

STRENGTHENING PROGRAM FOR RURAL BANKS IMPLEMENTING GUIDELINES

Pursuant to Philippine Deposit Insurance Corporation (PDIC) Board Resolution No. 2009-10-185 dated 07 October 2009 approving the Strengthening Program for Rural Banks (SPRB), the following guidelines for availment of the SPRB Financial Assistance (FA) is hereby issued.

Section 1.0 Legal Basis and Objectives

The SPRB is intended to encourage mergers and consolidations of rural banks in order to further strengthen the rural banking system via the grant of financial assistance (FA) by PDIC, pursuant to Section 17(d) of RA 3591, as amended (the PDIC Charter) and the grant by Bangko Sentral ng Pilipinas (BSP) of regulatory relief pursuant to the BSP Guidelines on the Grant of Regulatory Relief under the SPRB.

The SPRB is in recognition that the rural banking system provides essential financial services in the economy, particularly in providing adequate banking services in local communities and specialized or niche markets.

Section 2.0 Definition of Terms

For purposes of these guidelines, the following acronyms, words and/or phrases shall mean as follows:

- 2.1 “CAMELS” shall mean “Capital, Assets, Management, Earnings, Liquidity, and Sensitivity” rating given by the BSP;
- 2.2 “Consolidation”, subject to the provisions of existing applicable and relevant laws, shall involve the combination of at least one Eligible Rural Bank with an Eligible Strategic Third Party Investor (Eligible STPI), as defined under Section 2.6, resulting in the dissolution of the proponent banks and the creation of a new entity;
- 2.3 “DL” shall mean “Direct Loan” component of the SPRB FA;
- 2.4 Effective Interest Rate of Government Securities (GS) shall mean the annual coupon amount of GS purchased, net of tax, divided by the amount of DL;

- 2.5 “Eligible Rural Bank” (Eligible RB) shall mean any rural bank, having all the eligibilities provided under Section 4.1;
- 2.6 “Eligible Strategic Third Party Investor” (Eligible STPI) shall mean any rural bank, having all the eligibilities provided under Section 4.2;
- 2.7 “FA” shall mean “Financial Assistance” to be extended by PDIC under the SPRB;
- 2.8 “FXTN” shall mean “Fixed Rate Treasury Note”;
- 2.9 “Merger”, subject to the provisions of existing applicable and relevant laws, shall involve the combination of at least one Eligible RB with an Eligible STPI, one of which shall be the surviving entity;
- 2.10 “MOA” shall mean the “Memorandum of Agreement on the Strengthening Program for Rural Banks” between PDIC and BSP dated 03 August 2010;
- 2.11 “Net Interest Spread (NIS) Rate” is equal to 3%;
- 2.12 “Net Interest Spread (NIS) Amount” is equivalent to 3% of DL;
- 2.13 Premium Rate of GS shall mean the total premium, if any, divided by the term of the DL, divided by the amount of the DL;
- 2.14 “PN” shall mean “Promissory Note”;
- 2.15 “PS” shall mean the “Preferred Shares” component of the SPRB FA;
- 2.16 “RBCAR” shall mean “Risk Based Capital Adequacy Ratio”;
- 2.17 “SPRB Lane” shall mean the designated processing center, located at the PDIC Office, where SPRB applications shall be filed;
- 2.18 “Taxes” shall include all applicable taxes such as, but not limited to, value added tax (VAT), expanded withholding tax (EWT) and documentary stamp tax (DST).

Section 3.0 Program Period

The SPRB shall be available for a period of two (2) years, reckoned thirty (30) days from the signing of the MOA.

Section 4.0 Eligibility

4.1 Basic criteria for Eligible RBs:

- a) with RBCAR of less than 10%; and
- b) merging or consolidating with an Eligible STPI.

4.2 Basic criteria for Eligible STPIs

- a) BSP CAMELS rating of at least “3”;
- b) Not under BSP’s Prompt Corrective Action (PCA) Program; and
- c) No findings of unsafe and unsound banking practices by the PDIC or BSP.

Section 5.0 Procedures for Application

5.1 The Eligible STPI and the Eligible RB shall submit to SPRB Lane a joint letter, addressed to PDIC, indicating their intention to merge or consolidate under the SPRB.

