

Sterling Bank of Asia, Inc. (A Savings Bank)

Financial Statements
December 31, 2012 and 2011

and

Independent Auditors' Report

SyCip Gorres Velayo & Co.

SGV&Co
ERNST & YOUNG

INDEPENDENT AUDITORS' REPORT

The Stockholders and the Board of Directors
Sterling Bank of Asia, Inc. (A Savings Bank)

Report on the Financial Statements

We have audited the accompanying financial statements of Sterling Bank of Asia, Inc. (A Savings Bank), which comprise the statements of financial position as at December 31, 2012 and 2011, and the statements of income, statements of comprehensive income, statements of changes in equity and statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Philippine Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Philippine Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



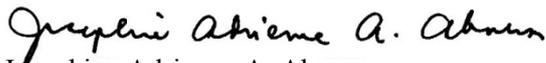
Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Sterling Bank of Asia, Inc. (A Savings Bank) as at December 31, 2012 and 2011, and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards.

Report on the Supplementary Information Required under Revenue Regulations 19-2011 and 15-2010

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information required under Revenue Regulations 19-2011 and 15-2010 in Notes 31 and 32 to the financial statements, respectively, is presented for purposes of filing with the Bureau of Internal Revenue and is not a required part of the basic financial statements. Such information is the responsibility of the management of Sterling Bank Asia, Inc. (A Savings Bank). The information has been subjected to the auditing procedures applied in our audit of the basic financial statements. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

SYCIP GORRES VELAYO & CO.



Josephine Adrienne A. Abarca
Partner

CPA Certificate No. 92126

SEC Accreditation No. 0466-AR-2 (Group A),
February 4, 2013, valid until February 3, 2016

Tax Identification No. 163-257-145

BIR Accreditation No. 08-001998-61-2012,
April 11, 2012, valid until April 10, 2015

PTR No. 3669656, January 2, 2013, Makati City

March 26, 2013



STERLING BANK OF ASIA, INC. (A Savings Bank)

STATEMENTS OF FINANCIAL POSITION

	December 31	
	2012	2011
ASSETS		
Cash and Other Cash Items	₱633,646,640	₱591,123,145
Due from Bangko Sentral ng Pilipinas (Note 15)	2,029,551,219	1,912,501,244
Due from Other Banks	1,097,031,428	447,348,222
Interbank Loans Receivable and Securities Purchased Under Resale Agreements with the Bangko Sentral ng Pilipinas (Note 6)	295,177,246	1,933,909,546
Financial Assets at Fair Value through Profit or Loss (Note 7)	393,154,823	2,599,443,790
Available-for-Sale Investments (Note 8)	5,628,538,664	3,340,129,529
Held-to-Maturity Investments (Note 9)	112,624,394	120,828,253
Loans and Receivables (Notes 10 and 26)	16,092,325,686	14,690,401,164
Property and Equipment (Note 11)	604,445,652	631,521,867
Investment Properties (Note 12)	121,944,300	147,017,620
Branch Licenses (Note 13)	225,390,000	225,390,000
Other Assets (Note 14)	120,533,461	135,771,739
	₱27,354,363,513	₱26,775,386,119
LIABILITIES AND EQUITY		
LIABILITIES		
Deposit Liabilities (Note 15)		
Demand	₱4,474,492,504	₱3,978,159,770
Savings	1,476,900,753	1,176,181,020
Time	17,418,808,461	18,735,806,015
	23,370,201,718	23,890,146,805
Manager's Checks	60,842,543	78,024,579
Bills Payable (Note 16)	297,251,097	121,492,338
Accrued Interest, Taxes, and Other Expenses (Note 17)	194,344,843	189,769,258
Income Tax Payable (Note 24)	2,638,390	-
Unsecured Subordinated Debt (Note 18)	500,000,000	-
Deferred Tax Liabilities (Note 24)	18,924,080	21,713,528
Other Liabilities (Note 19)	953,229,197	903,397,124
	25,397,431,868	25,204,543,632
EQUITY		
Common Stock (Note 25)	1,625,000,000	1,500,000,000
Perpetual Preferred Stock (Note 25)	62,500,000	-
Retained Earnings	134,398,663	87,824,050
Net Unrealized Gain (Loss) on Available-for-Sale Investments (Note 8)	155,975,555	(156,607)
Cumulative Translation Adjustment	(20,942,573)	(16,824,956)
	1,956,931,645	1,570,842,487
	₱27,354,363,513	₱26,775,386,119

See accompanying Notes to Financial Statements.



STERLING BANK OF ASIA, INC. (A Savings Bank)**STATEMENTS OF INCOME**

	Years Ended December 31	
	2012	2011
INTEREST INCOME		
Loans and receivables (Notes 10 and 26)	₱1,269,903,980	₱1,222,133,541
Investment securities (Notes 7, 8 and 9)	410,315,028	422,312,964
Interbank loans receivable and securities purchased under resale agreements with the Bangko Sentral ng Pilipinas (Note 6)	63,778,456	42,683,232
Deposits in banks and others (Notes 14 and 15)	20,304,124	20,673,364
	1,764,301,588	1,707,803,101
INTEREST EXPENSE ON DEPOSIT LIABILITIES, BILLS PAYABLE AND OTHERS (Notes 15, 16 ad 18)	897,467,507	822,915,307
NET INTEREST INCOME	866,834,081	884,887,794
Trading gains - net (Notes 5, 7 and 8)	375,292,054	348,815,760
Service charges, fees and commissions	155,753,004	122,892,184
Foreign exchange gains - net	27,624,025	9,577,679
Profit from assets sold or acquired - net (Notes 11, 12 and 14)	3,085,577	8,103,316
Gain on redemption by issuer of held-to-maturity investments (Note 9)	–	1,193,246
Miscellaneous	1,481,642	864,059
TOTAL OPERATING INCOME	1,430,070,383	1,376,334,038
Compensation and fringe benefits (Notes 22 and 26)	429,302,981	386,677,749
Taxes and licenses	188,476,597	175,371,621
Depreciation and amortization (Notes 11, 12 and 14)	152,139,092	146,225,686
Occupancy and equipment-related expenses (Note 21)	101,436,431	90,419,336
Provision for credit losses (Note 10)	78,011,138	58,477,334
Entertainment, amusement and representation	65,215,953	65,636,012
Security, messengerial and janitorial	55,151,054	55,683,300
Insurance expense	51,198,143	49,004,674
Others (Note 23)	184,106,468	150,938,546
TOTAL OPERATING EXPENSES	1,305,037,857	1,178,434,258
INCOME BEFORE INCOME TAX	125,032,526	197,899,780
PROVISION FOR INCOME TAX (Note 24)	78,457,913	71,588,294
NET INCOME	₱46,574,613	₱126,311,486

See accompanying Notes to Financial Statements.



STERLING BANK OF ASIA, INC. (A Savings Bank)
STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31	
	2012	2011
NET INCOME	₱46,574,613	₱126,311,486
OTHER COMPREHENSIVE INCOME (LOSS)		
Change in net unrealized gain on available-for-sale investments during the year (Note 8)	156,132,162	41,825,040
Cumulative translation adjustment	(4,117,617)	(15,382,331)
OTHER COMPREHENSIVE INCOME FOR THE YEAR	152,014,545	26,442,709
TOTAL COMPREHENSIVE INCOME	₱198,589,158	₱152,754,195

See accompanying Notes to Financial Statements.



STERLING BANK OF ASIA, INC. (A Savings Bank)

STATEMENTS OF CHANGES IN EQUITY

Years Ended December 31, 2012 and 2011

	Common Stock (Note 25)	Perpetual Preferred Stock (Note 25)	Deposits for Future Stock Subscription (Note 25)	Retained Earnings	Net Unrealized Gain (Loss) on Available- for-Sale Investments (Note 8)	Cumulative Translation Adjustment	Total Equity
Balance at January 1, 2012	₱1,500,000,000	₱–	₱–	₱87,824,050	(₱156,607)	(₱16,824,956)	₱1,570,842,487
Total comprehensive income (loss)	–	–	–	46,574,613	156,132,162	(4,117,617)	198,589,158
Issuance of capital stock	125,000,000	62,500,000	–	–	–	–	187,500,000
Balance at December 31, 2012	₱1,625,000,000	₱62,500,000	₱–	₱134,398,663	₱155,975,555	(₱20,942,573)	₱1,956,931,645
Balance at January 1, 2011	₱1,250,000,000	₱–	₱250,000,000	(₱38,487,436)	(₱41,981,647)	(₱1,442,625)	₱1,418,088,292
Total comprehensive income (loss)	–	–	–	126,311,486	41,825,040	(15,382,331)	152,754,195
Issuance of capital stock	250,000,000	–	(250,000,000)	–	–	–	–
Balance at December 31, 2011	₱1,500,000,000	₱–	₱–	₱87,824,050	(₱156,607)	(₱16,824,956)	₱1,570,842,487

See accompanying Notes to Financial Statements.



STERLING BANK OF ASIA, INC. (A Savings Bank)**STATEMENTS OF CASH FLOWS**

	Years Ended December 31	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before income tax	₱125,032,526	₱197,899,780
Adjustments for:		
Depreciation and amortization (Notes 11, 12 and 14)	152,139,092	146,225,686
Provision for credit losses (Note 10)	78,011,138	58,477,334
Amortization of premium on held-to-maturity investments (Note 9)	1,786,859	294,283
Gain on redemption by issuer of held-to-maturity investments (Note 9)	–	(1,193,246)
Profit from assets sold or acquired (Notes 11, 12 and 14)	(3,085,577)	(8,103,316)
Mark-to-market loss (gain) on financial assets at fair value through profit or loss (Note 7)	4,425,743	(41,071,386)
Gain on sale of available-for-sale investments (Note 8)	(207,307,450)	(144,081,892)
Changes in operating assets and liabilities:		
Decrease (increase) in the amounts of:		
Financial assets at fair value through profit or loss	2,201,863,224	(847,686,546)
Loans and receivables	(1,602,882,426)	(1,277,969,826)
Other assets	(17,377,324)	1,584,727
Increase (decrease) in the amounts of:		
Deposit liabilities	(519,945,087)	3,106,906,103
Manager's checks	(17,182,036)	14,700,300
Accrued interest, taxes and other expenses	4,575,585	58,403,510
Other liabilities	174,832,073	(351,791,863)
Net cash generated from operations	374,886,340	912,593,648
Income taxes paid	(69,684,809)	(61,094,430)
Net cash provided by operating activities	305,201,531	851,499,218
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisitions of:		
Available-for-sale investments	(11,455,629,888)	(5,839,063,083)
Property and equipment (Note 11)	(122,660,753)	(188,521,330)
Proceeds from:		
Sale of available-for-sale investments	9,533,669,922	6,359,401,369
Redemption by issuer of held-to-maturity investments	–	10,960,000
Disposal of investment properties (Note 12)	50,670,590	31,070,889
Disposal of chattel mortgage properties (Note 14)	102,892,027	60,179,057
Disposal of property and equipment (Note 11)	22,239,805	3,779,610
Net cash provided by (used in) investing activities	(1,868,818,297)	437,806,512
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from:		
Availments of bills payable	1,014,971,248	481,380,455
Issuance of capital stock (Note 25)	62,500,000	125,000,000
Issuance of unsecured subordinated debt (Note 18)	500,000,000	–
Payments of bills payable	(839,212,489)	(446,952,130)
Net cash provided by financing activities	738,258,759	159,428,325

(Forward)



	Years Ended December 31	
	2012	2011
EFFECT OF EXCHANGE RATE CHANGES IN CASH AND CASH EQUIVALENTS	(₱4,117,617)	(₱15,382,331)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(829,475,624)	1,433,351,724
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		
Cash and other cash items	591,123,145	625,873,173
Due from Bangko Sentral ng Pilipinas	1,912,501,244	636,104,375
Due from other banks	447,348,222	569,552,885
Interbank loans receivable and securities purchased under resale agreements with the Bangko Sentral ng Pilipinas	1,933,909,546	1,620,000,000
	4,884,882,157	3,451,530,433
CASH AND CASH EQUIVALENTS AT END OF YEAR		
Cash and other cash items	633,646,640	591,123,145
Due from Bangko Sentral ng Pilipinas	2,029,551,219	1,912,501,244
Due from other banks	1,097,031,428	447,348,222
Interbank loans receivable and securities purchased under resale agreements with the Bangko Sentral ng Pilipinas	295,177,246	1,933,909,546
	₱4,055,406,533	₱4,884,882,157

OPERATING CASH FLOWS FROM INTEREST

	Years Ended December 31	
	2012	2011
Interest received	₱1,746,066,862	₱1,679,137,787
Interest paid	903,414,697	801,517,382

See accompanying Notes to Financial Statements.



STERLING BANK OF ASIA INC. (A Savings Bank)

NOTES TO FINANCIAL STATEMENTS

1. Corporate Information

Sterling Bank of Asia, Inc. (A Savings Bank) (the Bank), formerly Far East Savings Bank, Inc. (FESB), was incorporated in the Philippines on January 20, 1998 to engage primarily in the general business of savings and mortgage banking. FESB was authorized by the Bangko Sentral ng Pilipinas (BSP) to operate as a savings bank on February 26, 1998 and started commercial operations on March 16, 1998.

On July 12, 2006, JTKC Equities, Inc., Surewell Equities, Inc., and Star Equities, Inc. (the Buyers) entered into a Memorandum of Agreement with the Bank of the Philippine Islands (BPI) to purchase the entire capital stock of FESB. BPI is the record or beneficial owner of the entire issued and outstanding capital stock of FESB. On October 20, 2006, the Buyers and BPI entered into an Agreement to Purchase Shares to confirm the Buyers' intention to purchase FESB, subject only to the formal approval of the BSP. The BSP approved the agreement on December 27, 2006.

On December 28, 2006, the board of directors (BOD) and shareholders, in a separate meeting, approved the change in name of FESB to Sterling Bank of Asia, Inc. (A Savings Bank). On February 15, 2007 and February 27, 2007, the BSP and the Securities and Exchange Commission (SEC), respectively, approved such change in corporate name.

On March 16, 2007, the BSP confirmed the Bank's authority to operate as a thrift bank. On March 30, 2007, the Bank started accepting deposits from and granting loans to clients.

On January 16, 2009, the BSP approved the Bank's change of principal place of business from Ground Floor, SSS Building, Ayala Avenue, corner R. V. Rufino Street, Makati City to Sterling Bank Corporate Center, Ortigas Avenue, Greenhills, San Juan City. The SEC subsequently approved such change on February 6, 2009.

On March 9, 2009, the Bank entered into a Share Purchase Agreement (the Agreement) with the Armed Forces and Police Savings and Loan Association, Inc. (AFPSLAI) and the Armed Forces and Police Mutual Benefit Association, Inc. (AFPMBAI) to buy all of the shares of stock (including licenses and tangible/intangible assets) of Centennial Savings Bank, Inc. ('CSB'), a banking corporation based in the Philippines. AFPSLAI and AFPMBAI are the registered and beneficial owners of CSB.

