

CONSOLIDATION PROGRAM FOR RURAL BANKS IMPLEMENTING GUIDELINES

Section 1 - Rationale

The Consolidation Program for Rural Banks (CPRB) was established in recognition of the need to further strengthen and enhance the viability of rural banks given their importance in providing essential financial services to the community, particularly in their specialized or niche markets, and in promoting financial inclusion and financial stability.

The CPRB aims to bring about more resilient rural banks and a less fragmented banking system by encouraging rural banks to merge or consolidate in order to: (i) improve financial strength, enhance viability and generate better return to shareholders; (ii) strengthen management and governance; (iii) generate synergies and economies of scale through common infrastructure, systems and resources; and (iv) expand their market reach.

Section 2 - Definition of Terms

For purposes of this Guidelines, the following acronyms, words and phrases shall mean as follows:

- 2.1 "Agencies" refers, collectively, to BSP, PDIC and LBP as authors and advocates of the CPRB.
- 2.2 "CAR" refers to "Capital Adequacy Ratio".
- 2.3 "CFIEP" refers to the Countryside Financial Institutions Enhancement Program which shall provide funding support to the CPRB, consistent with its objectives of improving the long term viability of countryside financial institutions.
- 2.4 "CFIEP TC" refers to the CFIEP Technical Committee which is composed of representatives from BSP, PDIC and LBP and is mainly tasked to monitor the implementation of CFIEP projects, including the CPRB.
- 2.5 "Consolidation" refers to the combination of at least five rural banks (RBs) resulting in their dissolution and the creation of a new entity, subject to the provisions of existing applicable and relevant laws and Section 5.
- 2.6 "Day" refers to business day or day other than a Saturday, Sunday or day on which commercial banks in Metro Manila are generally closed for business.

- 2.7 "Financial Adviser" refers to the adviser engaged by the Proponent Banks from among the top audit firms¹ and investment houses² with capability to undertake financial advisory services to the Proponent Banks as set forth under Section 8.7.
- 2.8 "Financial Adviser's Final Report" refers to the written report submitted by the Financial Adviser which includes but is not limited to the: (i) methodology of valuation; (ii) due diligence findings including report on the overall financial condition of the Proponent Banks; (iii) valuation of Proponent Banks which takes into consideration appraisal of assets and legal audit report on pending cases; (iv) proposed ownership and capital structure and proposed consolidation or merger plan of the Resulting Bank; and (v) all reports and documents required to be delivered by the Financial Adviser under this Guidelines and the engagement contract with the Financial Adviser.
- 2.9 "Merger" refers to the combination of at least five RBs, one of which shall be the Resulting Bank, subject to the provisions of existing applicable and relevant laws and Section 5.
- 2.10 "MOA" refers to the "Memorandum of Agreement on the Consolidation Program for Rural Banks among the Proponent Banks" which shall contain the Proponent Banks' agreements as indicated in Section 7(f).
- 2.11 "MOU" refers to the Memorandum of Undertaking in favor of the Agencies duly and jointly executed by and among the Proponent Banks which shall contain the commitments, representations, warranties and other obligations of the Proponent Banks as indicated in Section 7(g).
- 2.12 "Proponent Banks" refers to the participating RBs which qualify under the CPRB pursuant to Section 5.
- 2.13 "SEC" refers to the Securities and Exchange Commission which approves the registration of the Resulting Bank as a consolidated or merged bank.
- 2.14 "Resulting Bank" refers to the consolidated bank or surviving bank after consolidation or merger, respectively, of the Proponent Banks.

Section 3 - Interpretation

The headings in this Guidelines are inserted for convenience of reference only and shall not limit or affect the interpretation of its provisions. References to sections and annexes are to be construed as references to the Sections and Annexes to this Guidelines.

¹ As listed in the Business World Top 1,000 Corporations

² Members of the Investment House Association of the Philippines, provided they are not subsidiaries or affiliates of, or do not belong to the same business group as, any local or foreign bank.

