



BANGKO SENTRAL NG PILIPINAS

OFFICE OF THE GOVERNOR

CIRCULAR NO. 766
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Subject: Guidelines in Strengthening Corporate Governance and Risk Management Practices on Trust, Other Fiduciary Business, and Investment Management Activities

Pursuant to Monetary Board Resolution No. 1325 dated 9 August 2012, the Manual of Regulations for Banks (MORB)/Manual of Regulations for Non-Bank Financial Institutions (MORNBFI), respectively, are hereby amended to read as follows:

Section 1. "Section X401/4401Q Statement of Principles. The cardinal principle common to all trust and other fiduciary relationships is fidelity. Policies predicated upon this principle SHALL BE directed towards OBSERVANCE OF THE FOLLOWING:

1. **PRUDENT ADMINISTRATION.** THE TRUST, INVESTMENT MANAGEMENT AND OTHER FIDUCIARY ACCOUNTS SHALL BE ADMINISTERED IN CONFORMITY WITH THE INTENTION AND PURPOSE OF THE CLIENT AS MANIFESTED IN THE TERMS OF THE AGREEMENT, AND WITH THE SKILL, CARE, PRUDENCE AND DILIGENCE NECESSARY UNDER THE CIRCUMSTANCE THEN PREVAILING THAT A PRUDENT MAN ACTING IN LIKE CAPACITY AND FAMILIAR WITH SUCH MATTERS WOULD EXERCISE IN THE CONDUCT OF AN ENTERPRISE OF LIKE CHARACTER AND WITH SIMILAR AIMS.
2. **UNDIVIDED LOYALTY AND UTMOST CARE.** IN THE DISCHARGE OF FIDUCIARY RESPONSIBILITY, THE INTERESTS OF CLIENTS SHALL BE PLACED ABOVE THOSE OF THE BANK/NON-BANK FINANCIAL INSTITUTION (NBFI). CLEAR POLICIES AND PROCEDURES SHALL BE DEVELOPED IN DEALING WITH CONFLICT OF INTEREST SITUATIONS. THE FIDUCIARY ASSETS SHALL BE OBJECTIVELY AND FAIRLY ADMINISTERED, INVESTED AND DISTRIBUTED GIVING DUE REGARD TO THE BENEFICIARIES' RESPECTIVE INTERESTS.
3. **NON-DELEGATION OF RESPONSIBILITIES.** THE ADMINISTRATION OF THE TRUST, INVESTMENT MANAGEMENT, OR FIDUCIARY RESPONSIBILITIES OR THE PERFORMANCE OF ACTS THAT SHOULD BE PERSONALLY PERFORMED SHALL NOT BE DELEGATED AS THE CLIENT'S CONFIDENCE IS REPOSED ON THE TRUST ENTITY (TE).
4. **PRESERVING AND PROTECTING PROPERTY.** REASONABLE CARE AND DILIGENCE SHALL BE OBSERVED TO PRESERVE AND PROTECT THE PROPERTY ENTRUSTED. FIDUCIARY ASSETS SHALL BE KEPT LEGALLY SEPARATE AND DISTINCT FROM PROPRIETARY ASSETS AND FROM ONE FIDUCIARY/TRUST/INVESTMENT MANAGEMENT ACCOUNT TO ANOTHER.
5. **KEEPING AND RENDERING ACCOUNTS.** A TRUE AND ACCURATE ACCOUNT OR RECORD OF TRANSACTIONS ENTERED INTO SHALL BE KEPT. REPORTS ON THE

TRUST, INVESTMENT MANAGEMENT AND OTHER FIDUCIARY ACCOUNTS SHALL BE RENDERED TO THE TRUSTOR, PRINCIPAL, BENEFICIARY, OR OTHER PARTY IN INTEREST, OR THE COURT CONCERNED, OR ANY PARTY DULY DESIGNATED BY A COURT ORDER, AS THE CASE MAY BE, IN ACCORDANCE WITH SECTIONS X421/4421Q AND X425/4425Q. LIKEWISE, ALL MATERIAL FACTS WITHIN THE KNOWLEDGE OR REASONABLY DISCOVERABLE BY THE TE, PARTICULARLY INFORMATION THAT WOULD ENABLE CLIENTS TO MAKE WELL-INFORMED DECISIONS, SHALL BE PROMPTLY TRANSMITTED/RELAYED TO CLIENTS FOR THEM TO PROTECT THEIR INTERESTS.

"FURTHERMORE, practices SHALL BE CARRIED OUT in accordance with the basic standards (*Appendix 83, MORB/Q-48. MORBNBFI*) AND RISK MANAGEMENT GUIDELINES (APPENDIX A) for trust, other fiduciary and investment management accounts.

" x x x"

Section 2. "**Sections X403/4403Q Definitions.** For purposes of regulating the operations of trust and other fiduciary business and investment management activities, unless the context clearly connotes otherwise, the following shall have the meaning indicated.