On August 4, 2009, the BSP approved the Bank's application to acquire 100.0% of the shares of stock of CSB with the objective of merging it with the Bank. Although the acquisition is a temporary stage in the merger process, BSP noted that it will result in a technical violation of Section 12 of Republic Act (RA) No. 7906 (Thrift Banks Act of 1995), as implemented by Section X378 of the Manual of Regulations for Banks (MORB) for exceeding the 49.0% limit on investment in the equity of CSB, a financial allied undertaking. As a condition for the approval of the acquisition of 100.0% of the shares of stock of CSB, BSP required the Bank to submit a merger application with CSB within 30 days from receipt of notice of the BSP approval.

The Bank obtained control of CSB on August 18, 2009, the date when the Bank acquired the assets and assumed the liabilities of CSB.



The Bank and CSB executed the Plan of Merger on August 28, 2009 and submitted to the BSP an Application for Merger and the Plan of Merger documents on September 3, 2009. The Bank resubmitted the documents on December 9, 2009 to reflect the changes prescribed by the General Counsel of the BSP. The Plan of Merger indicates that the effective merger date will be the date of approval by the SEC and the SEC's issuance of the Certificate of Filing of the Articles of Merger.

The Bank obtained from the BSP the final approval of the merger on March 29, 2010 and the Certificate of Authority for the Approved Merger on June 2, 2010.

The SEC approved the merger and issued the Certificate of Filing of Articles of Merger on June 28, 2010.

On that date, the Bank and CSB merged, with the Bank as the surviving entity. As a result of the merger, the Bank no longer prepares separate parent company financial statements and consolidated financial statements. The financial statements of the Bank have been prepared as a continuation of the consolidated group.

The merger was accounted for in accordance with the pooling of interest method where the identifiable assets acquired and liabilities assumed from CSB were recognized at their carrying values.

The Bank's ultimate parent is JTKC Equities, Inc. by virtue of a direct interest of 40.0% and an indirect interest through Star Equities, Inc. of 29.9%. Star Equities, Inc. is a wholly-owned subsidiary of JTKC.

2. Summary of Significant Accounting Policies

Basis of Preparation

The accompanying financial statements have been prepared on a historical cost basis except for financial assets at fair value through profit or loss (FVPL), quoted available-for-sale (AFS) investments and derivative instruments which have been measured at fair value. The financial statements are presented in Philippine peso (₱) and all values are rounded to the nearest peso except when otherwise indicated.

The accompanying financial statements of the Bank include the accounts maintained in the Regular Banking Unit (RBU) and Foreign Currency Deposit Unit (FCDU). The functional currency of the RBU and the FCDU is the Philippine peso and United States dollar (USD), respectively. For financial reporting purposes, FCDU accounts and foreign currency-denominated accounts in the RBU are translated into their equivalents in Philippine peso, which is the Bank's presentation currency (see accounting policy on 'Foreign Currency Translation'). The financial statements of these units are combined after eliminating inter-unit accounts.

Statement of Compliance

The financial statements of the Bank have been prepared in compliance with Philippine Financial Reporting Standards (PFRS).



Presentation of Financial Statement

The Bank presents its statement of financial position in order of liquidity. An analysis regarding recovery or settlement within 12 months after the statement of financial position date and more than 12 months after the statement of financial position date is presented in Note 20.

Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year except for the adoption of the following amended standards which became effective on January 1, 2012. The adoption of these amendments did not have any impact on the financial statements of the Bank:

- *PFRS 7, Financial Instruments: Disclosures - Transfers of Financial Assets (Amendments)*
The amendments require additional disclosures about financial assets that have been transferred but not derecognized to enhance the understanding of the relationship between those assets that have not been derecognized and their associated liabilities. In addition, the amendments require disclosures about continuing involvement in derecognized assets to enable users of financial statements to evaluate the nature of, and risks associated with, the Bank's continuing involvement in those derecognized assets.
- *Philippine Accounting Standards (PAS) 12 Amendment, Income Taxes - Deferred Tax: Recovery of Underlying Assets*
This amendment to PAS 12 clarifies the determination of deferred tax on investment property measured at fair value. The amendment introduces a rebuttable presumption that the carrying amount of investment property measured using the fair value model in PAS 40, *Investment Property*, will be recovered through sale and, accordingly, requires that any related deferred tax should be measured on a 'sale' basis. The presumption is rebutted if the investment property is depreciable and it is held within a business model whose objective is to consume substantially all of the economic benefits in the investment property over time ('use' basis), rather than through sale. Furthermore, the amendment introduces the requirement that deferred tax on non-depreciable assets measured using the revaluation model in PAS 16, *Property, Plant and Equipment*, shall always be measured on a sale basis of the asset.

Foreign Currency Translation

Transactions and balances

For financial reporting purposes, the foreign currency-denominated assets and liabilities in the RBU are translated into their equivalents in Philippine pesos based on the Philippine Dealing System (PDS) closing rate prevailing at the statement of financial position date and foreign currency-denominated income and expenses, at the prevailing exchange rate at the date of transaction. Foreign exchange differences arising from revaluation and translation of foreign-currency denominated assets and liabilities are credited to or charged against operations in the year in which the rates change.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.



FCDU

As at the reporting date, the assets and liabilities of the FCDU are translated into the Bank's presentation currency (the Philippine Peso) at PDS closing rate prevailing at the statement of financial position date, and its income and expenses are translated at PDS weighted average rate for the year. Exchange differences arising on translation to the presentation currency are taken to the statement of comprehensive income under Cumulative translation adjustment. Upon disposal of the FCDU or upon actual remittance of FCDU profits to RBU, the deferred cumulative amount recognized in the statement of comprehensive income is recognized in the statement of income.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents consist of cash and other cash items (COCI), due from BSP and other banks, and interbank loans receivable and securities purchased under resale agreements (SPURA) with the BSP that are convertible to known amounts of cash, with original maturities of three months or less from dates of placements and that are subject to insignificant risk of changes in value.

Financial Instruments - Initial Recognition and Subsequent Measurement

Date of recognition

Regular way purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace are recognized on the settlement date. Settlement date is the date on which the transaction is settled by delivery of the assets that are the subject of the agreement. Settlement date accounting refers to (a) the recognition of an asset on the day it is received by the Bank, and (b) the derecognition of an asset and recognition of any gain or loss on disposal on the day that it is delivered by the Bank. Any change in the fair value of the financial asset to be received is recognized in the statement of income for financial assets at FVPL and in other comprehensive income for AFS investments. Deposits, amounts due from banks and loans and receivables are recognized when cash is received by the Bank or advanced to the borrowers.

Initial measurement of financial instruments

All financial instruments, except for financial assets and financial liabilities at FVPL, are initially recognized at fair value plus transaction costs, except for financial assets and financial liabilities at FVPL, that are directly attributable to the acquisition or issue of the financial asset or financial liability. The Bank classifies its financial assets in the following categories: financial assets at FVPL, AFS investments, held-to-maturity (HTM) investments and loans and receivables. Financial liabilities are classified into financial liabilities at FVPL and other financial liabilities at amortized cost. The classification depends on the purpose for which the investments were acquired and whether they are quoted in an active market. Management determines the classification of its investments at initial recognition and, where allowed and appropriate, re-evaluates such designation at every statement of financial position date.

Determination of fair value

The fair value for financial instruments traded in active markets at the statement of financial position date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and ask prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction.



For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist and other relevant valuation models.

'Day 1' difference

Where the transaction price in a non-active market is different from the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Bank recognizes the difference between the transaction price and fair value (a 'Day 1' difference) in the statement of income, unless it qualifies for recognition as some other type of asset. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognized in the statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Bank determines the appropriate method of recognizing the 'Day 1' difference amount.

Financial assets and liabilities at FVPL

Financial assets and liabilities at FVPL include financial assets and liabilities held for trading purposes and financial assets and liabilities designated upon initial recognition as at FVPL.

Financial assets and liabilities are classified as held-for-trading if they are acquired for purposes of selling and repurchasing in the near term. Derivatives, including any separated embedded derivatives, are also classified as financial assets or financial liabilities at FVPL, unless these are designated as hedging instruments in an effective hedge.

Financial assets or financial liabilities may be designated by the Bank on initial recognition as at FVPL when any of the following criteria are met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognizing gains or losses on them on a different basis;
- the assets and liabilities are part of a group of financial assets, liabilities or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

Financial assets and liabilities at FVPL are recorded in the statement of financial position at fair value. Subsequent changes in fair value are recognized in 'Trading gains - net' in the statement of income. Interest earned or incurred is recorded as interest income or expense, respectively, while dividend income is recorded as other income when the right to receive payment has been established.



Derivative instruments

The Bank uses derivatives instruments such as non-deliverable forwards and currency swaps to service customers and as means of reducing its foreign exchange exposure, as well as for trading purposes. Derivative instruments (including bifurcated embedded derivatives) are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Any gain or loss arising from changes in fair value of derivatives that do not qualify for hedge accounting is recognized in 'Trading gains - net' in the statement of income.

Embedded derivatives

An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined instrument vary in away similar to a stand-alone derivative.

Embedded derivatives are bifurcated from their host contracts, when the following conditions are met:

- (a) the entire hybrid contracts (composed of both the host contract and the embedded derivative) are not accounted for as financial assets and liabilities at FVPL;
- (b) when their economic risks and characteristics are not closely related to those of their respective host contracts; and
- (c) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative.

The Bank assesses whether embedded derivatives are required to be separated from the host contracts when it first becomes a party to the contract. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

AFS investments

AFS investments include equity and debt securities. Equity investments classified as AFS investments are those which are neither classified as held-for-trading nor designated as at FVPL. Debt securities in this category are those which are intended to be held for an indefinite period of time and which may be sold in response to liquidity needs or in response to changes in market conditions.

After initial measurement, AFS investments are subsequently measured at fair value. Unrealized gains and losses are recognized in other comprehensive income, except for impairment losses and foreign exchange gains and losses on monetary assets, until the financial asset is derecognized. When the security is disposed of, the cumulative gain or loss previously recognized in other comprehensive income is recognized as 'Trading gains - net' in the statement of income. Where the Bank holds more than one investment in the same security they are deemed to be disposed of on a first-come-first-out basis.

Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured shall be measured at cost less impairment loss.



Interest earned on holding AFS debt securities are reported as 'Interest income' using the effective interest rate (EIR). Dividend earned on holding AFS investments are recognized in the statement of income as "Other income" when the right to receive the payment has been established. The losses arising from impairment of AFS equity investments are recognized as "Provision for impairment losses" in the statement of income.

HTM investments

HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Bank's management has the positive intention and ability to hold to maturity. After initial measurement, HTM investments are carried at amortized cost using the effective interest method, less any impairment in value. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the EIR. The amortization is included in 'Interest income' in the statement of income. The losses arising from impairment of such investments are recognized in the statement of income. The effects of restatement on foreign currency-denominated HTM investments are recognized in the statement of income.

If the Bank were to sell more than an insignificant amount of HTM investments before maturity (other than in certain specific circumstances), the entire category would be tainted and would have to be reclassified as AFS investments. Furthermore, the Bank would be prohibited to classify any financial assets as HTM investments for the following two years.

Loans and receivables

Loans and receivables include receivables from customers, amounts due from BSP and other banks and interbank loans receivable and SPURA with the BSP. These are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not categorized as financial assets at FVPL or AFS investments.

After initial measurement, loans and receivables are subsequently measured at amortized cost using the effective interest method, less any allowance for credit losses. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the EIR. The amortization is included in 'Interest income' in the statement of income. The losses arising from impairment are recognized in 'Provision for credit losses' in the statement of income.

Other financial liabilities

Issued financial instruments or their components, which are not designated as at FVPL, are classified as liabilities carried at amortized cost, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of its own equity shares. Other financial liabilities include deposit liabilities, bills payable, manager's checks, accounts payable, payment orders payable, due to Philippine Deposit Insurance Corporation (PDIC) or BSP, bills purchased-contra and unsecured subordinated debt.

After initial measurement, other financial liabilities are subsequently measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any discount or premium on the issue and fees that are an integral part of the EIR.



Reclassification of Financial Assets

A financial asset is reclassified out of the FVPL category when the following conditions are met:

- The financial asset is no longer held for the purpose of selling or repurchasing it in the near term; and
- There is a rare circumstance.

Any gain or loss already recognized in the statement of income is not reversed. The fair value of the financial asset on the date of reclassification becomes its new amortized cost, as applicable.

A financial asset reclassified out of the AFS category is reclassified at its fair value on the date of reclassification. Any previous gain or loss on that asset that has been recognized in other comprehensive income is amortized to the statement of income over the remaining life of the investment using the effective interest method. Any difference between the new amortized cost and the expected cash flows is also amortized over the remaining life of the asset using the effective interest method. If the asset is subsequently determined to be impaired, then the amount recorded in other comprehensive income is recycled to the statement of income.

Reclassification is at the election of management, and is determined on an instrument-by-instrument basis. In 2008, the Bank reclassified USD-denominated investment securities from AFS investments to HTM investments (See Note 8).

Derecognition of Financial Assets and Liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired; or
- the Bank retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a “pass-through” arrangement; or
- the Bank has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained the risks and rewards of the asset but has transferred the control over the asset.

Where the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control over the asset, the asset is recognized to the extent of the Bank’s continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged, cancelled or has expired. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the statement of income.



Repurchase and Reverse Repurchase Agreements

Securities sold under agreements to repurchase at a specified future date ('repos') are not derecognized from the statement of financial position. The corresponding cash received, including accrued interest, is recognized in the statement of financial position.

Conversely, securities purchased under agreements to resell at a specified future date ('reverse repos') are not recognized in the statement of financial position. The corresponding cash paid, including accrued interest, is recognized in the statement of financial position as SPURA, and is considered as a loan to the counterparty. The difference between the purchase price and resale price is treated as interest income and is accrued over the life of the agreement using the effective interest method.

Offsetting Financial Instruments

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position, if and only if, there is a legally enforceable right to offset the recognized amounts and there is an intention to either settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, therefore, the related assets and liabilities are presented gross in the statement of financial position.

Financial Guarantees

In the ordinary course of business, the Bank provides financial guarantees. Financial guarantees are initially recognized in the statement of financial position at fair value, and the initial fair value is amortized over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of the amortized amount and the present value of any expected payment (when a payment under the guaranty has become probable).

Impairment of Financial Assets

The Bank assesses at each statement of financial position date whether there is any objective evidence that a financial asset or a group of financial assets is deemed to be impaired, if and only if, there is objective evidence as a result of one or more events that had occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Financial assets carried at amortized cost

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exist for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on financial assets carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred). The estimated future cash flows is discounted at the financial asset's original EIR. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flow that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. The



carrying amount of the asset is reduced through the use of an allowance account and the amount of loss is recognized in 'Provision for credit losses' in the statement of income. Interest income continues to be recognized based on the original EIR of the asset. Loans and receivables, together with the associated allowance accounts, are written off when there is no realistic prospect of future recovery and all collateral has been realized. If, in a subsequent year, the amount of the impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write off is later recovered, the recovery is credited to 'Provision for credit losses' in the statement of income.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the industry of the borrower. Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for the assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Restructured loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered as past due. Management continuously reviews restructured loans to ensure that all criteria are met and that future payments are likely to occur. The loan continues to be subject to an individual (calculated using the loan's original EIR) or collective impairment. The difference between the recorded value of the original loan and the present value of the restructured cash flows, discounted at the original EIR is recognized in "Provision for credit losses" in the statement of income.