Section 4 - CPRB Availability Period

The CPRB shall be available for two (2) years from approval by all governing boards of BSP, PDIC, and LBP. To avail of the CPRB, letters of intent/application duly supported by certification of board and shareholders' approvals of the Proponent Banks and all other required documents enumerated in Section 7 must have been duly submitted to and received by the PDIC on or before the expiration of the two-year availability period.

Section 5 - Eligibility of Proponent Banks to the CPRB

Proponent Banks should be at least five RBs, the head offices or majority of the branches of which shall preferably be located in the same region or area.

The Resulting Bank should meet all of the following:

- a. CAR of at least 12%; and
- b. Combined unimpaired capital of at least ₱100Mn.

If the Proponent Banks are less than five but based on the submitted documents, the Resulting Bank will have CAR of at least 12% and a combined unimpaired capital of at least ₱100Mn, the application may be accepted.

Section 6 - CPRB Support

The Proponent Banks may avail of the following:

- 6.1 Funding support, subject to subsidy limits set by the CFIEP TC, for:
 - a. Financial advisory services in accordance with Sections 8.6 and 13.2;
 - b. Business process improvement services in accordance with Section 13.2;
- 6.2 Capacity building support services in accordance with Section 12.3;
- 6.3 Possible equity participation by the LBP as provided under Section 10;
- 6.4 Regulatory Incentives under Subsection X108.3 of the Manual of Regulations for Banks and other existing laws and rules subject to the Proponent Banks' compliance with the requirements therein and approval of the concerned agencies; and
- 6.5 Other CPRB support as may be provided by BSP, PDIC, LBP, and CFIEP.

Section 7 - Procedures for Application

To avail of the CPRB's incentives, the Proponent Banks shall submit to PDIC, through the Office of the Vice President-Resolution Group, three sets of the following documents:

- a) Letter addressed to the PDIC and the BSP indicating their intention to consolidate or merge under the CPRB;
- b) Duly accomplished CPRB application form;
- c) Resolution of the Board of Directors of the respective Proponent Banks approving the consolidation or merger with other Proponent Banks under the CPRB. The resolution shall be certified under oath by the respective corporate secretaries of the Proponent Banks;
- d) Resolution of the stockholders representing at least two-thirds (2/3) of the outstanding capital stock of each Proponent Bank approving the consolidation or merger with other Proponent Banks under the CPRB. The resolution shall be certified under oath by the respective corporate secretaries of the Proponent Banks;
- e) Secretary's Certificate of Adoption of Board Resolutions of each of the Proponent Banks containing the following:
 - i. Approval by the Board of the request for availment of funding support under Section 6.1;
 - ii. Approval by the Board of the MOA among Proponent Banks containing the terms under Section 7(f), the MOU in favor of the Agencies containing the terms under Section 7(g), Confidentiality Agreement, and other documents as may be required under the CPRB; and
 - iii. Designation of the Proponent Bank's authorized signatories to execute and deliver the foregoing documents in relation to the CPRB and attesting to their specimen signatures.
- f) Duly executed joint MOA among Proponent Banks containing, among others, the following:
 - i. Agreement to consolidate or merge under the CPRB, and to comply with the CPRB's requirements.
 - ii. Commitment to: (a) allow the duly designated Financial Adviser to conduct due diligence on the Proponent Banks; and (b) voluntarily disclose and allow access to all records, documents and information pertinent to their respective banks' financial condition and other information as may be required by the Financial Adviser.