"A. *TRUST ENTITY* SHALL REFER TO A (A) BANK OR A NON-BANK FINANCIAL INSTITUTION, THROUGH ITS SPECIFICALLY DESIGNATED BUSINESS UNIT TO PERFORM TRUST FUNCTIONS, OR (B) TRUST CORPORATION, AUTHORIZED BY THE BANGKO SENTRAL NG PILIPINAS (BSP) TO ENGAGE IN TRUST AND OTHER FIDUCIARY BUSINESS UNDER SECTION 79 OF R. A. NO. 8791 (THE GENERAL BANKING LAW OF 2000) OR TO PERFORM INVESTMENT MANAGEMENT SERVICES UNDER SECTION 53 OF R. A. NO. 8791."

The definition of terms under items "a" to "u" shall be respectively assigned letters "b" to "v".

Section 3. "**Subsections X406.2/4406Q.2 Composition of trust committee.** The Trust Committee shall be composed of at least five (5) members including the (1) president OR ANY SENIOR OFFICER OF THE BANK/NBFI AND (2) the trust officer. THE REMAINING COMMITTEE MEMBERS, INCLUDING THE CHAIRPERSON, MAY BE ANY OF THE FOLLOWING: (1) NON-EXECUTIVE DIRECTORS¹ OR INDEPENDENT DIRECTORS² WHO ARE BOTH NOT PART OF THE AUDIT COMMITTEE; OR (2) THOSE CONSIDERED AS QUALIFIED "INDEPENDENT PROFESSIONALS", *PROVIDED, THAT*, the Philippine branch of a foreign bank may appoint its resident manager or chief executive officer in lieu of the president while the positions allotted for members of the board may be filled up by the area manager and/or officers/representatives from the Head Office, OR AFFILIATES OR SUBSIDIARIES OF THE HEAD OFFICE who are not involved in audit-related activities, *PROVIDED FURTHER, THAT*, IN CASE OF MORE THAN FIVE (5) TRUST COMMITTEE MEMBERSHIP, MAJORITY SHALL BE COMPOSED OF QUALIFIED NON-EXECUTIVE MEMBERS."

¹ As defined under Subsection X141.1/4141Q.1 of the MORB/MORBNBFI

² As defined under Subsection X141.2/4141Q.2 of the MORB/MORBNBFI

"A QUALIFIED 'INDEPENDENT PROFESSIONAL' SHALL REFER TO A PERSON WHO –

1. IS NOT A DIRECTOR/OFFICER/EMPLOYEE OF THE BANK/NBFI DURING THE LAST TWELVE (12) MONTHS COUNTED FROM THE DATE OF COMMITTEE MEMBERSHIP;
2. IS NOT A RELATIVE WITHIN THE FOURTH DEGREE OF CONSANGUINITY OR AFFINITY, LEGITIMATE OR COMMON-LAW OF ANY EXECUTIVE DIRECTOR OR THOSE INVOLVED IN THE DAY TO DAY MANAGEMENT OF INSTITUTION'S OPERATIONS OR OFFICER OF THE BANK/NBFI; AND
3. IS NOT ENGAGED OR DOES NOT ENGAGE IN ANY TRANSACTIONS WITH THE BANK/NBFI WHETHER BY HIMSELF OR WITH OTHER PERSONS OR THROUGH A FIRM OF WHICH HE IS A PARTNER, *OTHER THAN TRANSACTIONS WHICH ARE CONDUCTED AT ARMS LENGTH AND COULD NOT MATERIALLY INTERFERE WITH OR INFLUENCE THE EXERCISE OF HIS JUDGMENT.*

"AN INDEPENDENT PROFESSIONAL MAY BE APPOINTED AS A TC MEMBER OF OTHER BANKS/NBFIs THAT BELONG TO THE SAME FINANCIAL CONGLOMERATE.

"For purposes of this Subsection, the DEFINITION OF *OFFICER* UNDER SUBSECTIONS X142.1/X4142Q SHALL APPLY."

Section 4. "Subsections X406.3/4406Q.3 *Qualifications of committee members, officers and staff.* The TRUST ENTITY shall be staffed by persons of competence, integrity and honesty. Directors, committee members and officers charged with the administration of trust and other fiduciary activities shall, in addition to meeting the qualification standards prescribed for directors and officers of banks/NBFIs OR FOR QUALIFIED 'INDEPENDENT PROFESSIONALS', possess the necessary technical expertise AND RELEVANT EXPERIENCE in such business WHICH MAY BE INDICATED BY ANY OF THE FOLLOWING:

- a. AT LEAST ONE (1) YEAR OF ACTUAL EXPERIENCE IN TRUST, OTHER FIDUCIARY BUSINESS, OR INVESTMENT MANAGEMENT ACTIVITIES;
- b. AT LEAST THREE (3) YEARS OF PROFESSIONAL EXPERIENCE IN RELEVANT FIELD SUCH AS BANKING, FINANCE, ECONOMICS, LAW, AND RISK MANAGEMENT;
- c. COMPLETION OF AT LEAST NINETY (90) TRAINING HOURS ON TRUST, OTHER FIDUCIARY BUSINESS, OR INVESTMENT MANAGEMENT ACTIVITIES ACCEPTABLE TO THE BSP; OR
- d. COMPLETION OF A RELEVANT GLOBAL OR LOCAL PROFESSIONAL CERTIFICATION PROGRAM.