AFS investments

For AFS investments, the Bank assesses at each statement of financial position date whether there is objective evidence that an investment is impaired.

In the case of AFS debt investments, the Bank assesses individually whether there is objective evidence of impairment based on the same criteria as financial assets carried at amortized cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortized cost and the current fair value. Future interest income is based on the reduced carrying amount and is accrued based on the rate of interest used to discount future cash flows for the purpose of measuring impairment loss. Such accrual is recorded as part of 'Interest income' in the statement of income. If, in a subsequent year, the fair value of a debt investment increases and the increase can be objectively related to a credit event occurring after the impairment loss was recognized in the statement of income, the impairment loss is reversed through the statement of income.



In case of equity investments classified as AFS, this would include a significant or prolonged decline in the fair value of the investments below its cost. Where there is objective evidence of impairment, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the statement of income - is removed from other comprehensive income and recognized in the statement of income. Impairment losses on equity investments are not reversed through the statement of income. Increases in fair value after impairment are recognized directly in other comprehensive income.

Property and Equipment

Land is stated at cost less any impairment in value and depreciable properties including building and condominium units, furniture, fixtures and equipment, transportation equipment and leasehold improvements are stated at cost less accumulated depreciation and amortization and any impairment in value.

The initial cost of property and equipment consists of its purchase price, including import duties, taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the furniture, fixtures and equipment have been put into operation, such as repairs and maintenance are normally charged against operations in the period in which the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of furniture, fixtures and equipment. When assets are retired or otherwise disposed of, the cost and the related accumulated depreciation and amortization are removed from the accounts, any resulting gain or loss is reflected as income or loss in the statement of income.

Depreciation and amortization is computed on a straight-line basis over the estimated useful lives (EUL) of the related assets. The EUL of the depreciable assets follow:

Building and condominium unit	20 years
Furniture, fixtures and equipment	3 - 5 years
Leasehold rights and improvements	5 years or related lease term, whichever is shorter

The useful life and, depreciation and amortization methods are reviewed periodically to ensure that the period and method of depreciation and amortization are consistent with the expected pattern of economic benefits from the items of property and equipment.

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising from derecognition of the asset (calculated as the difference between the net disposal proceeds and carrying amount of the asset) is included in the statement of income in the year the asset is derecognized.



Investment Properties

Investment properties are measured initially at cost, including transaction costs. An investment property acquired through an exchange transaction is measured at fair value of the asset acquired unless the fair value of such an asset cannot be measured in which case the investment property acquired is measured at the carrying amount of asset given up. Any gain or loss on exchange is recognized in the statement of income. Foreclosed properties are classified under 'Investment properties' upon:

- a. entry of judgment in case of judicial foreclosure;
- b. execution of the Sheriff's Certificate of Sale in case of extra-judicial foreclosure; or
- c. notarization of the Deed of Dacion in case of payment in kind (dacion en pago).

Real properties acquired

Subsequent to initial recognition, depreciable real properties acquired are recorded at cost, which is the fair value at acquisition date, less accumulated depreciation and any impairment in value. Land is carried at cost less any impairment in value. Transaction costs, which include nonrefundable capital gains tax and documentary stamp tax, incurred in connection with foreclosure are capitalized as part of the cost of the real properties acquired.

The Bank applies the cost model in accounting for investment properties. Depreciation is computed on a straight-line basis over the EUL of ten (10) years. The EUL and the depreciation method are reviewed periodically to ensure that the period and the method of depreciation are consistent with the expected pattern of economic benefits from items of real properties acquired.

The carrying values of the real properties acquired are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. If any such indication exists and where the carrying value exceeds the estimated recoverable amount, the assets are written down to their recoverable amounts (see accounting policy on 'Impairment of Nonfinancial Assets').

Other Properties Acquired

Other properties acquired include chattel mortgage properties acquired in settlement of loan receivables. These are recorded at cost, which is the fair value at acquisition date, less accumulated depreciation and any impairment in value.

The Bank applies the cost model in accounting for other properties acquired. Depreciation is computed on a straight-line basis over the EUL of three (3) years. The estimated useful life and the depreciation method are reviewed periodically to ensure that the period and the method of depreciation are consistent with the expected pattern of economic benefits from items of other properties acquired.

The carrying values of the other properties acquired are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amounts (see accounting policy on 'Impairment of Nonfinancial Assets').

Branch Licenses

Branch licenses are capitalized on the basis of the costs incurred to acquire and of bringing the asset to its use in the operation. Branch licenses are deemed to have an indefinite useful life as there is no foreseeable limit to the period over which they are expected to generate net cash inflows for the Bank.



Branch licenses are tested for impairment annually. Where the carrying value of branch licenses exceed the estimated recoverable amount, the assets are written down to their recoverable amounts (see accounting policy on Impairment of Nonfinancial Assets).

Such intangibles are not amortized. Gains and losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in earnings when the asset is derecognized.

Impairment of Nonfinancial Assets

Property and equipment, investment properties and chattel mortgage properties

An assessment is made at each statement of financial position date as to whether there is any indication of impairment of an asset, or whether there is any indication that an impairment loss previously recognized for an asset in prior years may no longer exist or may have decreased. If any indication of impairment exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's or cash generating unit's (CGU) value in use or its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples or other available fair value indicators.

An impairment loss is recognized only if the carrying amount of an asset or CGU exceeds its recoverable amount. An impairment loss is charged against income in the year in which it arises, unless the asset is carried at a revalued amount in which case the impairment loss is charged against revaluation increment of the said asset.

If there is any indication that an impairment loss previously recognized for an asset in prior years may no longer exist or may have decreased, the Bank estimates the asset's or CGU's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's or CGU's recoverable amount since the last impairment loss was recognized. A previously recognized impairment loss is reversed by a credit to current operations, unless the asset is carried at a revalued amount, in which case, the reversal of the impairment loss is credited to the revaluation increment of the same asset, to the extent that it does not restate the asset to a carrying amount in excess of what would have been determined (net of any accumulated depreciation and amortization) had no impairment loss been recognized for the asset in prior years.

Branch licenses

Branch licenses are tested for impairment annually at the statement of financial position date either individually or at the CGU level, as appropriate.

Capital Stock

Capital stocks are recorded at par. Proceeds in excess of par value are recognized under equity as 'Capital paid in excess of par value' in the statement of financial position. Incremental costs incurred which are directly attributable to the issuance of new shares are shown in equity as a deduction from proceeds, net of tax.



Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized:

Interest income

For all financial instruments measured at amortized cost and interest-bearing financial instruments classified as AFS investments, interest income is recorded at the EIR, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. When calculating the EIR, the Bank estimates cash flows from the financial instrument (for example, prepayment options), but does not consider future credit losses. The calculation includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR and, all others premiums and discounts.

Once the recorded value of a financial asset or group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original EIR applied to the new carrying amount.

Trading gains - net

Trading gains - net represents results arising from trading activities including all gains and losses from changes in fair value of financial assets and financial liabilities held for trading, gains and losses from disposal of AFS investments, and gains or losses arising from derivatives transactions.

Fee and commission income

Fees and commissions arising from providing transaction services are recognized on completion of the transaction. Fees or components of fees that are linked to a certain performance are recognized after fulfilling the criteria.

Service charges and penalties

Service charges and penalties under 'Service charges, fees and commissions' in the statement of income are recognized only upon collection or accrued when there is reasonable degree of certainty as to its collectability.

Profit (loss) from assets sold or acquired

Income from sale of properties acquired is recognized upon completion of the earning process and the collectability of the sales price is reasonably assured. Gain or loss on foreclosure is determined as the difference between the fair value at foreclosure and the carrying amount of the loan. Gain on foreclosure is recognized when the risks and rewards of the property has been transferred to the Bank.

Expense Recognition

Expenses are recognized when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. Expenses are recognized when incurred.

Interest Expense

Interest expense for all interest-bearing financial liabilities are recognized under 'Interest expense' in the statement of income using the EIR of the financial liabilities to which they relate.



Operating expenses

Operating expenses constitute costs which arise in the normal business operation and are recognized when incurred.

Taxes and licenses

These consist of all other taxes, local and national, including gross receipts taxes (GRT), documentary stamp taxes, real estate taxes, licenses and permit fees, and are recognized when incurred.

Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

- a) there is a change in contractual terms, other than a renewal or extension of the arrangement;
- b) a renewal option is exercised or extension granted, unless that term of the renewal or extension was initially included in the lease term;
- c) there is a change in the determination of whether fulfillment is dependent on a specified asset;
or
- d) there is a substantial change to the asset.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios (a), (c) or (d) above, and at the date of renewal or extension period for scenario (b).

Bank as lessee

Operating lease payments are recognized as expense in the statement of income on a straight-line basis over the lease term.

Retirement Cost

The Bank has a noncontributory defined benefit retirement plan. The retirement cost of the Bank is determined using the projected unit credit method. Under this method, the current service cost is the present value of retirement obligation in the future with respect to services rendered in the current year.

The liability recognized in the statement of financial position in respect of the defined benefit pension plan is the present value of the retirement obligation at the statement of financial position date less the fair value of plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs. The retirement obligation is calculated annually by an independent actuary using the projected unit credit method. The present value of the retirement obligation is determined by discounting the estimated future cash outflows using interest rate on government bonds that have terms to maturity approximating the terms of the related retirement liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are credited to or charged against income when the net cumulative unrecognized actuarial gains and losses at the end of the previous period exceeded 10.0% of the higher of the retirement obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plan.



Past service costs, if any, are recognized immediately in statement of income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortized on a straight-line basis over the vesting period.

The defined benefit asset or liability comprises the present value of the defined benefit obligation less past service costs not yet recognized and less the fair value of plan assets out of which the obligations are to be settled directly. The value of any asset is restricted to the sum of any past service cost not yet recognized and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

Fiduciary Activities

Assets and income arising from fiduciary activities together with related undertakings to return such assets to customers are excluded from the financial statements of the Bank when the Bank acts in a fiduciary capacity such as a nominee, trustee or agent.

Provisions

Provisions are recognized when the Bank has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Contingent Liabilities and Contingent Assets

Contingent liabilities are not recognized in the financial statements but are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized but are disclosed in the financial statements when an inflow of economic benefits is probable. Where the Bank expects some or all of the provision to be reimbursed, for example an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of income at gross of any reimbursement and the reimbursement is recognized as income.

Income Taxes

Current taxes

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantially enacted as of the statement of financial position date.

Deferred tax

Deferred tax is provided on all temporary differences at the statement of financial position date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are recognized for all taxable temporary differences, except:

- Where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting income nor taxable income; and
- In respect of taxable temporary differences associated with investment in a subsidiary, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.



Deferred tax assets are recognized for all deductible temporary differences, carryforward of unused tax credits from excess minimum corporate income tax (MCIT) over regular corporate income tax (RCIT) and unused net operating loss carryover (NOLCO), to the extent that it is probable that taxable income will be available against which the deductible temporary differences and carryforward of unused excess MCIT or RCIT and unused NOLCO can be utilized except:

- Where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting income nor taxable income; and
- In respect of deductible temporary differences associated with investment in a subsidiary, deferred tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable income will be available against which the temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred tax assets to be utilized. Unrecognized deferred tax assets are reassessed at each statement of financial position date and are recognized to the extent that it has become probable that future taxable income will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are applicable to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the statement of financial position date.

Deferred tax assets and liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Events after the Reporting Date

Post year-end events that provide additional information about the Bank's position at the statement of financial position date (adjusting event) are reflected in the financial statements. Post year-end events that are not adjusting events, if any, are disclosed when material to the financial statements.

Future Changes in Accounting Policies

The Bank will adopt the following standards, interpretations and amendments to standards enumerated below when these become effective. Except as otherwise indicated, the Bank does not expect the adoption of these new and amended PFRS and Philippine Interpretations to have significant impact on the financial statements.

Effective in 2013

PAS 1, Financial Statement Presentation - Presentation of Items of Other Comprehensive Income (OCI)

The amended standard is effective for annual periods beginning on or after July 1, 2012. The amendments to PAS 1 change the grouping of items presented in OCI. Items that could be reclassified (or "recycled") to profit or loss at a future point in time (for example, upon derecognition or settlement) would be presented separately from items that will never be reclassified.



PFRS 7, Financial instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities

The amendments to PFRS 7 are to be retrospectively applied for annual periods beginning on or after January 1, 2013. These amendments require an entity to disclose information about rights of set-off and related arrangements (such as collateral agreements). The new disclosures are required for all recognized financial instruments that are set off in accordance with PAS 32. These disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or 'similar agreement', irrespective of whether they are set-off in accordance with PAS 32. The amendments require entities to disclose, in a tabular format unless another format is more appropriate, the following minimum quantitative information. This is presented separately for financial assets and financial liabilities recognized at the end of the reporting period:

- a) The gross amounts of those recognized financial assets and recognized financial liabilities;
- b) The amounts that are set off in accordance with the criteria in PAS 32 when determining the net amounts presented in the statement of financial position;
- c) The net amounts presented in the statement of financial position;
- d) The amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in (b) above, including:
 - i. Amounts related to recognized financial instruments that do not meet some or all of the offsetting criteria in PAS 32; and
 - ii. Amounts related to financial collateral (including cash collateral); and
- e) The net amount after deducting the amounts in (d) from the amounts in (c) above.

The amendment affects disclosures only and has no impact on the Bank's financial position and performance.

PFRS 12, Disclosure of Interests in Other Entities

This standard is effective for annual periods beginning on or after January 1, 2013.

PFRS 12 includes all disclosures that were previously in PAS 27 related to the consolidated financial statements, as well as all the disclosures that were previously included in PAS 31 and PAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required.

PFRS 13, Fair Value Measurement

This standard is effective for annual periods beginning on or after January 1, 2013. This standard establishes a single source of guidance under PFRS for all fair value measurements. The standard does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under PFRS when fair value is required or permitted.

PAS 19, Employee Benefits (Revised)

This standard is effective for annual periods beginning on or after January 1, 2013.

Amendments to PAS 19 range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and rewording. The revised standard also requires new disclosures such as, among others, a sensitivity analysis for each significant actuarial assumption, information on asset-liability matching strategies, duration of the defined benefit obligation, and disaggregation of plan assets by nature and risk. Once effective, the Bank has to apply the amendments retroactively to the earliest period presented.

The Bank reviewed its existing employee benefits and determined that the amended standard has significant impact on its accounting for retirement benefits. The Bank obtained the services of an external actuary to compute the impact to the financial statements upon adoption of the standard.



The effects are detailed below:

	As at 31 December 2012	As at 1 January 2012
Increase (decrease) in:		
<u>Statement of financial position</u>		
Net defined benefit liability	₱6,843,416	₱10,977,886
Other comprehensive income	4,400,886	-
Retained earnings	11,244,302	(10,977,886)
	2012	
<u>Statement of income</u>		
Net income	₱226,416	
Remeasurement	4,400,886	

Effective in 2014

PAS 32, Financial Instruments: Presentation - Offsetting Financial Assets and Financial liabilities

The amendments to PAS 32 are to be retrospectively applied for annual periods beginning on or after January 1, 2014. These amendments to PAS 32 clarify the meaning of “currently has a legally enforceable right to set-off” and also clarify the application of the PAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous.