- iii. Agreement to accept the results of the Financial Adviser's due diligence review including the consolidation/merger structure.
 - iv. Infusion of additional fresh capital, as may be needed, to bring the resulting CAR and combined adjusted capital of the Proponent Banks to the required capital level pursuant to Sections 5 and 9.
 - v. Agreement to adopt the human resource and systems integration plan for the Resulting Bank as proposed by the Financial Adviser.
 - vi. Nomination of directors in the Resulting Bank who possess the qualifications and none of the disqualifications under BSP regulations, who adhere to sound governance principles and who will work to ensure the viability of the Resulting Bank to attain the objectives of the CPRB.
 - vii. Installation in the Resulting Bank of a professional management team composed of individuals who meet BSP's fit and proper rule.
 - viii. Institution and adoption of capacity building measures.
 - ix. Submission of valuation and appraisal reports, due diligence findings (including report on the overall financial condition of the Proponent Banks) of the Financial Adviser and such other information as may be required by PDIC and BSP.
 - x. Submission of the business plan, including strategies, financial projections and proposed organizational structure for the Resulting Bank.
 - xi. Agreement on cost sharing of expenses under the CPRB including dealing with withdrawal (voluntary or involuntary) by any of the Proponent Banks.
 - xii. Agreement to fully reimburse CFIEP for the funding support it extended, in case the consolidation or merger of the Proponent Banks does not materialize.
 - xiii. Designation of a duly authorized representative and his alternate for purposes of communication and coordination with the Agencies.
- g) Duly executed joint MOU of the Proponent Banks' commitments to the Agencies as follows:
- i. Abide by the terms and conditions of the CPRB as outlined in the Guidelines, and their obligations under the MOA among the Proponent Banks referred to in Section 7(f).
 - ii. Abide by their warranties and representations to the Agencies.
 - iii. Grant authority to PDIC to request for proposals from the pool of financial advisers accredited under the CPRB.

- iv. In case the consolidation or merger of the Proponent Banks does not materialize, fully reimburse CFIEP's share as specified under Section 13.2 in accordance with their agreement on cost sharing, and to shoulder equally any deficiency in the reimbursement of CFIEP's share, in the event of failure of any of the Proponent Banks to pay its corresponding share.
 - v. Grant authority to BSP to deduct from their respective accounts with BSP, any amount due to the CFIEP, in case they fail to remit their corresponding share to reimburse CFIEP share under Section 13.2 in accordance with Sections 14.1 and 14.2.
 - vi. Engage a business process consultant for the Resulting Bank in accordance with Section 12.2, with the approval of the Proponent Banks' respective board of directors.
- h) Duly executed Confidentiality Agreement of each of the Proponent Banks; and
 - i) Copy of the Proponent Banks' respective latest audited and interim Financial Statements.

PDIC shall only receive complete sets of the foregoing documents from the Proponent Banks. PDIC shall furnish BSP and LBP copies of the complete documents which PDIC received from the Proponent Banks.

Section 8 - Engagement of the Financial Adviser

- 8.1 Upon receipt of the complete set of requirements as provided under Section 7, PDIC shall request the top audit firms and investment houses with capability to undertake financial advisory services under Section 8.7 to submit proposals for engagement of their services. The proposals shall be addressed directly to the Proponent Banks' duly designated authorized representative, copy furnished PDIC.
- 8.2 Within ten (10) days from receipt of all the proposals from the financial advisers, the Proponent Banks shall:
 - a. Collectively decide and select the Financial Adviser with the most reasonable and responsive proposal; and
 - b. Notify PDIC in writing of their choice of Financial Adviser.
- 8.3 Within two (2) days from receipt of notice of choice of Financial Adviser, PDIC shall communicate to CFIEP the Proponent Banks' choice of Financial Adviser.
- 8.4 Within five (5) days from receipt of the choice of the Financial Adviser, the CFIEP TC shall issue to the Proponent Banks' authorized representative the notice to proceed with the engagement of the Financial Adviser.

8.5 Within five (5) days from the receipt of the notice to proceed, the Proponent Banks shall enter into an engagement contract with the Financial Adviser, copy furnished PDIC.

8.6 Within five (5) days from the execution of the engagement contract with the Financial Adviser, the Proponent Banks' authorized representative shall release to the Financial Adviser the initial payment for its services equivalent to 20% of the Financial Advisers' fee as indicated in the said engagement contract. The balance equivalent to 80% of the Financial Adviser's fee, subject to the subsidy limits set by the CFIEP TC under Section 13.2, shall be for the account of CFIEP. Any excess from the subsidy limits set by the CFIEP TC under Section 13.2 shall be for the account of the Proponent Banks.

