

**Guidelines on the LBP Equity Investment Facility  
Under the Consolidation Program for Rural Banks (CPRB)**

**A. Rationale**

Upon consolidation or merger of Proponent Banks, and in case the resulting Risk-Based Capital Adequacy Ratio (RBCAR) and the unimpaired capital of the Surviving Bank based on the Financial Adviser's report are below 12% and P100Million, respectively, the Surviving Bank shall infuse additional fresh capital to meet the Program's capital and RBCAR requirements, through any or a combination of the following: (i) the existing shareholders of the Proponent Bank; and/or (ii) a third party investor.

In the event that upon capital infusion by the existing shareholders or third party investors, the resulting RBCAR of the Surviving Bank is at least 10% but below 12%, the Surviving Bank may avail of LBP's equity investment facility under the Program.

**B. Objectives**

LBP equity infusion shall be undertaken to meet the following objectives:

1. Increase the RBCAR from at least 10% to 12%;
2. Strengthen the capital base of the Surviving Bank;
3. Help sustain long-term viability of the Rural Banking sector.

**C. Equity Investment Facility**

1. Eligibility Criteria

- a. Surviving Bank (consolidated or merged bank) under the Program;
- b. No adverse findings on the principal (Directors/Key Officers);
- c. RBCAR of at least 10% but less than 12%;
- d. Minimum capitalization required by the Program;
- e. Adequate Reserves for the four (4) week period preceding the application (based on the submitted interim financial statements); and
- f. Net past due ratio of not more than 15%

2. Maximum amount : Up to 100% of the total capital requirement in bringing the RBCAR from at least 10% to 12%; or up to 30% of the total issued and paid-up capital stock, whichever is lower.

3. Features : a. Maturity of ten (10) years from the date of release, notwithstanding any change in the structure of ownership of the surviving bank;

- b. LBP's entitlement to be represented in the CFI Board;
- c. Preferred shares;
- d. Cumulative dividends;
- e. To be fully redeemed at maturity at par or book value, whichever is higher plus unpaid dividends, *if any*
- f. Non-voting but shall be entitled to vote on corporate acts specified under Section 6 of the Corporation Code
- g. Dividend Rate of 10-year R2 plus 2.5%, or a floor rate of 6.5%, *whichever is higher*, fixed at the time of availment;
- h. Booking of the equity by the CFI shall be recognized under Tier 2 Capital

#### 4. Other Terms and Conditions:

Issuance of the preferred shares under the Program shall require compliance with the following in accordance with BSP Circular No. 781, series of 2013 and other requirements:

- a. It must be issued and paid-in;
- b. It must be subordinated to depositors and general creditors of the Bank;
- c. It is neither secured nor covered by a guarantee of the Issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and general creditors of the Bank;
- d. With regard to maturity:
  - 1) It must have a minimum original maturity of at least five (5) years;
  - 2) Its recognition in regulatory capital in the remaining five (5) years before maturity will be amortized on a straight line basis as shown in the table below; and

Remaining Maturity	Discount Factor
5 years and above	0%
4 years to <5 years	20%
3 years to <4 years	40%
2 years to <3 years	60%
1 year to <2 years	80%
<1 year	100%

- 3) There are no step-ups or other incentives to redeem
- e. It may be callable at the initiative of the Issuer only after a minimum of five (5) years:
- 1) To exercise a call option the Bank must receive prior supervisory approval; and
  - 2) The Bank will not do anything which creates an expectation that the call will be exercised; and
  - 3) The Bank will not exercise a call unless:
    - i. The Bank replaces the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the Bank; or
    - ii. The Bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.
- f. The investor must have no rights to accelerate the repayment of future scheduled payments (coupon or principal), except in bankruptcy and liquidation;
- g. The instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the Bank's credit standing;
- h. Neither the Bank nor a related party over which the Bank exercises control or significant influence can have purchased the instrument, nor can the Bank directly or indirectly have funded the purchase of the instrument;
- i. It must be underwritten by a third party not related to the issuer bank nor acting in reciprocity for and in behalf of the issuer bank.
- j. The instrument shall be converted into common equity upon the occurrence of a trigger event subject to the provisions as may be defined by BSP. The trigger event occurs when the Bank is considered non-viable as determined by the BSP. Non-viability is defined as a deviation from a certain level of Common Equity Tier 1 (CET1) Ratio, inability of the Bank to continue business (CLOSURE) or any other event as determined by the BSP, whichever comes earlier.

The issuance of any new shares as a result of the trigger event must occur prior to any public sector injection of capital so that the capital provided by the public sector is not diluted.

The requirements on loss absorbency features of Tier 2 capital at point of non-viability as provided in Annex F of BSP Circular No. 781 dated 15 January 2013 shall likewise be observed.

Following the provisions of item 10 of Annex F of BSP Circular 781, the formula for the conversion of the total outstanding notes into common shares when the trigger event shall have occurred and the Issuer is declared by BSP to have reached the point of non-viability, shall be as follows:

No. of Common Shares	=	$\frac{\text{Amount of Investment}}{50\% \times \text{Adjusted Book Value per Share}}$
----------------------	---	--

where the amount of investment pertains to the preferred shares issued while the **adjusted book value per share** refers to the book value at the time the capital instrument is issued, and determined using the formula:

$$\frac{\text{Total Stockholder's Equity} - \text{Preferred Equity}}{\text{Total Outstanding Shares}}$$

The adjusted book value per share shall be the figure that will be obtained from the Financial Adviser's report or from the latest financial statements using the above formula.