Effective in 2015

PFRS 9, Financial Instruments: Classification and Measurement

PFRS 9 as issued reflects the first phase of the IASBs work on the replacement of PAS 39, *Financial Instruments: Recognition and Measurement* and applies to classification and measurement of financial assets and financial liabilities as defined in PFRS 9, as issued, reflects the first phase on the replacement of PAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in PAS 39. Work on impairment of financial instruments and hedge accounting is still ongoing, with a view to replacing PAS 39 in its entirety. PFRS 9 requires all financial assets to be measured at fair value at initial recognition. A debt financial asset may, if the fair value option (FVO) is not invoked, be subsequently measured at amortized cost if it is held within a business model that has the objective to hold the assets to collect the contractual cash flows and its contractual terms give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal outstanding. All other debt instruments are subsequently measured at fair value through profit or loss. All equity financial assets are measured at fair value either through other comprehensive income (OCI) or profit or loss. Equity financial assets held for trading must be measured at fair value through profit or loss. For FVO liabilities, the amount of change in the fair value of a liability that is attributable to changes in credit risk must be presented in OCI. The remainder of the change in fair value is presented in profit or loss, unless presentation of the fair value change in respect of the liability’s credit risk in OCI would create or enlarge an accounting mismatch in profit or loss. All other PAS 39 classification and measurement requirements for financial liabilities have been carried forward into PFRS 9, including the embedded derivative separation rules and the criteria for using the FVO. PFRS 9 is effective for annual periods beginning on or after January 1, 2015.



Annual Improvements to PFRSs (2009-2011 cycle)

The *Annual Improvements to PFRSs (2009-2011 cycle)* contain non-urgent but necessary amendments to PFRSs. The amendments are effective for annual periods beginning on or after January 1, 2013 and are applied retrospectively. Earlier application is permitted. The adoption of the amendments did not have any impact in the accounting policies, financial position or performance of the Group.

- PFRS 1, *First-time Adoption of PFRS - Borrowing Cost*
- PAS 1, *Presentation of Financial Statements - Clarification of the requirements for comparative information*
- PAS 16, *Property, Plant and Equipment - Classification of servicing equipment*
- PAS 32, *Financial Instruments: Presentation - Tax effect of distribution to holders of equity instruments*
- PAS 34, *Interim Financial Reporting - Interim financial reporting and segment information for total assets and liabilities*

3. Significant Accounting Judgments and Estimates

The preparation of the financial statements in accordance with PFRS requires the Bank to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingent assets and contingent liabilities, if any. Future events may occur which will cause the assumptions used in arriving at the estimates to change. The effects of any change in estimates are reflected in the financial statements as they become reasonably determinable.

Judgments and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The following are the critical judgments and key assumptions that have a significant risk of material adjustment to the carrying amounts of assets and liabilities within the next financial year:

Judgments

In the process of applying the Bank's accounting policies, management has made the following judgments, apart from those involving estimations, which have the most significant effect on the amounts recognized in the financial statements:

a. *Fair value of financial instruments*

Where the fair values of financial assets and financial liabilities recognized or disclosed in the financial statements cannot be derived from active markets, they are determined using an internal valuation techniques that include the use of mathematical models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Refer to Note 5 for the fair values and the measurement basis of the financial instruments.



b. *HTM investments*

The classification to HTM investment requires significant judgment. In making this judgment, the Bank evaluates its intention and ability to hold such investments to maturity. Ability to hold the debt securities to maturity is demonstrated by the availability of financial resources to continue to finance the investment until maturity. If the Bank fails to keep these investments to maturity other than in certain specific circumstances, it will be required to reclassify the entire portfolio as AFS investments. The investments would therefore be measured at fair value and not at amortized cost.

In 2011, a portion of the Bank's HTM investments were called on by the issuer who has the option to call or prepay at par value. The prepayment does not taint the HTM portfolio as the redemption was initiated by the issuer and is beyond the control of the Bank (see Note 9).

c. *Financial assets not quoted in an active market*

The Bank classifies financial assets by evaluating, among others, whether the asset is quoted or not in an active market. Included in the evaluation on whether a financial asset is quoted in an active market is the determination on whether quoted prices are readily and regularly available, and whether those prices represent actual and regularly occurring market transactions on an arm's length basis.

d. *Operating leases - Bank as lessee*

The Bank has entered into leases on premises it uses for its operations. The Bank has determined, based on the evaluation of the terms of the lease agreements, that all significant risks and rewards of ownership of the properties are retained by the respective lessors.

e. *Contingencies*

The Bank is currently involved in various legal proceedings. The estimate of the probable costs for the resolution of these claims has been developed in consultation with outside counsels handling the Bank's defense in these matters and is based on an analysis of potential results. The Bank currently does not believe that these proceedings will have a material adverse effect on the financial statements. It is possible, however, that future results of operations could be materially affected by changes in the estimates or in the effectiveness of the strategies relating to these proceedings (see Note 28).

f. *Functional currency*

PAS 21 requires management to use its judgment to determine the entity's functional currency such that it most faithfully represents the economic effects of the underlying transactions, events and conditions that are relevant to the entity. In making this judgment, the Bank considers the following:

- the currency that mainly influences sales prices for financial instruments and services (this will often be the currency in which sales prices for its financial instruments and services are denominated and settled);
- the currency in which funds from financing activities are generated; and
- the currency in which receipts from operating activities are usually retained.

g. *Going concern*

The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.



Estimates

a. *Credit losses on loans and receivables*

The Bank reviews its individually significant loans and receivables at each statement of financial position date to assess whether an impairment loss should be recorded in the statement of income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the Bank makes judgments about the borrower's financial situation and the net realizable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Loans and receivables that have been assessed individually and found not to be impaired and all individually insignificant loans and advances are then assessed collectively, in groups of assets with similar characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio, concentrations of risks and economic data.

Provision for credit losses of the Bank amounted to ₱78.0 million and ₱58.5 million in 2012 and 2011, respectively (see Note 10).

As of December 31, 2012 and 2011, loans and receivables of the Bank, net of allowance for credit losses and unearned discounts and deferred credits, amounted to ₱16.1 billion and ₱14.7 billion, respectively (see Note 10).

b. *Impairment of branch licenses*

Branch license is considered an intangible asset with an indefinite useful life and it is required to be tested for impairment annually by comparing its carrying amount with its recoverable amount, irrespective of whether there is any indication that it may be impaired.

When the branch license's fair value less cost of disposal is lower than its carrying amount, the Bank's impairment test is based on value in use calculations that use a discounted cash flow model. The cash flows are derived from the budget for the next five years and do not include restructuring activities that the Bank is not yet committed to or significant future investments that will enhance the asset base of the CGU being tested. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash-inflows and the growth rate used for extrapolation purposes.

As of December 31, 2012 and 2011, the total carrying amount of the Bank's branch licenses amounted to ₱225.4 million (see Note 13). No impairment loss was recognized for branch licenses in 2012 and 2011.

c. *Impairment of Other nonfinancial assets*

The Bank assesses impairment on other nonfinancial assets (i.e., Property and equipment, investment properties and chattel mortgage properties) whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The factors that the Bank considers important which could trigger an impairment review include the following:



- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of use of the acquired nonfinancial assets or the strategy for overall business; and
- significant negative industry or economic trends.

The carrying values of the Bank's other nonfinancial assets are as follows:

	2012	2011
Property and equipment (Note 11)	₱604,445,652	₱631,521,867
Investment properties (Note 12)	121,944,300	147,017,620
Chattel mortgage properties (Note 14)	22,435,023	51,694,304

There were no impairment losses recognized on other nonfinancial assets in 2012 and 2011.

d. *Estimated useful lives of property and equipment, investment properties and chattel mortgage properties*

The Bank reviews on an annual basis the EUL of depreciable property and equipment, investment properties and chattel mortgage properties based on expected asset utilization as anchored on business plans and strategies that also consider expected future technological developments and market behavior. It is possible that future results of operations could be materially affected by changes in these estimates brought about by changes in the factors mentioned. A reduction in the EUL of depreciable property and equipment, investment properties and chattel mortgage properties would decrease their respective balances and increase the recorded depreciation and amortization expense.

The carrying values of depreciable property and equipment, investment properties and chattel mortgage properties follow:

	2012	2011
Property and equipment (Note 11)	₱440,101,152	₱467,177,367
Investment properties (Note 12)	70,192,915	82,935,035
Chattel mortgage properties (Note 14)	22,435,023	51,694,304

e. *Recognition of deferred tax assets*

The Bank reviews the carrying amounts of deferred tax assets at each financial statement of financial position date and reduces it to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred tax assets to be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning strategies.

The Bank has been in a tax loss position over the past three years. However, estimates of future taxable income indicate that certain temporary differences will be realized in the future. As of December 31, 2012 and 2011, the Bank's recognized deferred tax assets amounted to ₱21.5 million (see Note 24).

As of December 31, 2012 and 2011, the Bank did not recognize deferred tax assets on temporary differences totaling ₱493.1 million and ₱353.6 million, respectively (see Note 24).



f. *Present value of retirement obligation*

The cost of defined retirement plan is determined using actuarial valuation. The actuarial valuation involves making assumptions about discount rates, future salary increases and mortality rates. Due to the long-term nature of this plan, such estimates are subject to significant uncertainty. The assumed discount rates were determined using the market yields of Philippine government bonds with terms consistent with the expected employee benefit payouts as of the statement of financial position date.

As of December 31, 2012 and 2011, the accrued retirement obligation (included under 'Accrued interest, taxes and other expenses' in the statements of financial position) amounted to ₱41.7 million and ₱26.9 million, respectively (see Notes 17 and 22).

4. **Financial Risk Management Objectives and Policies**

Introduction

The Bank has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk

Risk management framework

The Bank's BOD has overall responsibility for the oversight of the Bank's risk management process. The BOD committees, which are responsible for developing, managing and monitoring risk management policies in their specified areas, include the following:

1. Risk Management Committee (RMC)
2. Audit Committee (AC)
3. Asset-Liability Committee (ALCO)

The RMC, through the Risk Management Group (RMG), is responsible for monitoring the Bank's compliance with the risk management policies and guidelines and, for reviewing the soundness of risk management practices in relation to the risks faced by the Bank.

The RMG is under the RMC and performs daily market risk analyses to ensure compliance with the Bank's policies and procedures and makes recommendations based on such analyses. The RMG likewise monitors, supervises and controls the credit acceptance policies, the borrowing account ratings and portfolio development.

AC is responsible for monitoring the Bank's compliance with the risk management policies and procedures, and at the same time, for reviewing the adequacy of risk management framework in relation to the risks faced by the Bank. The AC is assisted in these functions by the Internal Audit (IA) department. IA undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the AC.

ALCO is also responsible for ensuring that the Bank maintain adequate liquidity, sufficient capital and the appropriate funding to meet all business requirements and comply with all regulatory requirements. It is also responsible for building a stable funding structure by managing the long-term profiles of the Bank's asset and liability maturities. Moreover, it manages the statement of



financial position and ensures that strategies are in accordance with adequate liquidity, capital and diversified funding, and establishes asset-liability pricing policies consistent with the strategies for the statement of financial position.

Credit Risk

Credit risk is the risk of financial loss to the Bank if a counterparty to a financial instrument fails to meet its contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits. For risk management purposes, credit risk emanating from treasury activities is managed independently, but reported as a component of market risk exposure.

Each business unit is responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolio. They are supported and controlled by the Credit Risk Control Unit of RMG, whose main task is to evaluate and control credit risks via reviews of loan proposals, credit processes, and accounts administration. Furthermore, regular audits of business units and credit processes are undertaken by IA.

The Bank extends various types of loans, some on clean basis, but mostly against hard collaterals and other form of securities. Personal and salary loans are generally granted on a clean basis. Auto loans are secured versus chattel mortgage on the vehicles at 50.0% to 80.0% loan value; real estate loans are secured versus first real estate mortgage at 50.0% to 80.0% loan value. The Bank's commercial/small-medium enterprise loans cover a mix of clean (unsecured, which include those under personal guarantees) as well as secured credit facilities; i.e., those supported by real estate and chattel mortgages, guarantees and other registered securities at 50.0% to 70.0% loan valuations. Estimates of fair value are based on the value of collateral assessed at the time of the borrowing.

All loan applications, covering the different types of loans, undergo strict credit evaluation in accordance with established approval criteria, to ensure that there are very strong expectations of repayment. The essential elements that the Bank looks for/at in all its credit dealings and account relationships are: favorable credit checkings; good credit standing and track record with other counterparties, banks and trade partners alike; financial strength and cash generating capabilities (fund sourcing) which translate into adequacy of paying capacity; and acceptable collateral/security, if applicable. Furthermore, loans are subject to approval at different levels of credit authorities, depending on facility risks and magnitudes of potential loan exposures.

Management of credit risk

The BOD has delegated the responsibility for the management of credit risk to its Credit Risk Control - Risk Management Group (CRC-RMG), which continuously implements its risk control programs, in line with its oversight function over the Bank's lending activities. The CRC-RMG is principally tasked with identifying, monitoring, reporting and controlling the Bank's credit risk. Its specific functions are as follows:

- It takes charge of administering the Bank's lending policies, ensuring compliance by those concerned with continuous issuance of updates on policies and process guidelines for bankwide implementation and compliance.
- It spearheads the activities of the Credit Committee, whose main objective is to evaluate and screen commercial loan proposals requiring approvals beyond line management levels.
- It classifies commercial borrowing accounts according to several levels of risk, based on the internal credit risk rating system and regularly determines loan impairments for the purpose of determining the appropriate loan loss reserves.



- It conducts credit stress testing and regularly evaluates and monitors the quality of the Bank's loan portfolio via the Portfolio Profile Report, as part of the scheme of controlling large concentration and group exposures.

