account 'Other Surplus Reserves - Retirement of Preferred Stock' and to revert the balance of the same to Undivided Profits/Surplus Free.

3. Redemption of preferred shares, declaration of stock dividend equal to amount of preferred

shares redeemed and payment of such dividend through the issuance of new shares of stock

(a) Capital Stock - Preferred Shares	xxx	
Cash/Due from Banks		xxx

To record the redemption of redeemable preferred shares.

(b) Undivided Profits/Surplus Free	xxx	
Dividends Distributable		xxx

(b) Dividends Distributable	xxx	
Capital Stock - Common Stock/Preferred Stock		xxx

To record payment of stock dividend (common stock).

- e. Treatment of changes in the market of the sinking fund portfolio. Gains and losses arising from changes in market values of component securities shall be deferred (not recognized) until the securities are liquidated.