A TC MEMBER SHOULD BE FAMILIAR WITH PHILIPPINE LAWS, RULES AND REGULATIONS ON TRUST BUSINESS, AS WELL AS UPHOLD AT ALL TIMES ETHICAL AND GOOD GOVERNANCE STANDARDS.

"The trust officer who shall be appointed shall POSSESS ANY OF THE FOLLOWING:

- a. At least five (5) years of actual experience in trust operations;
- b. At least three (3) years of actual experience in trust operations and must have 1) completed at least NINETY (90) TRAINING HOURS in trust, OTHER FIDUCIARY

BUSINESS, OR INVESTMENT MANAGEMENT ACTIVITIES acceptable to the BSP OR 2) COMPLETED A RELEVANT GLOBAL OR LOCAL PROFESSIONAL CERTIFICATION PROGRAM; OR

- c. At least five (5) years of actual experience as AN officer of a bank/NBFI and must have: 1) completed at least NINETY (90) TRAINING HOURS in trust, OTHER FIDUCIARY BUSINESS, OR INVESTMENT MANAGEMENT ACTIVITIES acceptable to the BSP OR 2) COMPLETED A RELEVANT GLOBAL OR LOCAL PROFESSIONAL CERTIFICATION PROGRAM.

"FOR THE PURPOSE OF THIS SUBSECTION, ACTUAL EXPERIENCE REFERS TO EXPOSURES IN TRUST OPERATIONS EITHER AS OFFICER OF A TRUST ENTITY OR MEMBER OF TRUST COMMITTEE."

Likewise, **item f of Sections 2404/3404 of the MORB** on the authority to engage in limited trust business to thrift banks and rural banks, respectively, shall be revised to read as follows:

"x x x

- f. Requirements for engaging in limited trust business. x x x

x x x

- (c) The appointment of a trust officer and subordinate officers of the trust department, office or unit: *Provided*, That the trust officer shall have the following:

- (i) at least two (2) years of actual experience in trust operations, or
- (ii) at least one (1) year of actual experience in trust operations and: 1) completion of a training program in trust, OTHER FIDUCIARY BUSINESS, OR INVESTMENT MANAGEMENT ACTIVITIES acceptable to the BSP OR 2) COMPLETION OF A RELEVANT GLOBAL OR LOCAL PROFESSIONAL CERTIFICATION PROGRAM, or
- (iii) at least two (2) years of actual experience as officer of a bank/NBFI OR RELATED ACTIVITIES and: 1) completion of a training program in trust, OTHER FIDUCIARY BUSINESS, OR INVESTMENT MANAGEMENT ACTIVITIES acceptable to the BSP OR 2) COMPLETION OF A RELEVANT GLOBAL OR LOCAL PROFESSIONAL CERTIFICATION PROGRAM;

x x x"

Section 5. **Subsections X406.4/4406Q.4 RESPONSIBILITIES OF ADMINISTRATION**

"A. BOARD OF DIRECTORS

THE RESPONSIBILITIES OF THE BOARD OF DIRECTORS (BOD) IN RELATION TO TRUST ACTIVITIES OF A BANK/NBFI SHALL BE THOSE SET FORTH UNDER SUBSECTIONS X141.3 AND 4141Q.3 OF THE MORB AND MORNBF, RESPECTIVELY (POWERS/RESPONSIBILITIES AND DUTIES OF DIRECTORS). THE BOD SHALL ENSURE AN APPROPRIATE DEGREE OF INDEPENDENCE BETWEEN THE ACTIVITIES OF THE BANK/NBFI PROPER AND ITS TRUST DEPARTMENT.

"B. TRUST COMMITTEE

THE TRUST COMMITTEE IS A SPECIAL COMMITTEE WHICH REPORTS DIRECTLY TO THE BOARD OF DIRECTORS AND IS PRIMARILY RESPONSIBLE FOR OVERSEEING THE FIDUCIARY ACTIVITIES OF THE BANK/NBFI. IN DISCHARGING ITS FUNCTION, IT SHALL:

1. ENSURE THAT FIDUCIARY ACTIVITIES ARE CONDUCTED IN ACCORDANCE WITH APPLICABLE LAWS, RULES AND REGULATIONS, AND PRUDENT PRACTICES;
2. ENSURE THAT POLICIES AND PROCEDURES THAT TRANSLATE THE BOARD'S OBJECTIVES AND RISK TOLERANCE INTO PRUDENT OPERATING STANDARDS ARE IN PLACE AND CONTINUE TO BE RELEVANT, COMPREHENSIVE AND EFFECTIVE;
3. OVERSEE THE IMPLEMENTATION OF THE RISK MANAGEMENT FRAMEWORK AND ENSURE THAT INTERNAL CONTROLS ARE IN PLACE RELATIVE TO THE FIDUCIARY ACTIVITIES;
4. ADOPT AN APPROPRIATE ORGANIZATIONAL STRUCTURE/STAFFING PATTERN AND OPERATING BUDGETS THAT SHALL ENABLE THE TRUST DEPARTMENT TO EFFECTIVELY CARRY OUT ITS FUNCTIONS;
5. OVERSEE AND EVALUATE PERFORMANCE OF THE TRUST OFFICER;
6. CONDUCT REGULAR MEETINGS AT LEAST ONCE EVERY QUARTER, OR MORE FREQUENTLY AS NECESSARY, DEPENDING ON THE SIZE AND COMPLEXITY OF THE FIDUCIARY BUSINESS; AND
7. REPORT REGULARLY TO THE BOD ON MATTERS ARISING FROM FIDUCIARY ACTIVITIES.

"C. TRUST OFFICER

THE MANAGEMENT OF DAY-TO-DAY FIDUCIARY ACTIVITIES SHALL BE VESTED IN THE TRUST OFFICER. IN THIS REGARD, THE TRUST OFFICER SHALL:

1. ENSURE ADHERENCE TO THE BASIC STANDARDS IN THE ADMINISTRATION OF TRUST, OTHER FIDUCIARY AND INVESTMENT MANAGEMENT ACCOUNTS PURSUANT TO APPENDIX 83 AND APPENDIX Q-48 OF THE MORB AND MORNBF, RESPECTIVELY;
2. DEVELOP AND IMPLEMENT RELEVANT POLICIES AND PROCEDURES ON FIDUCIARY ACTIVITIES;
3. OBSERVE SOUND RISK MANAGEMENT PRACTICES AND maintain necessary controls to protect assets under custody and held in trust or other fiduciary capacity;
4. CARRY OUT INVESTMENT AND OTHER FIDUCIARY ACTIVITIES IN ACCORDANCE WITH AGREEMENTS WITH CLIENTS AND PARAMETERS SET BY THE TRUST COMMITTEE AS APPROVED BY THE BOARD OF DIRECTORS;

5. REPORT REGULARLY TO THE TRUST COMMITTEE ON BUSINESS PERFORMANCE AND OTHER MATTERS REQUIRING ITS ATTENTION;
6. MAINTAIN ADEQUATE BOOKS, RECORDS AND FILES FOR EACH TRUST OR OTHER FIDUCIARY ACCOUNT AND PROVIDE TIMELY AND REGULAR DISCLOSURES TO CLIENTS ON THE STATUS OF THEIR ACCOUNTS; AND
7. SUBMIT PERIODIC REPORTS TO REGULATORY AGENCIES ON THE CONDUCT OF THE TRUST OPERATIONS."

Section 6. *Subsections X406.10/4406Q.10 CONFIRMATION of the appointment/designation of trust officer AND INDEPENDENT PROFESSIONAL*

AN INDEPENDENT PROFESSIONAL AND TRUST OFFICER MUST BE FIT AND PROPER TO DISCHARGE THEIR RESPECTIVE FUNCTIONS. IN DETERMINING WHETHER A PERSON IS FIT AND PROPER FOR THE POSITION, REGARD SHALL BE GIVEN TO THE FOLLOWING: INTEGRITY/PROBITY, PHYSICAL/MENTAL FITNESS, COMPETENCE, RELEVANT EDUCATION/FINANCIAL LITERACY/TRAINING, DILIGENCE AND KNOWLEDGE/EXPERIENCE

THE APPOINTMENT OR DESIGNATION OF INDEPENDENT PROFESSIONAL AND TRUST OFFICER SHALL BE SUBJECT TO CONFIRMATION BY THE MONETARY BOARD. THE BIO-DATA OF THE PROPOSED INDEPENDENT PROFESSIONAL AND TRUST OFFICER SHALL BE SUBMITTED TO THE BSP, IN A PRESCRIBED FORM INDICATED IN APPENDIX 6, MORB OR APPENDIX Q-3, MORNBF1, WITHIN SEVEN (7) BANKING DAYS FROM APPROVAL OF THE BOARD OF DIRECTORS OR ITS FUNCTIONAL OVERSIGHT EQUIVALENT WHICH SHALL INCLUDE THE COUNTRY HEAD IN CASE OF FOREIGN BANKS. MOREOVER, THE INDEPENDENT PROFESSIONAL SHALL CERTIFY THAT HE/SHE POSSESSES THE QUALIFICATIONS AS HEREIN PRESCRIBED AND THAT ALL THE INFORMATION THEREBY SUPPLIED ARE TRUE AND CORRECT.