The number of common shares obtained using the above formula shall be the **minimum** number of common shares to be received by LANDBANK.

Other terms/requirement on loss absorbency features include the following:

1. The issuer must make the necessary adjustments to its Articles of Incorporation to accommodate the conversion of the capital instrument into common shares for loss absorbency at the point of non-viability
- k. The write-down will have the following effects:
1. Reduce the claim of the instrument in liquidation;
  2. Reduce the amount re-paid when a call is exercised; and
  3. Partially or fully reduce coupon/dividend payments on the instrument.
- l. The Issuer must submit a written external legal opinion that it has met the requirements on the issuance of the preferred shares, including the subordination and loss absorption features.
- m. It must clearly state on its face that it is not a deposit and is not insured by the Philippine Deposit Insurance Corporation ("PDIC").
- n. The existing LBP equity investments and loans in the participating banks, *if any*, should be recognized by the Surviving Bank;
- o. Issuer must meet all of the following Eligibility Criteria prior to the release of the equity investment proceeds:

Parameters	Benchmark
1. Should be Surviving Bank (merged or consolidated) under the Program	Complied
2. No adverse findings on the principal (Directors/Key Officers)	Complied
3. Risk-Based Capital Adequacy Ratio (RBCAR)	At least 10% but less than 12%

4. Minimum capitalization required by the Program	At least P100 Million unimpaired capital
5. Adequate Reserves for the four (4) week period preceding the application (based on the submitted interim financial statements)	Complied
6. Past Due Ratio (net)	Not more than 15%

- p. The duly approved equity investment proposal can be availed of one (1) year from the date of approval;
- q. In compliance with the BSP Circular No. 826, series of 2014,
- 1) The Issuer shall provide the appropriate Risk Disclosure Statement for the issuance of additional Tier 2 capital instruments. The said disclosure statement shall explain the loss absorbency features of additional Tier 2 capital instruments as well as the resulting processes that will be effected when triggers for loss absorbency are breached;
  - 2) the LBP, through its Investment Banking Group, shall issue certification stating that:
    - i. it has been provided a Risk Disclosure Statement which among others, explains the concept of loss absorbency for additional Tier 2 capital instruments as well as the resulting processes should the triggers are breached;
    - ii. it has read and understood the terms and conditions of the issuance;
    - iii. it is aware of the risks associated with the capital instruments, and
    - iv. said risks include permanent write-down or conversion of the debt instrument into common equity at a specific discount.

## 5. Documentary Requirements

### a. Pre-processing Requirements

- 1) Written endorsement from LBP Servicing Lending Center (SLC) on CFI application for LBP equity investment
- 2) Original copy of CFI application letter signed by its duly authorized signatory
- 3) Original copy of BOD Resolution approving the CFI's authorized representative/signatory to CFI application for LBP equity investment with his/her picture and specimen signatures, and the CFI application for LBP equity investment
- 4) Copy of the merger or consolidation plan;
- 5) Certified true copy of Legal Reserves Schedule for 4 weeks immediately preceding the submitted latest quarter-ended FS of the current year
- 6) Financial Statements (FS) - Balance Sheet & Income Statement
  - a) Certified true copy of audited and BIR-filed FS for the past year/s, *if applicable*, stamped received by BIR
  - b) Certified true copy of latest quarter-ended FS of the current year, stamped received by BSP

- c) Certified true copy of Computation of Adjusted Risk-Based Capital Adequacy Ratio (RBCAR) comprising Part I: CAR Report and Part II: Qualifying Capital, stamped received by BSP:

- i. For the past year, *if applicable*; and
- ii. Latest quarter-ended FS of the current year

*Note: The required FS cover only the latest audited BIR-filed FS, latest quarter-ended FS of the current year, and RBCAR as of latest quarter-ended FS of the current year*

7) Business Plan

8) 5-yr. Financial Projection consisting of the following:

- a) Capital Structure
- b) Balance Sheet
- c) Income Statement
- d) Cash Flow Statement

9) Other documents:

- a) Certified true copy of CFI authority to operate granted by BSP
- b) Certified true copy of existing registration and articles of incorporation and by-laws
- c) List of major stockholders and their stockholdings with their bio-data
- d) List of Directors and key officers with their bio-data
- e) Latest BI/CI results on CFI (not more than 6 months from latest quarter-ended FS)
- f) Copy of latest approved CFP on Rediscounting facility granted to CFI, *if applicable*
- g) Copy of the Financial Adviser's Report

b. Pre-release Requirements

Original copies of the following:

- 1) CFI letter request for the release of proceeds of LBP equity investment
- 2) BOD Resolution designating CFI authorized signatory for the execution of MOA, Escrow Agreement and other pre-release documents with his/her picture and specimen signatures
- 3) Duly signed and notarized MOA on equity investment
- 4) Duly signed and notarized Escrow Agreement
- 5) Duly approved Investment Facilities Proposal (IFP) for LBP equity investment
- 6) ILC/BOD Resolutions approving the LBP equity investment
- 7) Certificate of stock issued in favor of LBP
- 8) Written commitment of CFI to effect the conversion at the point of non-viability

- 9) Waiver of the respective stockholders of their pre-emptive rights on the common shares to be issued to LBP at the point of non-viability".
- 10) SEC-approved amended Articles of Incorporation and by-laws indicating the features of equity investment, and to accommodate the conversion of equity investment to common shares at the point of non-viability in accordance with the Loss Absorption Features under the Terms and Conditions of the Issuance.