Republic of the Philippines
SECURITIES AND EXCHANGE COMMISSION
SEC Building, EDSA, Greenhills, Mandaluyong City, Metro Manila

SEC MEMORANDUM CIRCULAR NO. 10
Series of 2004

TO: ALL BROKERS DEALERS
PHILIPPINE STOCK EXCHANGE

SUBJECT: SHIFT TO AND EVENTUAL ADOPTION OF THE RISK BASED CAPITAL ADEQUACY REQUIREMENT/RATIO (RBCA) FOR BROKERS DEALERS

The Commission, pursuant to its regulatory and supervisory powers under Section 5 of the Securities Regulation Code, hereby declares the regulatory shift to and eventual adoption by all registered Brokers Dealers of the Risk Based Capital Adequacy Requirement/Ratio (RBCA).

RBCA, as defined under SRC Rule 28.1 (E) (2) (iv), refers to the minimum levels of capital that has to be maintained by firms which are licensed, or securing a Broker Dealer license, taking into consideration the firm size, complexity and business risk." In developing the RBCA model, The Commission has set the following key principles:

1. The shift should be in conformity with IOSCO's "Objectives and Principles of Securities Regulation" and consistent with similar shifts by security regulators in the region as well as globally.
2. In addition to liquidity risk, the model should be capable of covering other significant risks Broker Dealers are exposed to.
3. In quantifying the significant risks and the capital required to cover them, the model should adopt approaches which are consistent with international best practices.
4. Factors to be incorporated in the model for the measurement of the various risks should be based on the local market conditions where appropriate but in no case shall they be below the Basel Standards.
5. The model should be relatively easy to implement.
6. The introduction of the RBCA model should facilitate the proposed move to risk based supervision by the Commission and the

Exchange as well as the adoption by Broker Dealers of the minimum risk management standards which the Commission should also introduce.

7. The RBCA computation and the submission to the Commission and/or the Exchange of the result should be performed at the frequency that the Commission should prescribe.
8. The reporting system relative to the RBCA should incorporate appropriate early warning signals.
9. RBCA computation schedules and reports should be capable of easy adoption/transfer to an integrated electronic reporting and monitoring system when introduced.

Significant features of the proposed RBCA Model are as follows:

1. The risks proposed to be covered for the RBCA will include, among others, (1) Position or Market Risk, (2) Credit Risks such as Counterparty Risk, Settlement Risk, Large Exposure Risk, and Margin Financing Risk, and (3) Operational Risk.
2. The new capital requirements will be incorporated to supplement the existing net capital computation as prescribed under SRC Rule 49.1 (Net Capital Rule), which at present focuses primarily on Liquidity Risk.
3. For ease of implementation, the current net capital computation will be enhanced/modified to align it with the capital requirements for the additional risks identified above. For this purpose, the Commission will be revisiting the current net capital model to fine tune the provisions relating to the treatment of the various items of assets, liabilities and equity in the computation of net capital to fully capture the economic substance of the underlying risks and the available equity to cover them.
4. In calculating capital requirements, appropriate risk conversion factors (currently being developed by the Commission) will be applied to risk positions/exposures.
5. These factors, where appropriate, will be based on the volatilities derived from actual data in the Philippine equities and fixed income securities markets.

The Commission will also be reviewing the current levels of minimum capital and other capital-related provisions as part of the process of finalizing the initial model of the RBCA.

The Commission will be issuing the RBCA draft rules for comments by the first week of August 2004. In this regard, all concerned market participants are hereby enjoined to participate during the comment period. After considering all comments and incorporating the necessary modifications, the Commission will coordinate with the Exchange on the implementation of the

RBCA, including its gradual transition from the present net capital model to the RBCA.

In the meantime, the Exchange is directed to continue developing its regulatory processes leading to the mandated Risk Based Approach to Supervision of its Trading Participants. Brokers Dealers are likewise expected to be observing their own risk management program following sound principles on the same even as the Commission develops the pertinent minimum standards.

This Circular shall take effect fifteen (15) days from publication in the Commission's website at www.sec.gov.ph.

Signed this 13th day of July 2004, Mandaluyong City, Philippines.

For the Commission:

Lilia R. Bautista

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Chairperson