Maximum exposure to credit risk after collateral held or other credit enhancements

The Bank's maximum exposure to on-balance sheet credit risk is equal to the carrying value of its financial assets except for the following loans and receivables:

	2012			
	Carrying Amount	Fair value of Collaterals or Credit Enhancements	Maximum Exposure to Credit risk	Financial Effect of Collaterals or Credit Enhancements
Loans and receivables:				
Receivables from customers:				
Corporate loans	P10,188,513,856	P3,819,699,065	P7,783,834,209	P2,404,679,647
Consumer loans	3,933,738,234	4,308,320,099	803,134,739	3,130,603,495
Sub-total	P14,122,252,090	P8,128,019,164	P8,586,968,948	P5,535,283,142
Unquoted debt securities	1,392,343,929	-	1,392,343,929	-
Accrued interest receivable	231,355,431	-	231,355,431	-
Accounts receivable	46,683,243	-	46,683,243	-
Receivable from stockholders	9,426,020	-	9,426,020	-
Receivables purchased	282,949,617	270,178,519	22,102,599	260,847,018
Sales contracts receivable	7,315,356	-	7,315,356	-
	P16,092,325,686	P8,398,197,683	P10,296,195,526	P5,796,130,160

	2011			
	Carrying Amount	Fair value of Collaterals or Credit Enhancements	Maximum Exposure to Credit risk	Financial Effect of Collaterals or Credit Enhancements
Loans and receivables:				
Receivables from customers:				
Corporate loans	P8,457,650,238	P3,315,465,930	P6,060,438,026	P2,397,212,212
Consumer loans	4,356,187,112	6,168,808,833	925,729,633	3,430,457,479
Sub-total	P12,813,837,350	9,484,274,763	6,986,167,659	5,827,669,691
Unquoted debt securities	1,442,861,465	-	1,442,861,465	-
Accrued interest receivable	215,261,678	-	215,261,678	-
Accounts receivable	29,708,125	-	29,708,125	-
Receivables purchased	188,732,546	176,525,618	21,538,429	167,194,117
	P14,690,401,164	P9,660,800,381	P8,695,537,356	P5,994,863,808



Concentration of credit risk exposure of financial assets

The Bank monitors concentration of credit risk of counterparty by industry. The distribution of the Bank's financial assets and off-balance sheet items by industry sector, before taking into account collaterals held or other credit enhancements (maximum exposure) follows:

	2012				
	Loans and Receivables	Loans and Advances to Banks*	Investment Securities**	Others***	Total
Financial intermediaries	P854,819,041	P3,421,759,893	P1,954,442,209	P58,031,857	P6,289,053,000
Philippine government	1,392,343,929	-	4,163,802,209	-	5,556,146,138
Other community, social and personal activities	4,295,839,727	-	-	309,567	4,296,149,294
Real estate, renting and business activities	3,321,424,443	-	-	23,090,334	3,344,514,777
Manufacturing	2,535,726,223	-	-	-	2,535,726,223
Wholesale and retail trade	2,201,438,618	-	-	-	2,201,438,618
Agricultural, hunting and forestry	566,219,502	-	-	-	566,219,502
Transportation, storage and communication	527,917,515	-	-	-	527,917,515
Construction	497,059,098	-	-	-	497,059,098
Mining and quarrying	68,960,802	-	-	-	68,960,802
Hotel and restaurants	20,656,750	-	-	-	20,656,750
Electricity, gas and water supply	3,424,074	-	-	-	3,424,074
	16,285,829,722	3,421,759,893	6,118,244,418	81,431,758	25,907,265,791
Less allowance for credit losses	193,504,036	-	-	-	193,504,036
Total	P16,092,325,686	P3,421,759,893	P6,118,244,418	P81,431,758	P25,713,761,755

* Comprised of due from BSP, due from other banks and interbank loans receivables and SPURA with the BSP

** Comprised of Financial assets at FVPL, AFS investments and HTM investments (excluding unquoted equity securities)

*** Comprised of RCOCI, refundable deposits and contingencies relating to outstanding guarantees and domestic letters of credit

	2011				
	Loans and Receivables	Loans and Advances to Banks*	Investment Securities**	Others***	Total
Financial intermediaries	P579,655,395	P4,293,759,012	P2,300,787,291	P22,594,900	P7,196,796,598
Philippine government	1,442,861,465	-	3,743,540,818	-	5,186,402,283
Other community, social and personal activities	4,736,723,503	-	-	1,446,600	4,738,170,103
Real Estate, renting and business activities	2,803,735,361	-	-	15,241,345	2,818,976,706
Manufacturing	2,287,741,126	-	-	-	2,287,741,126
Wholesale and retail trade	1,604,636,928	-	-	-	1,604,636,928
Transportation, storage and communication	509,347,310	-	-	-	509,347,310
Construction	439,741,516	-	-	-	439,741,516
Agricultural, hunting and forestry	438,349,900	-	-	-	438,349,900
Mining and quarrying	48,960,802	-	-	-	48,960,802
Hotel and restaurants	21,630,043	-	-	-	21,630,043
	14,913,383,349	4,293,759,012	6,044,328,109	39,282,845	25,290,753,315
Less allowance for credit losses	222,982,185	-	-	-	222,982,185
Total	P14,690,401,164	P4,293,759,012	P6,044,328,109	P39,282,845	P25,067,771,130

* Comprised of due from BSP, due from other banks and interbank loans receivables and SPURA with the BSP

** Comprised of Financial assets at FVPL, AFS investments and HTM investments (excluding unquoted equity securities)

*** Comprised of RCOCI, refundable deposits and contingencies relating to outstanding guarantees and domestic letters of credit



The Bank regularly assesses whether there is objective evidence that a financial asset or group of financial assets is impaired. Indication or evidence of impairment may include indications that a borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that the borrower will enter bankruptcy or other financial reorganization and where observable data indicate that there is measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

The Bank determines the allowance appropriate for each individually significant loan or advance on an individual basis. Factors considered in determining the appropriate amounts of allowances include an account’s age, payment and collection history, short and medium term prospects in the industry, and timing of expected cash flows and realizable value of collateral.

The Bank sets criteria for specific loan impairment testing and uses the discounted cash flow method to compute for impairment loss. Accounts subjected to specific impairment and are found to be impaired shall be excluded from the collective impairment computation.

Collectively assessed allowances

Allowances are assessed collectively for losses on commercial loans and advances that are not individually significant and those significant loans and advances which were individually assessed for impairment but were found not to be impaired. Generally, the Bank applies the probability of loss method in determining the collective impairment allowance for its consumer loans, where such probability is derived from the product of default rate and loss rate. For personal and salary loans in particular, the added dimension of net flow rate method is considered. This method utilizes the historical data on movements of arrearages (flow-over and flow-back) across the different delinquency age buckets, as a means of determining default and loss rates.

Credit quality per class of financial assets

In compliance with BSP Circular No. 439, the Bank has developed and continually reviews and calibrates its internal risk rating system for large exposures aimed at uniformly assessing its credit portfolio in terms of risk profile. Where appropriate, it obtains security, enters into master-netting agreements, and limits the duration of exposures to maintain and even further enhance the quality of the Bank’s credit exposures.

The credit quality of trading and investment securities is generally monitored through the external ratings of eligible external credit rating institutions. Presented below is the mapping of the credit risk rating from external rating agencies to the Bank’s internal risk rating for investment securities:

A. Moody’s Rating:

Credit Quality	Rating				
	Long-term			Short-term	
High Grade	Aaa	Aa	A	Baa	P
Standard Grade	Ba	B			
Substandard Grade	Caa	Ca			
Impaired	C				



B. S&P Rating:

Credit Quality	Rating				
	Long-term			Short-term	
High Grade	AAA	AA	A	BBB	A
Standard Grade	BB	B			B
Substandard Grade	CCC	CC	C		C
Impaired	D				

C. Fitch Rating:

Credit Quality	Rating				
	Long-term			Short-term	
High Grade	AAA	AA	A	BBB	A
Standard Grade	BB	B			B
Substandard Grade	CCC				C
Impaired	DDD	DD	D		

D. Philratings:

Credit Quality	Rating				
	Long-term				Short-term
High Grade	PRS Aaa	PRS Aa	PRS A	PRS Baa	PRS 1
					PRS 2
					PRS 3
Standard Grade	PRS Ba	PRS B			PRS 4
Substandard Grade	PRS Caa	PRS Ca			PRS 5
Impaired	PRS C				PRS 6

For debt securities which are not rated by any rating agency, the Bank performs the credit review rating for the issuers of the debt securities based on quantitative and qualitative analysis, the data of which are provided by the Treasury/Trust Group. Below is the guidance in evaluating if the investment is impaired or not.

Credit Quality	Rating	Assessment
High Grade	1 and 2	Not Impaired
Standard Grade	3	Not Impaired
Substandard Grade	4	Impaired
Impaired	5	Impaired

For loans, the credit quality is generally monitored using the Bank's internal ratings system. It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates management to focus on major potential risk and the comparison of credit exposures across all lines of business, demographics and products. The rating system has two parts, namely, the borrower's risk rating and the facility risk rating. It is supported by a variety of financial analytics, combined with an assessment of management and market information to provide the main inputs for the measurement of credit risk.

The Bank uses Internal Credit Risk Ratings to classify the credit quality of its receivables portfolio. This is being upgraded, as needed, to enhance credit evaluation parameters across different market segments and achieve a more sound and robust credit risk assessment.



Descriptions of the loan grades used by the Bank for receivable from customers are as follows:

<u>Risk Rating</u>	<u>Classification</u>	<u>Credit Quality</u>
1	Excellent	High Grade
2	Strong	High Grade
3	Good	High Grade
4	Satisfactory	Standard Grade
5	Acceptable	Standard Grade
6	Weak	Standard Grade
7	Poor	Impaired
8	Substandard	Impaired
9	Doubtful	Impaired
10	Loss	Impaired

Risk Rating 1 - Excellent

The borrower's ability to meet its financial commitments is extremely strong and there is a very low probability that it will default on payments due in the coming year. The borrower has a high degree of stability, substance and diversity.

A borrower in this category has access to substantial amounts of funds through the public capital markets at any time. It has a strong debt service capacity and has conservative balance sheet leverage (vis-a-vis the industry in which the borrower operates). The track record in profit terms is very good. The borrower is of the highest quality, operating reliably under virtually any and all economic conditions.

Risk Rating 2 - Strong

The borrower's ability to meet its financial commitments is very strong and there is a low probability that it will default on payments due in the coming year. The borrower normally has a comfortable degree of stability, substance and diversity. Under normal market conditions, borrowers in this category have good access to public markets to raise funds.

Borrower has a strong market and financial position with a history of successful performance. The overall debt service capacity as measured by cash flow to total debt service is very strong; the critical balance sheet ratios (vis-à-vis applicable industry) are conservative.

These borrowers herein categorized are described as quality multinational or local corporations which are adequately capitalized and operating profitably.

Risk Rating 3 - Good

The borrower's ability to meet its financial commitments is strong. It may be described as big or small corporation whose access to public capital markets or to alternative financial markets is easy, may be limited to periods of favorable economic and/or market conditions.

A borrower in this category usually exhibits characteristics of some degree of stability and substance and the probability of default is still quite low. However, it may still be susceptible to the negative effects of cyclical business changes.

Typical traits include a combination of comfortable asset protection and an acceptable balance sheet structure (vis-à-vis that industry). The debt service capacity as measured by cash flow analysis is strong.



Risk Rating 4 - Satisfactory

The borrower has adequate capacity to meet its financial commitments. Borrower operates in an environment where clear risk elements exist and the probability of default is somewhat greater. This probability is reflected in volatility of earnings and overall performance. A borrower in this category normally has limited access to public financial markets. It should be able to withstand normal business cycles, but any prolonged unfavorable economic climate may create gradual deterioration in its financial health.

Typical for this kind of borrower is the combination of reasonably sound asset and cash flow protection. The debt service capacity as measured by cash flow is deemed adequate. The borrower has reported profits for the past fiscal year and is expected to report a profit in the current year.

Risk Rating 5 - Acceptable

The borrower is less vulnerable but faces major ongoing uncertainties and exposure to adverse business, financial, or economic conditions that could lead to its inadequate capacity to meet its financial commitments.

This category represents borrowers who may still be able to withstand normal business cycles; however, any prolonged unfavorable economic and/or market condition would create an immediate deterioration beyond acceptable levels.

This category will apply where the risk is still acceptable for the following reasons:

- There is sufficient cash flow either historically or expected for the future, in spite of an economic downturn combined with asset protection; or
- There is a new business or project finance transaction.

Risk Rating 6 - Weak

The borrower is more vulnerable but currently has the capacity to meet its financial commitments. Adverse business, financial, or economic conditions will likely impair the borrower's capacity or willingness to meet its financial requirements.

This category represents the type of borrower for which unfavorable industry or company-specific risk factors represent a concern. Operating performance and financial strength may be marginal and it is uncertain whether the borrower can attract alternative sources of financing. Typically, the borrower will find it very hard to cope with any significant economic downturn and a default in such a case is more than a possibility.

Generally, a borrower in this category incurs net losses for one or more years. Normally, there is an expectation that conditions will improve and the rating may be upgraded. Any deterioration, however, will almost certainly result in an automatic downgrade.

In summary, this category includes those borrowers where the credit exposure is not at risk of loss at the moment, but wherein performance has weakened, and unless present trends are reversed, could lead to losses.

Risk Rating 7 - Poor

The borrower is currently vulnerable and is dependent on favorable business, financial and economic conditions to meet its financial obligations.



A borrower in this category is characterized by some probability of default, manifested by some or all of the following:

- Evidence of weakness in the borrower's financial condition or creditworthiness
- Unacceptable risk generated by potential or emerging weaknesses as far as asset protection and/or cash flow is concerned. Concerns center on the potential for a continuation of unfavorable economic, market, or borrower specific conditions or trends, which may affect future debt service capacity.
- Indications that the borrower's ability or willingness to service debt are in doubt.
- Necessity or strong likelihood for rescheduling of the loan.
- Decline in values of, or adverse developments on, collaterals securing the loan.

Risk Rating 8 - Substandard

The borrower is currently highly vulnerable and is in a state of default.

Substandard loans are loans or portions thereof which appear to involve a substantial and unreasonable degree of risk to the Bank because of unfavorable or unsatisfactory characteristics. These well-defined adverse elements exist in such loans where there is a possibility of future loss to the institution unless given closer supervision. Such may include adverse trends or development of a financial, managerial, economic or political nature or significant weakness in collateral. Basic characteristics are:

- Past due and circumstances are such that there is an imminent possibility of foreclosure or acquisition of the collateral because of failure of all collection efforts;
- Past due loans to borrowers whose properties securing the loan have declined in value materially or have been found with defects as to ownership or other adverse information;
- Current loans to borrowers whose financial statements audited by SEC-accredited external auditors show impaired/negative net worth except for startup firms which should be elevated on a case-to-case basis;
- Renewed loans of borrowers with declining trend in operations, illiquidity, or increasing leverage trend in the borrower's financial statements without at least 20.0% repayment of the principal before renewal or extension;
- Current loans of borrowers with unfavorable results of operations for two consecutive years or with impaired/negative net worth except for startup firms which should be evaluated on a case-to-case basis;
- Loans under litigation; and
- Loans past due for more than 90 days.

Risk Rating 9 - Doubtful

Borrower is in a state of default, where any of the following factors are present:

- Account is already in "non-performing loan" (NPL) status;
- Any portion of any interest and/or principal repayment is in arrears for more than 90 days;
- The borrower is unable or unwilling to service debt over an extended period of time and near future prospects of orderly debt service is doubtful; and
- Overdue loans wherein the prospects of fully applying the collaterals is impaired due to material declines in market values, or subject of adverse claim.

The extent of probability of loss cannot be exactly quantified at this time. Although the possibility of loss is significant, there may be certain important and reasonably specific pending factors that can work to the advantage of the Bank and result in a strengthening of assets of the borrower.



Pending factors include merger, acquisition, capital injection and additional cover.

Risk Rating 10 - Loss

Borrower is in a state of default and the prospect for re-establishment of creditworthiness and debt service is remote.

This category also applies where the Bank will take or has taken title to the assets of the borrower and is preparing a foreclosure and/or liquidation of the company.

These are loans or portions thereof which are considered uncollectible or worthless and of such little value that their continuance as bankable assets is not warranted although the loans may have some recovery or salvage value. The amount of loss is difficult to measure and it is neither practical nor desirable to defer writing off these basically worthless assets even though partial recovery may be obtained in the future. Basic characteristics are:

- Past due clean loans, the interest of which has remained unpaid for a period of 6 months;
- Loans payable in installments where amortization applicable to interest is past due for a period of 6 months, unless the loan is fully secured;
- When the borrower's whereabouts are unknown, or he is insolvent, or his earning power is permanently impaired and his co-makers or guarantors are insolvent or that their guarantee is not financially supported;
- Where the collaterals securing the loans are considered worthless and the borrower and/or his co-makers are insolvent; and
- Loan considered as absolutely uncollectible.