The engagement contract with the Financial Adviser shall become effective upon the Financial Adviser's receipt of the 20% initial payment from the Proponent Banks pursuant to the terms of the Financial Adviser's engagement, and such other terms and conditions as may be agreed between the Proponent Banks and the Financial Adviser.

8.7 Upon receipt of the 20% initial payment, the Financial Adviser shall immediately commence and render financial advisory services, which include but are not limited to the following:

a. Conduct due diligence review to determine the financial condition of each Proponent Bank using standard parameters.

The due diligence review shall take off from the Proponent Bank's latest audited financial statements (Balance Sheet, Income Statement and Cash Flow) and supporting schedules and related documents, as well as the latest interim end-of-month financial statements.

The Financial Adviser shall ensure that the financial statements were prepared in accordance with Philippine Financial Reporting Standards (PFRS) and BSP rules and regulations for banks, and reflect the latest financial condition of the Proponent Banks which shall be as of the end of the month immediately preceding the date of application under the CPRB. In case it becomes necessary to adjust the books of the Proponent Banks in order to comply with PFRS and BSP rules and regulations, the Financial Adviser shall restate the financial statements accordingly.

b. Prepare valuation study on each Proponent Bank based on net asset value (NAV) approach, taking into consideration the appraised value of the fixed assets and the estimated contingent assets and liabilities based on the audit of significant legal cases.

i. Where updated appraisal of the Proponent Banks' real properties and fixed assets is necessary, the Financial Adviser shall set the parameters for the internal appraisal and/or for the engagement by the Proponent Banks of (an) independent appraiser(s).

- ii. The Financial Adviser shall also set the parameters for the legal audit by existing retained/in-house lawyers and/or for the engagement by the Proponent Banks of (a) law firm(s) which shall conduct the legal audit.
 - c. Recommend ownership and capital structure of the Resulting Bank based on the results of the valuation study.
 - d. Assist the Proponent Banks in the preparation of the business plan/strategy, financial projections, organizational structure and human resource strategy for the Resulting Bank.
 - e. Assist in coordinating with the SEC, the Agencies and the Bureau of Internal Revenue, if necessary.
 - f. Undertake other functions/activities required to complete and implement the transaction contemplated under the CPRB.
- 8.8 Within fifteen (15) days from the conclusion of their due diligence review, the Financial Adviser shall submit the Financial Adviser's Final Report containing the result of valuation and the Resulting Bank's ownership structure for approval of the Proponent Banks' respective boards of directors and shareholders, copy furnished PDIC and BSP.

The due diligence, valuation study and capital structuring shall not exceed six (6) months from the effective date of the engagement contract with the Financial Adviser.

Section 9 - Infusion of Additional Capital

- 9.1 In case the resulting CAR and the unimpaired capital of the Resulting Bank based on the Financial Adviser's Final Report are below 12% and ₱100Mn, respectively, the Proponent Banks shall infuse additional fresh capital to meet the CPRB's minimum capital requirements in accordance with their commitment under the MOA and MOU.
- 9.2 The Proponent Banks shall cause the infusion of the fresh capital required under the CPRB through any or a combination of the following: (i) the existing shareholders of the Proponent Banks; and/or (ii) a third party investor.

Section 10 - Possible Equity Investment Facility from LBP

- 10.1 In the event that the resulting CAR of the Resulting Bank falls short of the 12% requirement but is at least 10%, the Resulting Bank may avail of LBP's Equity Investment Facility to bring the CAR to 12%.
- 10.2 The Resulting Bank's eligibility under this facility shall be subject to the Guidelines on the LBP Equity Investment Facility for CPRB.

Section 11 - Approval of the Consolidation or Merger

- 11.1 The Proponent Banks shall secure the approval of their respective boards of directors and shareholders on the final plan of consolidation or merger.
- 11.2 Within forty-five (45) days from receipt of the Financial Adviser's Final Report, the Proponent Banks shall secure the regulatory consents and/or approval of PDIC, BSP and SEC as provided under existing laws for all banks on consolidations or mergers.
- 11.3 Upon BSP's issuance of the Certificate of Authority to operate as the Resulting Bank, the Proponent Banks shall secure from the SEC the Certificate of Registration of the Resulting Bank.