IF AFTER EVALUATION, THE MONETARY BOARD SHALL FIND GROUNDS FOR DISQUALIFICATION, THE CONCERNED BANK/NBFI SHALL BE INFORMED THEREOF AND THE INDEPENDENT PROFESSIONAL AND TRUST OFFICER SO APPOINTED OR DELEGATED SHALL BE REMOVED FROM OFFICE EVEN IF HE/SHE HAS ASSUMED THE POSITION TO WHICH HE/ SHE WAS APPOINTED OR DELEGATED.

Section 7. *Transitory provision.* Trust entities of banks/NBFIs that do not meet the requirements of this Circular shall be given twelve (12) months from the date of effectivity to comply.

Section 8. *Sanctions.* Non-compliance with the provisions of this Circular shall subject the bank/NBFI and its board of directors to sanctions provided under Sections 36 and 37 of R.A. 7653 without prejudice to the imposition of other sanctions as the Monetary Board may consider warranted under the circumstances that may include but not limited to curtailment of fiduciary activities, and/or introduction of new business, and such other sanctions as may be provided by law.

Section 9. Repealing clause. This Circular amends/modifies the provisions of existing circulars, memoranda, and/or regulations that are inconsistent herewith.

This Circular shall take effect fifteen (15) days following its publication either in the Official Gazette or in a newspaper of general circulation.

FOR THE MONETARY BOARD:



AMANDO M. TETANGCO, JR.
Governor

17 August 2012

RISK MANAGEMENT GUIDELINES FOR TRUST AND OTHER FIDUCIARY BUSINESS AND INVESTMENT MANAGEMENT ACTIVITIES

I. Introduction

Recent changes in the nature and complexity of fiduciary activities have underscored the need for an effective and sound risk management process. With the deepening of the capital market and the increasing complexity of the financial environment, the risk management practices and techniques employed by financial institutions should continuously improve and adapt to these evolving financial landscape.

These guidelines aim to provide principles-based guidance in the implementation of sound risk management practices for trust, other fiduciary business, and investment management activities. As such, the applicability of these guidelines shall depend on the size, complexity, and risk profile of the institution's fiduciary activities.

II. Statement of Policy

It is the policy of the Bangko Sentral ng Pilipinas to support the development of the Philippine financial market and promote adequate level of protection to investors through, full and fair disclosure on financial instruments covering banking and fiduciary activities. With the continuous emergence of complex financial products, investor protection is a significant concern in building investors' confidence in the Philippine financial market. It is in furtherance of this policy that BSP prescribes risk management guidelines for fiduciary activities aligned with the basic standards in the administration of fiduciary products and services by trust entities (TEs).

III. Risk Management Principles for Fiduciary Activities

Risk management practices must be designed to ensure that exposures are well within TEs capacity to manage and risks taken by the TE and its clients are consistent with their respective risk tolerance. Risk management practices shall also promote efficiency in the administration and operation of the fiduciary business; ensure adherence and conformity with the terms of the instrument or contract; and maintain absolute separation of property free from any intrusion of conflict of interest.

As fiduciary activities become more diverse and complex, an institutions' ability to effectively identify, measure, monitor and control risks should keep pace and continue to evolve. There is no single risk management framework that would effectively work for all TEs due to differing size, business model, complexity of activities, and risk profile. Nevertheless, regardless of the structure in place, the framework shall cover the following key elements of sound risk management system:

- a. Active and appropriate oversight by the Board of Directors (BOD)/Trust Committee or its functional oversight equivalent in case of foreign banks/institutions;
- b. Adequate risk management processes, policies and procedures;

- c. Appropriate risk measurement system, prudent risk limits, monitoring and management information system; and
- d. Comprehensive and effective internal control system, audit, and compliance program.

IV. Risks Associated with Fiduciary Activities

For purposes of these Guidelines, the following definitions of risks are adopted:

1. Credit/counterparty risk is the current and prospective risk to client's earnings or principal contribution arising from an obligor's failure to meet the terms of any contract with the TE or otherwise perform as agreed. Credit risk is found in all activities where success depends on counterparty, issuer, or borrower performance. It arises anytime fiduciary funds are extended, committed, invested, or otherwise exposed through actual or implied contractual agreements, and reflected in the client's financial statements. Credit/counterparty risk exists in the loan portfolio and other forms of credit accommodations
2. Market risk is the current and prospective risk to client's earnings or principal contribution arising from changes in the value of the TE's holdings of investment portfolios. Market risk arises from dealing and position-taking activities in interest rate, foreign exchange and equity markets.
3. Liquidity risk is the current and prospective risk to client's earnings or principal contribution arising from a TE's inability to recognize or address unplanned changes in client's and/or beneficiary's needs thereby affecting the ability to liquidate assets quickly with minimal loss in value. The TE shall determine and maintain adequate level of liquidity in each accounts based on client-defined constraints/circumstances or product specifications.
4. Operational risk is the current and prospective risk to the bank's/non-bank financial institution's earnings or capital arising from fraud or error, and the inability of the TE to deliver products or services, maintain a competitive position and manage information. Operational risk is evident in each fiduciary product and service offered. As the fiduciary products and services become sophisticated or volume of activities expands, so does the level of operational risk. This risk encompasses product development and delivery, operational processing, systems development, and the internal control environment. Operational risk is present in the day-to-day operations of TEs and in all aspects of fiduciary activities.