The following tables show the credit quality of financial assets by class (gross of allowance) of the Bank (amounts in thousands):

	2012					
	Neither Past Due nor Impaired			Past Due but not Impaired		
	High Grade	Standard Grade	Total	Impaired	Total	
Financial assets at FVPL:						
Government securities	₱-	₱272,942	₱272,942	₱-	₱-	₱272,942
Private bonds	108,254	11,346	119,600	-	-	119,600
Derivative Assets	612	-	612	-	-	612
AFS investments:						
Government securities	-	3,917,080	3,917,080	-	-	3,917,080
Private debt securities	1,486,212	225,247	1,711,459	-	-	1,711,459
HTM investments:						
Government securities	-	112,624	112,624	-	-	112,624
Loans and receivables:						
Loans and discount:						
Corporate	2,049,523	7,615,792	9,665,315	290,711	107,329	10,063,355
Consumer	2,820,040	820,579	3,640,619	471,896	-	4,112,515
Bills purchased	422,836	-	422,836	-	-	422,836
Unquoted debt securities	1,392,344	-	1,392,344	-	-	1,392,344
Accrued interest receivable	231,355	-	231,355	-	-	231,355
Accounts receivable	46,683	-	46,683	-	-	46,683
Receivable from stockholders	9,426	-	9,426	-	-	9,426
Sales contracts receivable	7,315	-	7,315	-	-	7,315
Other assets:						
RCOCI	310	-	310	-	-	310
Refundable deposits	23,090	-	23,090	-	-	23,090
Loans and advances to banks:						
Due from BSP	-	2,029,551	2,029,551	-	-	2,029,551
Due from other banks	1,097,031	-	1,097,031	-	-	1,097,031
Interbank loans receivable and SPURA with the BSP	295,177	-	295,177	-	-	295,177
	₱9,990,208	₱15,005,161	₱24,995,369	₱762,607	₱107,329	₱25,865,305



	2011					
	Neither Past Due nor Impaired			Past Due but not Impaired		
	High Grade	Standard Grade	Total	Impaired	Impaired	Total
Financial assets at FVPL:						
Government securities	₱-	₱2,168,546	₱2,168,546	₱-	₱-	₱2,168,546
Private bonds	80,922	349,975	430,897	-	-	430,897
AFS investments:						
Government securities	-	1,793,194	1,793,194	-	-	1,793,194
Private debt securities	430,631	1,100,231	1,530,862	-	-	1,530,862
Unquoted equity security	-	16,073	16,073	-	-	16,073
HTM investments:						
Government securities	-	120,828	120,828	-	-	120,828
Loans and receivables:						
Loans and discount:						
Corporate	2,860,574	5,119,579	7,980,153	267,268	113,122	8,360,543
Consumer	3,580,146	612,293	4,192,439	387,287	-	4,579,726
Bills purchased	285,284	-	285,284	-	-	285,284
Unquoted debt securities	1,442,861	-	1,442,861	-	-	1,442,861
Accrued interest receivable	215,262	-	215,262	-	-	215,262
Accounts receivable	29,708	-	29,708	-	-	29,708
Other assets:						
RCOCI	1,447	-	1,447	-	-	1,447
Refundable deposits	15,241	-	15,241	-	-	15,241
Loans and advances to banks:						
Due from BSP	-	1,912,501	1,912,501	-	-	1,912,501
Due from other banks	447,348	-	447,348	-	-	447,348
Interbank loans receivable and SPURA with the BSP	1,933,910	-	1,933,910	-	-	1,933,910
	₱11,323,334	₱13,193,220	₱24,516,554	₱654,555	₱113,122	₱25,284,231

The table below shows the aging analysis of past due but not specifically impaired loans and receivables by class (in thousands).

	2012					Total
	Less than 30 days	31 to 60 days	61 to 90 days	91 to 180 days	Over 180 days	
Loans and discount:						
Corporate	₱3,000	₱-	₱-	₱3,007	₱284,704	₱290,711
Consumer	6,842	8,599	93,532	86,894	276,029	471,896
Total	₱9,842	₱8,599	₱93,532	₱89,901	₱560,733	₱762,607

	2011					Total
	Less than 30 days	31 to 60 days	61 to 90 days	91 to 180 days	Over 180 days	
Loans and discount:						
Corporate	₱-	₱34,689	₱2,081	₱-	₱230,498	₱267,268
Consumer	2,105	7,809	41,610	51,845	283,918	387,287
Total	₱2,105	₱42,498	₱43,691	₱51,845	₱514,416	₱654,555

The above aging analysis already excludes accounts that have been assessed to be specifically impaired. Further, the definition of past due follows that of PFRS 7, which states that a financial asset is past due when the counterparty has failed to make a principal or interest payment when due.

See Note 10 for the detailed information with respect to the Bank's allowance for credit losses on loans and receivables.

Collateral and other credit risk mitigation

The amount and type of collateral required depends on an assessment of the credit risk of the obligor. The Bank implements certain requirements regarding the acceptability of types of collateral and valuation.



Collateral comes in the form of financial or non-financial assets. The main types of collateral obtained include cash or securities, charges over real estate or chattel properties, inventory and trade receivables and mortgages over residential properties. The Bank also obtains guarantees from parent companies for loans of borrowing entities belonging to a group of companies. The Bank monitors the market value of collateral, and request for additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowances for credit losses.

The following table shows the fair value of collaterals held against neither past due nor impaired loans and receivables of the Bank:

	2012	2011
Properties	₱3,613,656,367	₱7,687,227,460
Deposits	1,733,981,376	1,433,399,003
	₱5,347,637,743	₱9,120,626,463

It is the Bank's policy to dispose assets acquired in an orderly fashion. Such assets for disposal are offered for sale through public bidding (only after they are appraised anew to determine current market values; and duly bid for, based on the approved minimum bid price/s). The proceeds of the sale of the foreclosed assets classified as 'Investment properties' are used to reduce or repay the outstanding claim.

Liquidity Risk

Liquidity risk is generally defined as the current and prospective risk to earnings or capital arising from the Bank's inability to meet its obligations when they come due without incurring unacceptable losses or costs. Specifically, this pertains to events that may necessitate the Bank to enter into transactions that would realize significant losses or costs in order to meet its obligations when they fall due.

ALCO is responsible for formulating the Bank's liquidity risk management policies, whereas the RMG is responsible for monitoring such risks. Liquidity management is among the most important activities conducted within the Bank. The Bank manages its liquidity risk through analyzing net funding requirements under alternative scenarios, diversification of funding sources and contingency planning. The Bank utilizes a diverse range of sources of funds, although short-term deposits made with the Bank's network of domestic branches comprise the majority of such funding.

The Bank's liquidity risk is managed by holding sufficient liquid assets of appropriate quality to ensure short-term funding requirements are met with minimum sacrifice to market price and by maintaining a balanced loan portfolio which is repriced on a regular basis. Deposits with banks are made on a short-term basis with almost all being available on demand or within three months.

The Bank's treasury department uses liquidity forecast models that estimate the Bank's cash flow needs based on the Bank's actual contractual obligations and under normal circumstances and extraordinary circumstances. The RMG prepares a monthly maximum cumulative outflow report, which is an analysis of maturity gaps of the Bank's assets and liabilities.



Aging of financial assets and financial liabilities by remaining contractual maturities

The tables below summarize the maturity profile of the Bank's financial liabilities and financial assets used for liquidity management based on contractual undiscounted payments and receipts as of December 31, 2012 and 2011:

	2012						Total
	On demand	Within 30 days	31 to 60 days	61 to 180 days	181 to 360 days	Over 360 days	
Financial Assets							
Financial assets at FVPL	₱-	₱3,365,034	₱246,443	₱1,381,322	₱-	₱395,220,835	₱400,213,634
AFS investments	-	52,433,788	7,711,193	10,924,652	8,389,676	5,665,566,291	5,745,025,600
HTM investments	-	-	3,712,345	-	3,712,345	112,624,394	120,049,084
COCI	633,646,640	-	-	-	-	-	633,646,640
Loans and receivables:							
Due from BSP	-	2,029,789,775	-	-	-	-	2,029,789,775
Due from other banks	-	1,097,031,428	-	-	-	-	1,097,031,428
Interbank loans receivable and SPURA with the BSP	-	295,177,246	-	-	-	-	295,177,246
Loans and receivables:							
Loans and discounts	-	2,385,359,635	1,694,658,549	4,444,332,801	2,056,982,970	4,455,970,097	15,037,304,052
Unquoted debt securities	-	-	11,604,450	-	570,035,851	824,459,541	1,406,099,842
Accrued interest receivable	-	37,885,775	20,812,742	68,773,357	24,983,715	78,899,842	231,355,431
Accounts receivable	-	17,041,040	875,940	3,503,759	5,255,639	20,006,865	46,683,243
Receivable from stockholders	-	-	-	-	-	9,426,020	9,426,020
Sales contracts receivable	-	-	-	-	-	7,315,356	7,315,356
	633,646,640	5,918,083,721	1,739,621,662	4,528,915,891	2,669,360,196	11,569,489,241	27,059,117,351
Financial Liabilities							
Deposit liabilities:							
Demand	4,474,492,504	-	-	-	-	-	4,474,492,504
Savings	-	84,209,631	75,850,493	288,490,197	424,753,351	618,622,227	1,491,925,899
Time	-	8,277,752,055	2,112,310,474	2,769,252,202	922,075,213	3,348,964,084	17,430,354,028
	4,474,492,504	8,361,961,686	2,188,160,967	3,057,742,399	1,346,828,564	3,967,586,311	23,396,772,431
Manager's checks	-	60,842,543	-	-	-	-	60,842,543
Bills payable	-	297,251,097	-	-	-	-	297,251,097
Accrued interest and other expenses	-	84,775,647	2,536,706	10,146,823	15,220,234	30,440,468	143,119,878
Unsecured Subordinated Debt	-	-	7,656,250	7,656,250	15,312,500	444,564,236	475,189,236
Derivative liabilities	-	334,897	-	-	-	-	334,897
Other liabilities*	-	902,421,854	22,233,230	-	-	-	924,655,084
	₱4,474,492,504	₱9,707,587,724	₱2,220,587,153	₱3,075,545,472	₱1,377,361,298	₱4,442,591,015	₱25,298,165,166

* Comprised of accounts payable, due to PDIC, payment orders payable, bills purchased-contra and derivative liabilities

	2011						Total
	On demand	Within 30 days	31 to 60 days	61 to 180 days	181 to 360 days	Over 360 days	
Financial Assets							
Financial assets at FVPL	₱-	₱31,974,303	₱-	₱49,288,153	₱81,262,456	₱4,709,002,508	₱4,871,527,420
AFS investments	-	33,238,286	5,762,200	89,232,392	128,232,878	6,024,110,326	6,280,576,082
HTM investments	-	4,789,520	-	-	4,789,520	266,203,482	275,782,522
COCI	591,123,145	-	-	-	-	-	591,123,145
Loans and receivables:							
Due from BSP	-	1,912,889,359	-	-	-	-	1,912,889,359
Due from other banks	-	447,348,222	-	-	-	-	447,348,222
Interbank loans receivable and SPURA with the BSP	-	1,933,909,546	-	-	-	-	1,933,909,546
Loans and receivables:							
Loans and discounts	-	2,119,230,026	1,384,951,794	2,409,710,115	2,364,209,116	5,021,959,901	13,300,060,952
Unquoted debt securities	-	-	18,258,750	-	18,258,750	1,469,152,407	1,505,669,907
Accrued interest receivable	-	136,176,509	51,082,022	28,003,147	-	-	215,261,678
Accounts receivable	-	5,186,335	1,576,036	2,364,053	4,728,107	15,853,594	29,708,125
	591,123,145	6,624,742,106	1,461,630,802	2,578,597,860	2,601,480,827	17,506,282,218	31,363,856,958
Financial Liabilities							
Deposit liabilities:							
Demand	3,978,159,770	-	-	-	-	-	3,978,159,770
Savings	-	46,854,617	93,709,234	140,563,851	281,127,703	562,255,406	1,124,510,811
Time	-	1,733,905,376	3,287,310,541	3,286,554,071	364,643	10,490,951,354	18,799,085,985
	3,978,159,770	1,780,759,993	3,381,019,775	3,427,117,922	281,492,346	11,053,206,760	23,901,756,566
Manager's checks	-	78,024,579	-	-	-	-	78,024,579
Bills payable	-	121,492,338	-	-	-	-	121,492,338
Accrued interest and other expenses	-	78,413,628	8,007,891	10,530,065	15,133,040	29,183,813	141,268,437
Other liabilities*	-	722,327,995	258,258	-	-	-	722,586,253
	₱3,978,159,770	₱2,781,018,533	₱3,389,285,924	₱3,437,647,987	₱296,625,386	₱11,082,390,573	₱24,965,128,173

* Comprised of accounts payable, due to PDIC, payment orders payable and bills purchased-contra



Market Risk

Market risk is the risk of loss to future earnings, fair values or future cash flows as a result of changes in interest rates, foreign exchange rates, commodity prices, equity prices and other market changes. The Bank's market risk originates from its holdings of debt securities.

ALCO, chaired by the Head of Treasury, is the senior review and decision-making body for the management of all related market risks. In managing market risk, the Bank uses a framework of policies and procedures, measurement tools, controls and limits. The Treasury Group manages asset/liability risks arising from both normal banking operations and from trading operations in financial markets. Daily monitoring of compliance with the policies, procedures and limits is performed by the Market Risk Unit under RMG. The limits are annually reviewed by the ALCO and RMG and approved by the BOD. The RMG regularly reports to ALCO and to the RMC, which is a sub-committee of the BOD.

Interest rate risk

The Bank follows a prudent policy on managing its assets and liabilities so as to ensure that exposure to fluctuations in interest rates are kept within acceptable limits.

The Bank measures the sensitivity of its assets and liabilities to interest rate fluctuations by way of Earnings-at-Risk (EaR). EaR is a measure of likely earnings volatility for accrual portfolios. It is calculated as the change in income over the next 12 months, given current exposures that will result from one-year standard deviation change in interest rates, updated quarterly. EaR is calculated based on 99.0% confidence level. It is accomplished monthly, with quarterly stress test.

The following tables demonstrate the sensitivity to a reasonable possible change in interest rates of the Bank's net interest income and equity with all other variables held constant (amounts in millions).

	2012			
	Increase (Decrease) in Basis Points			
	50	100	(50)	(100)
Change in net interest income				
Loans and receivables	₱51.78	₱103.55	(₱51.78)	(₱103.55)
Deposit liabilities	(116.83)	(233.66)	116.83	233.66
As a percentage of the Bank's net interest income for the year	(5%)	(9%)	5%	9%
Change in equity*				
AFS investments	(267.70)	(504.90)	261.44	556.71

* The impact on the Bank's equity already excludes the impact on transactions affecting the statement of income.

