**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)**
**QUESTIONS AND ANSWERS (Q&As)**

**Q&A No. 2019-07**

# Classification of Members' Capital Contributions of Non-Stock Savings and Loan Associations (NSSLA)

## Background:

The Bangko Sentral ng Pilipinas (BSP) issued Circular No. 1045 on August 29, 2019 to amend the Manual of Regulations for Non-Bank Financial Institutions Applicable to Non-Stock Savings and Loan Associations (MORNBFI-S) – Regulatory Capital of Non-Stock Savings and Loan Associations (NSSLAs) and Capital Contributions of Members.

Under the Circular, each qualified member of an NSSLA shall maintain only one capital contribution account representing his/her capital contribution. While only one capital account is maintained, the Circular breaks down a member's capital contributions as follows:

a. **Fixed capital** which cannot be reduced for the duration of membership except upon termination of membership. The minimum amount of fixed capital is Php1,000, but a higher minimum can be prescribed under the NSSLA's by-laws.

b. **Capital contribution buffer**, which pertains to capital contributions in excess of fixed capital. The capital contribution buffer can be withdrawn or reduced by the member without affecting his membership. However, the NSSLA shall establish and prescribe the conditions and/or circumstances when the NSSLA may limit the reduction of the members' capital contribution buffer, such as, when the NSSLA is under liquidity stress or is unable to meet the capital-to-risk assets ratio requirement under Sec. 4116S of the MORNBFI-S Regulations. Such conditions and/or circumstances have to be disclosed to the members upon their placement of capital contribution buffer and in manners as may be determined by the Board.

For purposes of identifying and monitoring the fixed capital and capital contribution buffer of a member's capital contribution, NSSLAs shall maintain subsidiary ledgers showing separately the fixed and capital contribution buffer of each member. Further, upon receipt of capital contributions from their members, NSSLAs shall simultaneously record the amount contributed as fixed and capital contribution buffer in the aforementioned subsidiary ledgers. However, NSSLAs may use other systems in lieu of subsidiary ledgers provided that that the system will separately show the fixed and capital contribution buffer of each member.

## Issue

Would both the Fixed capital and the Capital contribution buffer qualify as "equity" in the NSSLA's financial statements?

## Consensus

As both Fixed capital and Capital contribution buffer give its members the right to require redemption for cash, they meet the definition of puttable instruments. In assessing whether these instruments qualify as equity, reference has to be made to paragraphs 16A and 16B of PAS 32, *Financial Instruments: Presentation*.

| **PAS 32 16A and 16B Requirements** | **Assessment** |
|---|---|
| 16A A puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all the following features:<br><br>(a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:<br><br>(i) dividing the entity's net assets on liquidation into units of equal amount; and<br>(ii) multiplying that amount by the number of the units held by the financial instrument holder. | **Met for both Fixed capital and Capital contribution buffer.**<br>Upon liquidation, the assets of the NSSLA are distributed to members after settling its liabilities. A member’s share in the net assets of the NSSLA is based on his total capital contributions (both Fixed capital and Capital contribution buffer are treated the same) |

| PAS 32 16A and 16B Requirements | Assessment |
|---|---|
| (b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:<br><br>(i) has no priority over other claims to the assets of the entity on liquidation, and<br><br>(ii) does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments. | **Met for both Fixed capital and Capital contribution buffer.**<br>Both Fixed capital and Capital contribution buffer meet the two (2) characteristics to be considered included in the most subordinate class of instruments. Upon liquidation, both capital are treated the same. That is, payment is based on the same formula and there is no priority given to either capital in terms of priority of payment. |
| (c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features. For example, they must all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for all instruments in that class. | **Met for both Fixed capital and Capital contribution buffer.**<br>Both Fixed capital and Capital contribution buffer have the same redemption rights and features. Both can be withdrawn anytime using the same redemption formula. The only difference is loss of membership upon withdrawal of the Fixed capital, but this is not a consideration as it does not impact ability to withdraw |
| (d) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments as set out in subparagraph (b) of the definition of a financial liability. | **Met for both Fixed capital and Capital contribution buffer.**<br>There are no other features that would cause liability classification for both types of capital. |

| PAS 32 16A and 16B Requirements | Assessment |
|---|---|
| (e) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the profit or loss, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity over the life of the instrument (excluding any effects of the instrument). | **Met for both Fixed capital and Capital contribution buffer.**<br>Members share in the profit of the NSSLA once a year on the basis of their capital contributions. |
| 16B In addition to the instrument having all the features in (a) to (e) above, the issuer must have no other financial instrument or contract that has:<br><br>a. total cash flows based substantially on the profit or loss, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity (excluding any effects of such instrument or contract); and<br>b. the effect of substantially restricting or fixing the residual return to the instrument holders. | **Met for both Fixed capital and Capital contribution buffer.**<br>There are no other types of capital contributions or financial instruments with cash flows based on the profit or loss of the NSSLA and with the effect of restricting the net income distributions to the Fixed capital and Capital contribution buffer. |

Given that both types of capital contributions meet all the requirements of paragraphs 16A and 16B of PAS 32, they both qualify to be classified as equity by the NSSLA.

**Transition and Effective Date**

The consensus in this Q&A is effective from the approval date and should be applied retrospectively.

Date approved by PIC: November 28, 2019

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