A part of Operational risk is Legal risk which arises from non-adherence with the terms of the fiduciary agreement and the potential that unenforceable contracts, lawsuits, or adverse judgments can disrupt or otherwise negatively affect the operations of a TE.

5. Compliance risk is the current and prospective risk to the bank's/non-bank financial institution's earnings or capital arising from violation of laws, rules and regulations of regulatory authorities, prescribed practices or sound fiduciary principles, internal

policies and procedures, and prudent ethical standards. Compliance risk also arises in situations where the laws or rules governing certain fiduciary products or activities of the TE may be ambiguous or untested. This risk exposes the TE to fines, payment of damages, and the voiding of contracts. Compliance risk can lead to limited business opportunities, reduced expansionary potential, unenforceability of contract or even adversely affect TE's reputation.

6. Strategic risk is the current and prospective risk to the bank's/non-bank financial institution's earnings and capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes. Strategic risk is a function of the compatibility of a financial institution's strategic goals, the business strategies developed to achieve those goals, the resources deployed in support of these goals, and the quality of implementation. The TE's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environmental changes. Financial success requires a sound strategic planning process embraced by the board and senior management.
7. Reputation risk is the current and prospective risk to the bank's/non-bank financial institution's earnings and capital arising from negative publicity regarding the financial institution's fiduciary business practices. The negative public opinion can cause (a) clients to question or doubt the TE's integrity to engage in fiduciary activities which can result in the termination of fiduciary relationships, (b) litigation costs to increase, or (c) revenues to decline. Reputation risk affects the TE's ability to establish new fiduciary relationships or services, or continue servicing existing relationships. Since public's perception is critical in the fiduciary business, TEs should exercise an abundance of caution in dealing with clients and the public in general.

V. Risk Management Process

A TE shall develop and implement a formal, comprehensive, and effective risk management program that outlines, among other things, the risk management processes that effectively identify, measure, monitor and control risks affecting the clients and the TE. These processes shall also recognize and address the differences in the needs, objectives and risk tolerance of the clients and the TE. An effective risk management program can serve as an early warning system that enables the TE to anticipate and/or pro-actively identify potential problems from arising which may result in unanticipated loss to the clients and the TE. A risk management program should:

1. **Identify risk.** TEs shall recognize and understand existing exposures or those that may arise from new products/services, acceptance of new clients, and changes in operating environment. They shall establish procedures that identify and address such risks prior to initiation of the activities. Risk identification is a continuing process that should be embedded in all phases of TE's activities and shall cover both the individual investment transactions and portfolio activities. Identifying risk also involves the determination of the desired level of exposures both for the TE and client after taking into account the willingness and the ability to absorb risks.

2. **Measure risk.** TEs shall have appropriate systems or tools in place that could adequately quantify or measure both their client and their own risk exposure/s. It shall be the TE's responsibility to ensure that the risk measurement tools can adequately and reliably capture and quantify exposures. Risk measurement tools shall be subjected to independent and periodic validation and review to ensure that they remain reliable and appropriate. Effective risk measurement systems assess the risks of both individual transactions and portfolios and ensure that the sophistication of the risk measurement tools remains proportionate to the complexity of exposures.
3. **Monitor risk.** TEs shall monitor risk levels to ensure timely review of risk positions and exceptions. Monitoring reports should be frequent, timely, accurate, and informative and should be distributed to clients/individuals and appropriate level of management to ensure corrective action, when necessary.
4. **Control risk.** TEs shall establish and communicate risk limits through policies, standards, and procedures that define responsibility and authority. The types and sophistication of control processes shall be consistent with the risk tolerance standards defined by the BOD/Trust Committee and the client. TEs shall implement a process for tracking and reporting exposures to monitor the TE's compliance with risk tolerance standards.

The risk management process for fiduciary activities should be structured and incorporated in the required basic standards in the administration of fiduciary products and services.

VI. Sound Risk Management System

Consistent with the guidelines on supervision by risk set forth under Appendix 72 (appendix to Section X173), the BSP shall assess the suitability and adequacy of a TE's risk management system in accordance with the following elements:

A. Active Board and Senior Management Oversight

1. The Board of Directors (or its functional oversight equivalent which may include the country head in the case of foreign banks/institutions) and the Trust Committee shall perform their responsibilities in accordance with the applicable provisions of the Manual of Regulations for Banks (MORB)/Manual of Regulations for Non-Bank Financial Institutions (MORNBFI).
2. Independent Risk Management Function

To uphold the principles of undivided loyalty and impartiality, and discourage possible conflicts of interest, the process of measuring, monitoring, and controlling risks shall be managed as independently as practicable by a body or personnel apart from those individuals who have the authority to initiate transactions. The Board-designated body or personnel performing independent risk management on fiduciary activities shall either be part of or directly report to

the risk management unit/department of the bank/institution proper to ensure holistic implementation of enterprise-wide risk management framework. Nevertheless, the Board-designated body or personnel tasked to perform risk management function for fiduciary activities is not precluded to freely communicate with the trust officer or relevant trust committee any information relative to the discharge of its function.