	2011			
	Increase (Decrease) in Basis Points			
	50	100	(50)	(100)
Change in net interest income				
Loans and receivables	₱39.60	₱79.20	(₱39.60)	(₱79.20)
Deposit liabilities	(119.48)	(238.96)	119.48	238.96
As a percentage of the Bank's net interest income for the year	(10%)	(20%)	10%	20%
Change in equity*				
AFS investments	(114.39)	(186.70)	43.39	129.56

* The impact on the Bank's equity already excludes the impact on transactions affecting the statement of income.



As one of the goals in the risk management process, the Bank has set the adoption of the economic value approach in measuring the interest rate risk in the banking book to complement the earnings approach or EaR currently used.

Foreign currency risk

Foreign currency risk is the risk of an investment's value erosion due to an adverse movement in foreign exchange rates. It arises due to a mismatch in the Bank's foreign currency denominated assets and liabilities.

Foreign currency denominated deposits are generally used to fund the Bank's foreign currency denominated loan and investment portfolio in the FCDU. Banks are required by the BSP to match the foreign currency denominated liabilities with the foreign currency denominated assets held under the FCDU books. In addition, the BSP requires a 30.0% liquidity reserve on all foreign currency liabilities held under the FCDU. As of December 31, 2012 and 2011, the Bank is in compliance with the said regulation.

The Bank's policy is to maintain foreign currency exposure within acceptable limits and within existing regulatory guidelines.

The following table summarizes the Bank's foreign currency denominated financial assets and financial liabilities as of December 31, 2012 and 2011. Included in the tables are the Bank assets and liabilities at carrying amounts, categorized by currency (amounts in Philippine Peso equivalent).

	2012			2011		
	USD	Others*	Total	USD	Others*	Total
Financial Assets						
Cash and cash equivalents	₱157,965,505	₱852,465	₱158,817,970	₱244,406,433	₱-	₱244,406,433
Due from other banks	885,128,478	150,886,208	1,036,014,686	260,465,899	91,050,218	351,516,117
Interbank loan receivable	295,177,246	-	295,177,246	33,909,546	-	33,909,546
Financial assets at FVPL	186,251,711	-	186,251,711	503,700,216	-	503,700,216
AFS investments	412,498,088	-	412,498,088	1,233,544,800	-	1,233,544,800
HTM investments	112,624,394	-	112,624,394	120,828,253	-	120,828,253
Loans and receivables	223,606,276	-	223,606,276	306,620,598	-	306,620,598
Total financial assets	2,273,251,698	151,738,673	2,424,990,371	2,703,475,745	91,050,218	2,794,525,963
Financial Liabilities						
Deposit liabilities	2,263,444,664	1,111,906	2,264,556,570	2,752,946,861	-	2,752,946,861
Accrued interest and other expenses	13,696,824	-	13,696,824	11,854,178	-	11,854,178
Other liabilities	32,830,576	-	32,830,576	7,296,258	-	7,296,258
Total financial liabilities	2,309,972,064	1,111,906	2,311,083,970	2,772,097,297	-	2,772,097,297
Net Exposure	(₱36,720,366)	₱150,626,767	₱113,906,401	(₱68,621,552)	₱91,050,218	₱22,428,666

* Consist of Euro, United Kingdom pound, Canadian dollar, Australian dollar, Hongkong dollar, New Zealand dollar, Singapore dollar and Japanese yen and Chinese Yuan.

The following table sets forth the impact of reasonably possible changes in the USD exchange rate on the Bank's net income (amounts in millions):

	2012			
	Increase (Decrease) in Currency Rates			
	5.0%	10.0%	(5.0%)	(10.0%)
USD	₱0.58	₱1.17	(₱0.58)	(₱1.17)
	2011			
	Increase (Decrease) in Currency Rates			
	5.0%	10.0%	(5.0%)	(10.0%)
USD	₱1.50	₱3.01	(₱1.50)	(₱3.01)



The increase in USD exchange rate represents depreciation of Philippine peso while the decrease in USD exchange rate represents appreciation of Philippine peso.

There is no other impact in the Bank's equity other than those already affecting the statements of income.

Market Risk in the Trading Book

The Bank is exposed to the potential loss in its trading portfolio because the value of its trading positions is sensitive to changes in market prices and rates. The trading activities of the Bank include investments on fixed income securities and foreign exchange trading which exposes the bank to interest rate and foreign exchange risks. In the trading book, market risk is controlled by a daily analysis of the Value-at-Risk (VaR) of financial instruments under normal market conditions.

Objectives and limitations of the VaR methodology

The Bank uses the VaR approach in assessing the possible changes in the market value of the trading portfolio based on historical data for a rolling one year period. The VaR models are designed to measure market risk in a normal market environment. The Bank employs the use of parametric methodology or the variance-covariance method in calculating the VaR. This model assumes that any changes occurring in the risk factors affecting the normal market environment will follow a normal distribution. The use of VaR has limitations because it is based on historical correlations and volatilities in market prices and assumes that future price movements will follow a statistical distribution. Due to the fact that VaR relies heavily on historical data to provide information and may not clearly predict the future changes and modifications of the risk factors, the probability of large market movements may be underestimated if changes in risk factors fail to align with the normal distribution assumption. VaR may also be under or over estimated due to the assumptions placed on risk factors and the relationship between such factors for specific instruments. Even though positions may change throughout the day, the VaR only represents the risk of the portfolios at the close of each business day, and it does not account for any losses that may occur beyond the 99.0% confidence level.

The VaR figures are backtested to validate the robustness of the VaR model. The Bank performs both the hypothetical and actual backtesting procedures. Hypothetical backtesting is done using the Qrisk system while actual backtesting is done manually using an excel worksheet. Likewise, to complement VaR measure, the Bank performs stress tests wherein the trading portfolios are valued under extreme market scenarios not covered by the confidence interval of the Bank's VaR model.

VaR assumptions/parameters

The VaR that the Bank measures is an estimate, using a confidence level of 99.0% of the potential loss that is not expected to be exceeded if the current market risk positions were to be held unchanged for one day. The use of a 99.0% confidence level means that, within a 1 day horizon, losses exceeding the VaR figure should occur, on average, not more than once every 100 days.

Since VaR is an integral part of the Bank's market risk management, VaR limits have been established annually for all financial trading activities and exposures against the VaR limits are monitored on a daily basis. Limits are based on the tolerable risk appetite of the Bank.

The Market Risk Officer of the Bank prepares a daily VaR report containing details on the VaR amount, VaR limit utilization, and VaR limit breaches, if any. This report is sent to the traders concerned, Treasury Head, Chief Risk Officer, Treasury Operations Head, and the President. Moreover, the VaR results are discussed and reported in the monthly Risk Management Committee and Executive Committee meetings.



The following table provides the VaR summary of the Bank for the years ended December 31, 2012 and 2011 (amounts in thousands):

	2012		2011	
	Foreign Exchange	Fixed Income	Foreign Exchange	Fixed Income
December 28	₱798	₱85,023	₱216	₱88,718
Average Daily	824	92,724	2,220	80,965
Highest	3,232	136,932	8,994	127,771
Lowest	10	37,440	14	49,942

Fixed Income VaR includes value-at-risk for investment securities denominated in currencies other than Philippine Pesos

The Bank's trading in fixed income securities is exposed to movements in interest rates. The high and low of the total portfolio may not equal to the sum of the individual components as the high and low of the individual portfolios may have occurred on different trading days. The VaR for foreign exchange is the foreign exchange risk throughout the Bank. The Bank when aggregating the foreign exchange VaR and interest VaR does not consider the correlation effects between the two risks.

Capital Management

The Bank's capital base is composed of the Bank's paid-up capital stock and deposits for future stock subscription. The primary objectives of the Bank's capital management are to ensure that it complies with externally imposed capital requirements and to maintain strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value.

The Bank manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital structure, or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

Regulatory Qualifying Capital

Under Section 9 of the Thrift Banks Act, the combined capital accounts of each bank should not be less than the amount equal to ten percent (10.0%) of its risk assets. Risk assets consist of total assets after exclusion of cash on hand, due from BSP, loans covered by hold out or assignment of deposits, loans or acceptances under letters of credit to the extent covered by margin deposits and other non-risk items as determined by the Monetary Board.

The determination of the Bank's compliance with regulatory requirements and ratios is based on the amount of the Bank's "unimpaired capital" (regulatory net worth) as reported to the BSP, which is determined on the basis of regulatory accounting policies which differ from PFRS in some respects.



As of December 31, 2012 and 2011, the Bank was in compliance with the capital adequacy ratio (CAR) prescribed by BSP. The table below shows the Bank's CAR, as reported to the BSP (amounts in thousands):

	2012	2011
Total qualifying capital	₱2,315,099	₱1,777,327
Risk weighted assets	16,347,370	13,602,650
CAR	14.16%	13.07%

Regulatory capital comprises share capital, surplus including current year profit and deferred income tax. Certain adjustments are made in PFRS-based results and reserves, as prescribed by the BSP.

The Bank has complied with all externally imposed capital requirements in 2012 and 2011.

5. Fair Value Measurement and Derivative Instruments

The methods and assumptions used by the Bank in estimating the fair value of the financial instruments are:

COCI, due from BSP and other banks, RCOCI, interbank loans and SPURA with the BSP - Carrying amounts approximate fair values due to the relatively short-term maturity of these investments.

Loans and receivables - Fair values of loans are estimated using the discounted cash flow methodology, using the Bank's current incremental lending rates for similar types of loans.

Debt securities - Fair values are generally based on quoted market prices. Where the debt securities are not quoted or the market prices are not readily available, the Bank obtained valuations from independent parties offering pricing services, used adjusted quoted market prices of comparable investments, or applied discounted cash flow methodologies.

Unquoted equity securities - The investments are carried at cost less allowance for impairment losses due to the unpredictable nature of future cash flows and the lack of suitable methods of arriving at a reliable fair value.

Time deposits and bills payable - Fair values of time deposits and bills payable are estimated using the discounted cash flow methodology using the Bank's current incremental borrowing rates for similar borrowings with maturities consistent with their remaining liabilities being valued.

Derivative instruments - Derivatives are valued using valuation techniques that make use of market observable inputs prevailing at the statement of financial position date. For the Bank's outstanding currency swaps and foreign currency forward contracts, the discounted cash flow model is applied taking into consideration the prevailing forward exchange rates as of statement of financial position date applicable to the remaining tenor of the derivatives.

Refundable deposits - Fair value is based on discounted cash flows using the prevailing credit-adjusted interest rates.



Other financial liabilities - For financial liabilities other than time deposits and bills payable, the carrying amounts approximate fair values considering that these are due and demandable.

The table below presents a comparison by category of carrying amounts and estimated fair values of all of the Bank's financial instruments as of December 31, 2012 and 2011:

	2012		2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets				
Financial Assets at FVPL:				
Government debt securities	₱272,942,414	₱272,942,414	₱2,168,546,293	₱2,168,546,293
Private bonds	119,600,353	119,600,353	430,897,497	430,897,497
Derivative asset	612,056	612,056	–	–
	393,154,823	393,154,823	2,599,443,790	2,599,443,790
AFS investments:				
Government securities	3,917,080,383	3,917,080,383	1,793,194,254	1,793,194,254
Private bonds	1,695,384,818	1,695,384,818	1,530,861,812	1,530,861,812
Unquoted equity security	16,073,463	16,073,463	16,073,463	16,073,463
	5,628,538,664	5,628,538,664	3,340,129,529	3,340,129,529
HTM investments:				
Government securities	112,624,394	163,264,306	120,828,253	154,917,276
COCI	633,646,640	633,646,640	591,123,145	591,123,145
Loans and receivables:				
Due from BSP	2,029,551,219	2,029,551,219	1,912,501,244	1,912,501,244
Due from other banks	1,097,031,428	1,097,031,428	447,348,222	447,348,222
Interbank loans receivable	295,177,246	295,177,246	1,933,909,546	1,933,909,546
Loans and receivables:				
Loans and discounts:				
Corporate	10,007,730,559	10,079,175,687	8,302,483,312	8,319,659,198
Consumer	3,974,635,604	4,287,242,326	4,414,802,438	4,715,536,935
Bills purchased	422,835,544	422,835,544	285,284,146	285,284,146
Unquoted debt securities	1,392,343,929	2,579,380,187	1,442,861,465	2,581,549,463
Accrued interest receivable	231,355,431	231,355,431	215,261,678	215,261,678
Accounts receivable	46,683,243	46,683,243	29,708,125	29,708,125
Receivable from stockholders	9,426,020	9,426,020	–	–
Sales contracts receivable	7,315,356	7,315,356	–	–
	16,092,325,686	17,663,413,794	14,690,401,164	16,146,999,545
Other assets:				
RCOCI	309,567	309,567	1,446,600	1,446,600
Refundable deposits	23,090,334	21,496,272	15,241,345	13,122,501
	23,399,901	21,805,839	16,687,945	14,569,101
Total loans and receivables	19,537,485,480	21,106,979,526	19,000,848,121	20,455,327,658
	₱26,305,450,001	₱27,925,583,959	₱25,652,372,838	₱27,140,941,398
Financial Liabilities				
Other financial liabilities:				
Deposit liabilities:				
Demand	₱4,474,492,504	₱4,474,492,504	₱3,978,159,770	₱3,978,159,770
Savings	1,476,900,753	1,476,900,753	1,176,181,020	1,176,181,020
Time	17,418,808,461	17,441,703,187	18,735,806,015	18,763,498,716
	23,370,201,718	23,393,096,444	23,890,146,805	23,917,839,506
Manager's checks	60,842,543	60,842,543	78,024,579	78,024,579
Bills payable	297,251,097	297,251,097	121,492,338	121,492,338
Accrued interest and other expenses	143,119,878	143,119,878	141,268,437	141,268,437
Accounts payable	478,010,033	478,010,033	411,536,743	411,536,743

(Forward)



	2012		2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Due to PDIC	₱23,506,671	₱23,506,671	₱23,634,266	₱23,634,266
Bills purchased - contra	422,835,544	422,835,544	285,284,146	285,284,146
Payment order payable	637,733	637,733	2,131,098	2,131,098
Unsecured Subordinated Debt	500,000,000	571,894,902	-	-
Derivative liabilities	334,897	334,897	-	-
	1,926,538,396	1,998,433,298	1,063,371,607	1,063,371,607
	₱25,296,740,114	₱25,391,529,742	₱24,953,518,412	₱24,981,211,113

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: valuation techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: valuation techniques which make use of inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

	2012		2011	
	Level 1	Level 2	Level 1	Level 2
Financial Assets				
Financial assets at FVPL:				
Government securities	₱272,942,414	₱-	₱2,168,546,293	₱-
Private bonds	119,600,353	-	430,897,497	-
Derivative assets	-	612,056	-	-
AFS investments:				
Government securities	3,917,080,383	-	1,793,194,254	-
Private bonds	575,271,937	1,120,112,881	787,114,592	743,747,220
Financial Liabilities				
Financial Liabilities at FVPL:				
Derivative liabilities	-	334,897	-	-

As of December 31, 2012 and 2011, the Bank has no financial instruments measured using level 3 inputs. There were no transfers between levels of fair value measurements in 2012 and 2011.

Derivative Instruments

On September 23, 2009, the BSP approved the Bank's application for a Type 3 Limited User derivatives authority which allows the Bank, as an end-user, to enter into derivative transactions for purposes other than hedging.