5.2 The letter shall be accompanied by the following:

- a) duly accomplished application form (SPRB Form No. 1);
- b) request for regulatory relief addressed to BSP in accordance with the “**BSP Guidelines on the Grant of Regulatory Relief under the SPRB**”, attached herewith as Annex “A”; and
- c) documentary requirements as listed in Annex “B.”

The letter and all requirements to be submitted to the SPRB Lane shall be in duplicate.

- 5.3 All applications shall be evaluated only upon receipt of the complete set of requirements as provided for under Sections 5.1 and 5.2.
- 5.4 Applications for the SPRB must be filed no later than three (3) months before the end of the Program Period, as provided under Section 3.0.
- 5.5 PDIC shall have the right to conduct due diligence, including validation of the RBCAR of Eligible RBs and/or Eligible STPI.

Section 6.0 The Financial Assistance (FA)

- 6.1 FA will have two (2) components:
 - a) Equity Component in the form of Preferred Shares (PS); and
 - b) Direct Loan (DL)
- 6.2 The total cost of providing the above combination of FA (PS and DL) shall be subject to the limitations provided under Sec. 17(d) of the PDIC Charter.
- 6.3 Subject to the restrictions and/or limitations under existing applicable and relevant laws, rules, regulations, issuances and circulars, the following shall be the features/terms of PS:
 - a) Amount – up to 50% of the additional capital required to bring the Eligible RB's RBCAR to 10% as determined by the BSP
 - b) Dividend rate – equal to prevailing 5-year FXTN rate, on gross basis, on the date of PDIC's subscription to the PS, payable annually to PDIC. Such rate shall be based on PDST-R2 set the previous business day
 - c) Non-voting, cumulative, convertible to common shares
 - d) Redeemable starting at the end of 5th year but not later than the 10th year from issuance of PS
 - e) Put option on the PS exercisable by PDIC
- 6.4 Terms of the DL

- a) Purpose – the proceeds of the DL shall be used solely to purchase Government Securities (GS);
- b) Principal – equivalent to such amount to be determined using the following formula:

$$\text{Principal} = (\text{PS} / \text{Tenor of DL}) / \text{NIS rate}$$

which will allow the merged/consolidated bank an annual NIS amount, over the tenor of the DL, to accumulate to a sum equivalent to the PS;

- c) Interest rate per annum – Effective Interest Rate of the GS purchased less NIS rate of 3%, less premium rate of GS, if any.
- d) Tenor – 10 years, but shall become due and demandable upon redemption of PS or exercise of put option
- e) Collateral/Security – Pledge to PDIC of the GS to be purchased using proceeds of DL, and such other collateral / security or arrangements as PDIC may require

Section 7.0 Terms and Conditions of FA

- 7.1 The relationship between the parties to the SPRB shall be principally governed by an FA Agreement to be executed by the subject banks and PDIC, in line with these Guidelines.
- 7.2 The terms and conditions of the SPRB FA shall include, but shall not be limited to, the following:
 - a) Quasi-reorganization and/or Capital restructuring
 - b) Compliance with the FA agreement terms and conditions as follows:
 - b.1) Financial Covenants
 - compliance with payment terms and conditions
 - achievement of business plan/performance targets

b.2) Non-financial covenants

- submission of required reports
- improvement of merged/consolidated bank operations and governance
- conduct by PDIC of periodic on-site inspection and review
- PDIC's appointment of consultants and/or nomination of representative in the merged/consolidated bank's board of directors, as may be necessary.

c) Compliance with PDIC and BSP regulatory issuances, and other banking rules and regulations

Section 8.0 Monitoring Activities

- 8.1 PDIC shall monitor the performance of the merged/consolidated banks and their compliance with all the conditions of the FA Agreement.
- 8.2 The merged/consolidated bank shall comply with the following regular reporting requirements:
- a) quarterly statement of conditions, and income and expenses;
 - b) annual audit report by an independent external auditor.
- 8.3 PDIC, pursuant to these Guidelines and the FA Agreement, shall be authorized to conduct a special review of operations of the Eligible RB, Eligible STPI, or merged or consolidated bank anytime, as it may deem necessary, to check compliance with financial targets, business plan and relevant terms of the FA.