B. Adequate Risk Management Processes, Policies and Procedures

The TE shall have Board-approved written risk management policies and documentation standards which provide detailed guidance for the day-to-day implementation of the TE's strategies and generally include risk limits, operating procedures and control processes designed to safeguard the TE and its clients from excessive and imprudent risks. Terminologies relevant to trust, other fiduciary and investment management activities shall be specifically defined and clearly described through appropriate sample documents/exhibits to avoid the likelihood of incomplete communication, ambiguities and misinterpretations.

Policies shall provide an outline on the formal process for the BOD/Management's review (at least annually), amendment and approval. In the case of personnel management, the policies and procedures shall provide for personnel recruitment, training, performance evaluation, and salary administration that must address staffing needs, and compensation programs. Effective risk management requires experienced and competent officers and supporting staff.

Policies and procedures shall delineate lines of responsibility and accountability. Copies of policies and procedures, including updates and changes, shall be promptly transmitted to all concerned personnel who are directly or indirectly involved in fiduciary activities. Policies and procedures shall, at the minimum, include:

1. Scope of fiduciary products and types of services offered to clients with clear description of each product and service
2. Organizational structure
3. Authorities and responsibilities of the:
 - a. Board of Directors
 - b. Trust Committee
 - c. Trust Investment Committee and Other Related Committees
 - d. Trust Officer*
 - e. Trust Department/Branch/Unit Heads*
 - f. Account Officers/Marketing Personnel, including those assigned in branches*
 - g. Trading or Dealing Officers and Staff*
 - h. Backroom Officers and Staff*

** including minimum qualification standards*

4. Basic standards in the administration of trust, other fiduciary business and investment management activities
5. Accounting and records maintenance
6. Policy review
7. System of financial and regulatory reporting
8. Client-oriented safety nets

C. Appropriate Risk Measurement System, Prudent Risk Limits, Monitoring and Management Information System

The process of measuring, controlling and monitoring fiduciary risks shall be carried out independently by personnel not directly involved in fiduciary activities. Results of this process shall be reported to the BOD, or to the appropriate Board-level committee, thru the risk management unit/department of the bank/institution proper in a timely and comprehensive manner. In the same manner, the trust officer or relevant trust committee should be apprised of the results of these processes and relevant risk management issues.

Risk Measurement System

In formulating the risk measurement models and methodologies for its fiduciary risk-taking activities, the TEs shall be guided by the minimum requirements prescribed in Appendix 73 (appendix to Section X174) and 74 (appendix to Section X175), and the guidelines provided under Appendix 25 (appendix to Section X611) of the Manual of Regulations for Banks, as applicable.

TEs are expected to adopt models/methodologies commensurate to the size, complexity and nature of the fiduciary activities undertaken. In addition, the TE's risk measurement system shall provide detailed guidelines on the:

- a. Frequency of risk measurement
- b. Sources of data, i.e., market prices
- c. Appropriateness of risk measurement tools given the complexity and level of risk assumed (including the reasonableness and validity of assumptions)
- d. Frequency of validation of risk measurement tools
- e. Ability to measure risk at both transactional and portfolio levels
- f. Frequency of review of the risk measurement system by the BOD and the trust committee

TEs shall develop a liquidity contingency plan for its investment portfolios especially for the UITFs to demonstrate how liquidity funding needs will be handled in times of crises, as well as supplement their market and liquidity risk measurement models with periodic stress testing.

Prudent Risk Limits

Risk limits shall be established, approved and periodically reviewed by the BOD or trust committee. In setting limits, the risk management policy shall include the determination of the experience, background and authority of individuals involved in setting portfolio limits, and the processes for setting and changing individual and portfolio limits; and shall recognize the restrictions/constraints that the client may impose on the TE. The risk management policy should also indicate when excess over approved limits may be allowed and the appropriate approving authority for such excess.

Limits must be documented and promptly communicated to all concerned personnel. Portfolio limits must be reviewed at least annually, but client-set limits must be reviewed at least quarterly to ensure consistency with the investment objectives set by the client and conformity to the terms of the contract.

Risk Monitoring and Management Information Systems (MIS)

Effective risk monitoring and control is dependent on accurate, timely, reliable, and relevant information processing and reporting systems. Rapid technology advancements create new risk monitoring and control issues, thus, the BOD should ensure that the impact of emerging technologies on fiduciary activities is properly considered. The BOD and Trust Committee shall be afforded with adequate information on the trust and investment management activities to properly fulfill their responsibilities. Accordingly, the TEs shall have policies and procedures in reporting information on fiduciary activities to the BOD and trust committee specifying, among other things, the type, amount and timing of information reported; methodology to ensure all identified risks are monitored; frequency, timeliness, accuracy and clarity of monitoring reports; report distribution to management and staff; and comparability of output against predetermined limits.