Section 12 - Integration and Other Activities of the Resulting Bank

- 12.1 Within twenty-five (25) days from the issuance by the CFIEP TC of the certificate of completion of the Financial Adviser's Final Report, the Proponent Banks shall conduct:
 - a. Integration and business process improvement;
 - b. Capacity building activities; and
 - c. Such other activities necessary to ensure the success and viability of the Resulting Bank.
- 12.2 Should the Proponent Banks decide to avail of the funding support for the business process improvement services, it shall notify PDIC of such decision and the choice of consultant, in which case, procedures for the engagement of the Financial Adviser under Section 8 shall be observed as may be appropriate. Provided, however, that the sharing of expenses shall be subject to Section 13.2.

The business process improvement shall include:

 - a. Integration process (data and records integration, consolidation of backroom activities, financial reporting);
 - b. Development and updating of manuals; and
 - c. Guidance on automation/new system requirement as a result of the integration.
- 12.3 The Agencies and CFIEP shall provide capacity building support services such as trainings on credit evaluation and administration, audit and internal control, personnel management, accounting/record keeping, treasury, information technology, and governance at no cost to the Resulting Bank.

Section 13 - CPRB's Funding and Expenses

- 13.1 CFIEP shall participate in the CPRB by providing the funding requirements in accordance with this Guidelines.
- 13.2 Subject to the subsidy limits set by the CFIEP TC, the cost of the financial advisory and business process improvement services inclusive of applicable taxes shall be shared by the CFIEP and the Proponent Banks (or Resulting Bank) in accordance with the following proportion:
- | | |
|--------------------------------|-----|
| CFIEP | 80% |
| Proponent Banks/Resulting Bank | 20% |
- 13.3 The Agencies shall not be liable for any amount due to the Financial Adviser in excess of CFIEP's share under Section 13.2. Any additional payment for the financial advisory and business process improvement service providers shall be for the account of the Proponent Banks (or Resulting Bank).
- 13.4 All other fees and expenses related to the consolidation or merger of the Proponent Banks under the CPRB shall be shouldered by the Proponent Banks (or Resulting Bank).
- 13.5 For CFIEP's corresponding share in the fees under Section 13.2, the same shall be remitted to the Financial Adviser and the business process consultant only after the Proponent Banks shall have paid their proportionate share.

Section 14 - Reimbursement to CFIEP

- 14.1 The Proponent Banks shall be under obligation to reimburse CFIEP's share under Section 13.2 in accordance with their agreement on cost sharing within three (3) days from receipt of the demand for reimbursement in case the consolidation or merger does not materialize.
- 14.2 In case a Proponent Bank refuses or fails to remit any payment due to CFIEP under Section 14.1, BSP, after due notice from the CFIEP to the Proponent Bank concerned, shall proceed to debit the Proponent Bank's demand deposit account therewith, corresponding to the amount due for payment as contained in the CFIEP's demand for reimbursement/payment from the Proponent Bank concerned pursuant to the authority granted to BSP under the MOU executed by the Proponent Banks. The full amount debited shall be credited to the demand deposit account of the CFIEP with BSP.
- 14.3 Any deficiency due to the failure by any of the Proponent Banks to pay CFIEP in full of its corresponding share shall be divided equally among the remaining Proponent Banks. The procedures set forth under the preceding section shall be observed in the payments/collection of such deficiency. The Proponent Banks shall exercise their rights under their agreement if any, or under the law, to exact reimbursement from any non-paying Proponent Bank accordingly.

Section 15 - Amendments

The Agencies may execute a supplement or amendment hereto for the purpose of adding, changing or modifying provisions of this Guidelines as may be necessary to achieve the CPRB's objectives.

Section 16 - Repealing Clause

Previous issuances/ guidelines inconsistent herewith are deemed superseded.

Section 17 - Effectivity

This Guidelines shall take effect immediately.