Section 9.0 Non-Compliance with the Terms and Conditions

- 9.1 Non-compliance with any of the terms and conditions of the FA Agreement shall give PDIC the option to exercise its rights under Section 6.3 (e) and to pre-terminate the loan.

Section 10.0 Effectivity

These Guidelines shall take effect immediately.

**BSP GUIDELINES ON THE GRANT OF REGULATORY RELIEF
UNDER THE STRENGTHENING PROGRAM FOR RURAL BANKS
(SPRB)**

In pursuance of the policy to promote mergers and consolidations as a means to develop bigger and stronger rural banks (RBs), and to further strengthen the rural banking system, constituent RBs may, subject to prior BSP approval, avail themselves of any or all of the following merger or consolidation incentives under the SPRB:

1. Conversion of the existing head offices, branches and/or extension offices of the merging or consolidating RBs into head office, branches or extension offices of the merged/consolidated RB;
2. Relocation/opening of existing/approved but unopened branches, extension offices and/or other banking offices of the merged/consolidated RB within two (2) years from date of merger or consolidation subject to applicable requirements on relocation of branches, extension offices and/or other banking offices;
3. Condonation of liquidated damages on past due rediscounting/emergency loans and/or monetary penalties for violation of BSP issuances on rediscounting/emergency loans of the eligible RBs as of the end of the month immediately preceding the date of request for loan restructuring;
4. Restructuring of past due rediscounting/emergency loans of the eligible RBs with the BSP, subject to compliance with the following guidelines:

a) Amount to be Restructured

The amount to be restructured shall consist of the following:

- o *Principal* – outstanding balance of the principal obligation as of the end of the month immediately preceding the date of request for loan restructuring
- o *Accrued Interest* – accrued interest on the outstanding principal obligation as of the end of the month immediately preceding the date of request for loan restructuring.

b) Interest Rate

Only the restructured principal obligation shall be charged interest at the rate equal to the prevailing 364-day Treasury Bill rate of the last auction immediately preceding the date of request for loan restructuring. No interest shall be charged on the restructured accrued interest.

c) Term of Repayment

The amount to be restructured shall be paid by the merged/consolidated RB in the monthly amortizations over a period not exceeding ten (10) years.

d) Collateralization

A surety agreement shall be executed by the stockholders owning at least sixty seven percent (67%) of the shares of stock of the merged/consolidated RB.

e) Default Clause

- i. *Event of Default* – failure to pay two (2) amortizations shall constitute an event of default and shall render the entire obligation due and demandable.
- ii. *Consequence of default* – the amount of liquidated damages on past due rediscounting/emergency loans waived shall be restored and the payments already made shall be re-applied, first to liquidated damages, and the balance, if any, to interest, then to the principal loan. Monetary penalties for violation of BSP issuances on rediscounting, if any, shall also be restored and payment thereof in full shall be demanded against the defaulting merged/consolidated RB.
- iii. *Legal Action* – the BSP may institute appropriate legal action without further need for demand or notice to the defaulting merged/consolidated RB.

f) Documentary Requirement

The merged/consolidated RB shall execute a Letter of Understanding with the BSP covering the terms and conditions of the approved restructured loan/s together with the authority for the BSP to debit the surviving/consolidated

RB's demand deposit account with the BSP for the amortizations due.

5. Preferred Shares for Staggered Redemption

The shares for staggered redemption shall be the LBP preferred shares of stock of the eligible RBs, representing the rediscounting arrearages with BSP converted into LBP equity. Repayment arrangement should be made by the merged or consolidated RB directly with the LBP.

a) Dividend Rate

The dividend rate shall be four percent (4%)

b) Redemption Term

The staggered redemption shall be effected by the merged/consolidated RB in monthly installments over a period not exceeding ten (10) years.

c) Waiver of Dividends

Dividends due on the LBP preferred shares of stock of the eligible RBs as of date of merger or consolidation shall be waived.

d) Documentary Requirement

Upon approval, the merged/consolidated RB shall execute a written agreement with the LBP for the staggered redemption of the LBP preferred shares of stock of the eligible RBs, copy furnished the BSP.