The sophistication of management information system (MIS) shall be commensurate with the complexity and diversity of the TE's operations such that a complex TE shall have a more comprehensive MIS.

Because of the cost involved in developing technology, a TE may opt to purchase information technology rather than develop its own internal system. Nonetheless, regardless of the source of information system, the BOD and Trust Committee shall exercise the proper level of control and oversight to appropriately fulfill their fiduciary duties. Service Agreements or vendor contracts shall be thoroughly reviewed by legal counsel to ensure that they include appropriate indemnification and recourse language. In addition, contracts shall contain specific language recognizing the authority of the TE's regulators to conduct reviews of third-party vendors as part of their overall supervisory activities.

D. Comprehensive and effective internal controls, audit, and compliance program

Internal Control Systems

A comprehensive internal control is the foundation for the safe and sound functioning of a TE and its fiduciary risk management system. It shall form an integral part of the TE's overall system of controls and shall promote effective fiduciary operations and reliable financial and regulatory reporting, safeguard assets and help ensure compliance with relevant laws, regulations, and institutional policies.

Effectiveness of the internal control system shall be periodically tested by an independent party (preferably the auditor, or at least an individual not involved in the process being reviewed) who shall submit a formal report on the results of such testing/review directly to the BOD or the audit committee. The review shall cover all material controls and shall consider:

- The change in the nature and extent of significant risks, and the TE's ability to respond to such changes;
- The scope and quality of management's ongoing monitoring of risks and of the system of internal control, and the work of its internal audit function;
- The extent and frequency of the communication of results of the monitoring to the BOD or appropriate committee;
- The incidence of significant control failings or weaknesses that have been identified, and the extent to which they have resulted in losses or potential losses; and
- The effectiveness of the TE's reporting processes.

Given the importance of appropriate internal controls to an organization, management's response to results of the test/review should be documented.

The system of internal control shall set forth clear lines of authority and appropriate segregation of operational duties and functions to ensure independence of the control areas from the business lines. An organizational chart shall specify the reporting lines for risk management, compliance, and internal audit groups.

Audit Program

A well-designed and executed internal audit program is essential to effective risk management and provides an independent assessment of the efficiency and effectiveness of the internal control system.

An effective audit program shall be based on an appropriate risk assessment methodology that documents the TE's significant fiduciary activities and their associated risks, and internal control systems. Such documentation shall be available for review by the BSP. It shall describe the objectives of specific audit activities and list the procedures to be performed during the process.

While the frequency and extent of the internal audit review and testing shall be consistent with the nature, complexity and risk of the TE's fiduciary activities, existing BSP regulations require the conduct of periodic internal audits of the TE at least once every twelve (12) months. The BOD may also require the adoption of a suitable continuous audit system to supplement or replace the periodic audit. In any case, the audit shall ascertain whether the TE's fiduciary activities have been administered in accordance with laws, BSP rules and regulations, and sound fiduciary principles.

There shall also be a system that allows sensitive findings (e.g., defined non-observance of the basic principles on fiduciary relationships, unsafe and unsound practices, operational lapses/deficiencies resulting to recognition of material losses) to be reported directly to the BOD. Moreover, the audit committee and/or BOD shall review the effectiveness of the internal audit and other control review activities on a regular basis.

BSP regulations also require annual external audit of the fiduciary activities of TEs and of each unit investment trust fund by an independent auditor acceptable to the BSP.

Compliance Program

The TE shall develop and implement a compliance system for its trust, other fiduciary business and investment management activities, and appoint/designate a compliance officer to oversee its implementation in accordance with Sections X180/4180Q and their corresponding subsections of the MORB/MORNBFI, respectively. The Board-designated body or personnel performing independent compliance function on fiduciary activities shall either be part of or directly report to the compliance unit/department of the bank/institution proper to ensure holistic implementation of enterprise-wide compliance program. Nevertheless, the Board-designated body or personnel tasked to implement the compliance program for fiduciary activities is not precluded to freely communicate with the trust officer or relevant trust committee any information relative to the discharge of its function.

The compliance system must provide a written and comprehensive compliance program designed to monitor observance with relevant laws, rules and regulations, internal policies including risk limits, internal control systems, fiduciary principles, and agreements with clients. The compliance system shall be periodically reviewed for relevance, effectiveness and appropriate follow-up.

The BOD must recognize the scope and implications of applicable laws; approve a compliance program that protects the TE from adverse litigation, increased regulatory oversight, and damage to reputation; and ensure that the compliance officer primarily undertakes to oversee and coordinate the implementation of the compliance system.

The extent of formality of the compliance program may vary from one TE to another. Nevertheless, an effective compliance programs have common elements that include:

1. A strong commitment from the BOD and Trust Committee;
2. A formalized program coordinated by a designated compliance officer that includes periodic testing and validation process;
3. Responsibility and accountability from line management;
4. Comprehensive training programs; and
5. Timely reporting and follow-up process