6. Rediscount ceiling of at least one hundred fifty percent (150%) of the adjusted capital accounts of the merged/consolidated RB for a period of one (1) year reckoned from the date of merger or consolidation, subject to compliance with the existing eligibility requirements of the BSP as provided under Subsec. X268.3 of the Manual of Regulations for Banks, as amended by Circular No. 648 dated 02 March 2009.
7. Waiver of monetary penalties imposed on the eligible RBs for violation of existing laws and BSP rules and regulations, except penalties accruing to the other parties, e.g. Micro, Small and Medium Enterprises Development (MSMED) Council Fund as

provided under Section 19 of R.A. No. 6977 (Magna Carta for Micro, Small and Medium Enterprises), as amended, and Agricultural Guarantee Fund Pool (AGFP) and Philippine Crop Insurance Corporation (PCIC) as provided under Section 10 of R.A. No. 10000 (The Agri-Agra Reform Credit Act of 2009), as of date of merger/consolidation.

STRENGTHENING PROGRAM FOR RURAL BANKS
Documentary Requirements

1. Articles of Merger or Consolidation duly signed by the President or Vice President and certified by the corporate secretary or assistant corporate secretary of each of the Eligible STPI and Eligible RB (constituent institutions) setting forth the following as required in Section 78 of the Corporation Code:
 - ❖ The Plan of Merger or Consolidation;
 - ❖ The number of shares outstanding; and
 - ❖ The number of shares voting for and against the Plan, respectively.

2. Plan of Merger or Consolidation setting forth the following:
 - ❖ The names of the constituent institutions;
 - ❖ The terms of the merger or consolidation and the mode of carrying the same into effect;
 - ❖ A statement of the changes, if any, in the Articles of Incorporation of the surviving institution in the case of merger; and in the case of consolidation, all the statements required to be set forth in the Articles of Incorporation; and
 - ❖ Such other provisions with respect to the proposed merger or consolidation as are deemed necessary or desirable.

3. Resolution of the Board of Directors of the respective constituent institution approving the Plan of Merger or Consolidation. The resolution shall be certified under oath by the respective corporate secretaries of the constituent institutions;

4. Resolution of the meeting of the stockholders in which at least two-thirds (2/3) of the outstanding capital stock of each constituent institution have approved the plan of merger or consolidation. The resolution shall be certified under oath by the respective corporate secretaries of the constituent institutions;

5. Financial Statements:
 - ❖ Latest financial statements as of month immediately preceding the date of application and latest 3-year audited financial statements of the constituent institutions; and
 - ❖ 10-year financial projections with valid assumptions of the merged or consolidated institutions' balance sheet and income statement.

6. List of regulatory relief the constituent institutions will avail from BSP;
7. Letter to BSP requesting restructuring of past due rediscounting/emergency loan; and letter to LBP requesting staggered redemption of matured LBP preferred shares;
8. List of stockholdings of each of the constituent institutions before and after the merger;
9. List of directors and officers of each of the constituent institutions;
10. List of proposed officers and directors of the merged or consolidated institution and the summary of their qualifications;
11. Organizational chart of the merged or consolidated institution including the number of offices and locations thereof;
12. Inter-company transactions relative to the submitted Financial Statements;
13. Computation of Risk Based Capital Adequacy Ratio on the submitted financial statements;
14. Schedule of unbooked valuation reserves based on latest BSP-ROE;
15. Viable Operational Plan with the following components:
 - Marketing Strategies
 - Proposed Target Market
 - Proposed Loan Portfolio Diversification
 - Deposit Generation
 - Proposed Improvements in Accounting System
 - Operations Control
 - Computerization Plan
 - Communication System
16. The appraiser's report of reappraisal of bank premises, if any, done by an independent and licensed appraiser;
17. Proposed Increase of Capital Stock of surviving bank;
18. Proposed Amendments in the Articles of Incorporation of surviving bank;

19. Director's Certificate (surviving bank) on the proposed amendment of the Articles of Incorporation increasing the authorized capital stock;
20. Copy of due diligence report on the Eligible RB, if any; and
21. Any other reasonable requirement deemed material in the proper evaluation of the merger or consolidation as may subsequently be requested by the BSP and/or PDIC.