In 2012, the Bank started to engage in the following derivative transactions:

Non-deliverable currency forwards

Non-deliverable currency forward contracts (NDFs) are contractual agreements to buy or sell a specified currency at a specific rate and date in the future. These are customized contracts transacted in the over-the-counter market where the settlement, at maturity, between counterparties is based on the actual profit or loss on the contract, calculated as the difference between the spot exchange rate and the agreed forward rate.



Currency swaps

A currency swap is an agreement to exchange amounts in different currencies based on the spot rate at trade date and to re-exchange the same currencies at a future date based on an agreed rate.

As of December 31, 2012, the Bank has outstanding positions as follows:

		2012	
	Notional Amounts	Derivative Assets (Note 7)	Derivative Liabilities (Note 19)
Forward Sell USD currency swaps	\$6,000,000	₱363,093	₱184,776
Forward Buy USD NDFs	\$6,000,000	248,963	150,121
		₱612,056	₱334,897

The weighted average contract rates for the outstanding currency swaps and NDFs are ₱40.92 and ₱40.87, respectively. In 2012, trading gains from derivative transactions amounted to ₱3.0 million. These are included in 'Trading gains - net' in the statements of income.

6. Interbank Loans Receivable and Securities Purchased Under Resale Agreements with the Bangko Sentral ng Pilipinas

The Bank extends short-term loans with maturities of up to three months to local and foreign banks with interest rates ranging from 0.13% to 4.56% and 0.01% to 1.10%, respectively, in 2012 and 0.15% to 4.50% and 0.01% to 1.10%, respectively, in 2011. As of December 31, 2012 and 2011, the Bank has interbank loans receivable amounting to ₱295.2 million and ₱33.9 million, respectively. Interest income on interbank loans receivable amounted to ₱4.2 million in 2012 and ₱3.9 million in 2011.

As of December 31, 2011, the Bank has outstanding SPURA with BSP of ₱1.9 billion. There is no outstanding balance as of December 31, 2012. SPURA with the BSP earned interest at 3.5% and 4.5% in 2012 and 2011, respectively. Interest income amounted to ₱59.6 million and ₱38.8 million in 2012 and 2011, respectively.

7. Financial Assets at Fair Value through Profit or Loss

As of December 31, 2012 and 2011, this account consists of the following held-for-trading (HFT) investments:

	2012	2011
Government securities	₱272,942,414	₱2,168,546,293
Private bonds	119,600,353	430,897,497
Derivative assets (Note 5)	612,056	-
	₱393,154,823	₱2,599,443,790

As of December 31, 2012 and 2011, the Bank's net unrealized gains (losses) on HFT securities amounted to (₱4.4 million) and ₱41.1 million, respectively. Gains or losses from changes in fair value of HFT securities are included in 'Trading gains - net' in the statements of income. Trading gains in 2012 and 2011 amounted to ₱165.0 million and ₱204.7 million, respectively.



Peso-denominated HFT securities bear effective interest rates ranging from 4.5% to 6.5% in 2012 and 2011, while foreign currency-denominated HFT securities bear effective interest rates ranging from 2.05% to 12.4% in 2012 and 3.5% to 15.1% in 2011. Interest income earned in 2012 and 2011 amounted to ₱160.3 million and 160.9 million, respectively.

8. Available-for-Sale Investments

The Bank's AFS investments consist of the following:

	2012	2011
Government securities	₱3,917,080,383	₱1,793,194,254
Private bonds	1,695,384,818	1,530,861,812
Unquoted equity security	16,073,463	16,073,463
	₱5,628,538,664	₱3,340,129,529

Unquoted equity security pertains to a Bancnet share. This is carried at cost less allowance for impairment losses since its fair value cannot be reliably estimated. There is no active market for this investment and the Bank intends to hold it on a long-term basis.

Peso-denominated AFS investments bear effective interest rates ranging from 2.0% to 5.7% in 2012 and 3.5% to 8.5% in 2011, while foreign currency-denominated AFS investments bear effective interest rates ranging from 2.4% to 8.1% in 2012 and 2.7% to 15.4% in 2011. Interest income earned in 2012 and 2011 amounted to ₱241.2 million and ₱250.7 million, respectively.

The details of net unrealized gain (loss) on AFS investments of the Bank follow:

	2012	2011
Balance at beginning of year	(₱156,607)	(₱41,981,647)
Changes in fair value during the year	363,135,815	184,757,388
Gains taken to profit and loss	(207,307,450)	(144,081,892)
Amortization of unrealized losses on reclassified AFS investments	303,797	1,149,544
Subtotal	156,132,162	41,825,040
Balance at end of year	₱155,975,555	(₱156,607)

As of December 31, 2012 and 2011, the Bank's net unrealized gain (loss) on AFS investments includes unrealized losses on reclassified AFS investments amounting to ₱7.9 million and ₱8.2 million, respectively.

Reclassification of AFS investments

As allowed under PAS 39, the Bank identified certain eligible AFS investments for which it had a clear change of intent to hold these financial assets until maturity in order to adequately manage its net interest earning streams by matching these securities against its core funding, as defined under its existing risk management measurements and parameters.

On July 1, 2008, the Bank reclassified USD-denominated investment securities with face amount totaling USD2.3 million and effective interest of 6.8% from AFS investments to HTM investments.



The reclassification is also compliant with the criteria and rules set forth in BSP Circular Nos. 626 and 628 as well as those provided in SEC Memorandum Circular No. 10, Series of 2008, on Amendments to PAS 39 and PFRS 7.

As of December 31, 2012, the carrying amount and fair value of financial assets reclassified out of AFS investments to HTM investments amounted to ₱112.6 million and ₱163.3 million, respectively. As of December 31, 2011, the carrying amount and fair value of financial assets reclassified out of the AFS investments to HTM investments amounted to ₱120.8 million and ₱154.9 million, respectively.

Prior to reclassification, the fair value loss on the reclassified AFS investments recognized in 'Net unrealized loss on AFS investments' reported under the equity section of the statements of financial position amounted to ₱9.7 million. Had the reclassification not been made, the fair value loss recognized in 'Net unrealized loss on AFS investments' would have decreased by ₱44.5 million in 2012 and ₱25.9 million in 2011. As of December 31, 2012 and 2011, the Bank expects to recover the entire cash flows of these reclassified financial assets.

9. Held-to-Maturity Investments

The Bank's HTM investments consist of the following:

	2012	2011
Government securities:		
Face value	₱94,415,000	₱100,832,000
Unamortized premium	18,209,394	19,996,253
	₱112,624,394	₱120,828,253

At the start of 2011, HTM investments include Landbank corporate bonds maturing on October 19, 2016. The Landbank bonds provide an option to the issuer to call or prepay the bonds at par value. Consequently, the bonds were called on by the issuer on October 19, 2011. This resulted in a gain on early redemption of ₱1.2 million, which pertains to the unamortized discount on the bonds as at call date. The prepayment does not taint the HTM portfolio as the redemption was initiated by the issuer and is beyond the control of the Bank.

As of December 31, 2012 and 2011, HTM investments pertain to Republic of the Philippines bonds that will mature on February 2, 2030. The bonds bear effective interest of 9.50%.

Interest income earned on HTM investments in 2012 and 2011 amounted to ₱8.8 million and ₱10.7 million, respectively.



10. Loans and Receivables

This account consists of:

	2012	2011
Loans and discounts		
Corporate	₱10,066,447,465	₱8,364,184,935
Consumer	4,112,514,657	4,579,725,447
Less unearned discounts and capitalized interest	3,091,923	3,642,447
	14,175,870,199	12,940,267,935
Bills purchased	422,835,544	285,284,146
Unquoted debt securities	1,392,343,929	1,442,861,465
Accrued interest receivable	231,355,431	215,261,678
Accounts receivable	46,683,243	29,708,125
Receivable from stockholders (Note 26)	9,426,020	-
Sales contracts receivable	7,315,356	-
	16,285,829,722	14,913,383,349
Less allowance for credit losses	193,504,036	222,982,185
	₱16,092,325,686	₱14,690,401,164

Receivables from customers consist of:

	2012	2011
Loans and discounts	₱13,563,318,473	₱12,589,590,967
Customers' liabilities under letters of credit and trust receipts	303,951,170	136,279,838
Receivables purchased	311,692,479	218,039,577
Bills purchased	422,835,544	285,284,146
	14,601,797,666	13,229,194,528
Less unearned discounts and capitalized interest	3,091,923	3,642,447
	₱14,598,705,743	₱13,225,552,081

Unquoted debt securities consist of the following:

	2012	2011
Private bonds:		
Face value	₱1,420,444,412	₱1,498,656,095
Unamortized discount	(28,100,483)	(55,794,630)
	₱1,392,343,929	₱1,442,861,465

Unquoted debt securities bear effective interest rates ranging from 3.9% to 4.1% in 2012 and 2011.

As of December 31, 2012 and 2011, Accounts receivable includes amounts due from officers of ₱25.0 million and ₱19.4 million, respectively, relating to the Bank's car plan for employees.



The movements in the Bank's allowance for credit losses on loans and receivables follow:

	2012		
	Corporate Lending	Consumer Lending	Total
Balance at beginning of year	₱58,059,176	₱164,923,009	₱222,982,185
Write-offs	(6,345,136)	(101,144,151)	(107,489,287)
Provision for credit losses during the year	3,910,943	74,100,195	78,011,138
Balance at end of year	₱55,624,983	₱137,879,053	₱193,504,036
Individual impairment	₱53,375,819	₱-	₱53,375,819
Collective impairment	2,249,164	137,879,053	140,128,217
	₱55,624,983	₱137,879,053	₱193,504,036
Gross amount of loans individually determined to be impaired	₱107,329,040	₱-	₱107,329,040

	2011		
	Corporate Lending	Consumer Lending	Total
Balance at beginning of year	₱80,769,692	₱83,735,159	₱164,504,851
Provision for (recovery of) credit losses during the year	(22,710,516)	81,187,850	58,477,334
Balance at end of year	₱58,059,176	₱164,923,009	₱222,982,185
Individual impairment	₱55,812,236	₱-	₱55,812,236
Collective impairment	2,246,940	164,923,009	167,169,949
	₱58,059,176	₱164,923,009	₱222,982,185
Gross amount of loans individually determined to be impaired	₱113,122,304	₱-	₱113,122,304

The following table shows information relating to receivables from customers by collateral (at gross amounts):

	2012		2011	
	Amount	%	Amount	%
Secured by:				
Real estate mortgage	₱2,519,805,369	17.26	₱1,966,579,501	14.87
Chattel mortgage	1,884,594,650	12.91	2,352,728,170	17.78
Others	1,995,042,918	13.66	2,223,978,352	16.81
	6,399,442,937	43.83	6,543,286,023	49.46
Unsecured	8,202,354,729	56.17	6,685,908,505	50.54
	₱14,601,797,666	100.00	₱13,229,194,528	100.00

As of December 31, 2012 and 2011, information on the concentration of credit (at gross amounts) as to industry follow:

	2012		2011	
	Amount	%	Amount	%
Other community, social and personal activities	₱4,004,977,906	27.43	₱4,495,518,961	33.98
Real estate	3,321,424,443	22.75	2,803,612,547	21.19
Manufacturing (various industries)	2,535,726,223	17.37	2,287,741,126	17.29
Wholesale and retail trade	2,201,438,618	15.08	1,604,636,928	12.13
Financial intermediaries	853,992,735	5.85	579,655,395	4.38
Agricultural, hunting and forestry	566,219,502	3.88	438,349,900	3.31
Transportation, storage and communication	527,917,515	3.62	509,347,310	3.85
Construction	497,059,098	3.40	439,741,516	3.32
Mining and quarrying	68,960,802	0.47	48,960,802	0.37
Hotel and restaurants	20,656,750	0.14	21,630,043	0.16
Electricity, gas and water supply	3,424,074	.02	-	-
Total	₱14,601,797,666	100.00	₱13,229,194,528	100.00



Thrift banks are not covered by the loan concentration limit of 30.0% as prescribed by the BSP.

Current banking regulations allow banks with no unbooked valuation reserves and capital adjustments to exclude from nonperforming classification those loans classified as loss in the latest examination of the BSP which are fully covered by allowance for credit losses, provided that interest on said loans shall not be accrued.

NPLs shall, as a general rule, refer to loan accounts whose principal and/or interest is unpaid for 30 days or more after due date or after they have become past due in accordance with existing rules and regulations. This applies to loans payable in lump sum and loans payable in quarterly, semi-annual, or annual installments, in which case, the total outstanding balance thereof is considered nonperforming.

In the case of receivables that are payable in monthly installments, the total outstanding balance is considered nonperforming when three or more installments are in arrears. In the case of receivables that are payable in daily, weekly, or semi-monthly installments, the total outstanding balance thereof is considered nonperforming at the same time that they become past due in accordance with existing BSP regulations, i.e., the entire outstanding balance of the receivable is considered as past due when the total amount of arrearages reaches ten percent (10.0%) of the total receivable balance.

As of December 31, 2012 and 2011, the Bank's NPLs not fully covered by allowance for credit losses follow:

	2012	2011
Total NPLs	₱869,936,963	₱767,676,256
Less NPLs classified as loss by the BSP and are fully covered by allowance for credit losses*	-	106,110,806
	₱869,936,963	₱661,565,450

*Written-off in 2012

As of December 31, 2012 and 2011, breakdown of the Bank's NPLs as to secured and unsecured follows:

	2012	2011
Secured	₱305,746,114	₱379,113,228
Unsecured	564,190,849	388,563,028
	₱869,936,963	₱767,676,256

Restructured loans which do not meet the requirements to be treated as performing receivables are also considered as NPLs. As of December 31, 2012 and 2011, the Bank's restructured loans amounted to ₱18.5 million and ₱23.2 million, respectively, while interest income on these restructured receivables amounted to ₱5.1 million and ₱2.5 million, respectively.

The details of interest income on loans and receivables follow:

	2012	2011
Corporate loans	₱683,696,893	₱610,237,491
Consumer loans	519,460,211	542,833,158
Unquoted debt securities	66,746,876	69,062,892
	₱1,269,903,980	₱1,222,133,541



Of the total loans and receivables as of December 31, 2012 and 2011, 66.2% and 51.7%, respectively, are subject to periodic interest repricing. Remaining peso-denominated loans earn annual fixed interest rates ranging from 3.8% to 24.0% in 2012 and 4.5% to 24.0% in 2011.

11. Property and Equipment

The composition of and movements in this account are as follows:

	2012				Total
	Land	Building and Condominium Units	Furniture and Equipment	Leasehold Improvement	
Cost					
Balance at beginning of year	₱164,344,500	₱230,426,293	₱399,734,027	₱185,610,540	₱980,115,360
Additions	–	2,584,474	85,246,014	34,830,265	122,660,753
Disposal	–	–	(33,587,867)	–	(33,587,867)
Balance at end of year	164,344,500	233,010,767	451,392,174	220,440,805	1,069,188,246
Accumulated Depreciation and Amortization					
Balance at beginning of year	–	28,356,430	244,375,241	73,194,605	345,926,276
Depreciation and amortization	–	11,711,391	88,579,704	27,376,672	127,667,767
Disposal	–	–	(11,518,666)	–	(11,518,666)
Balance at end of year	–	40,067,821	321,436,279	100,571,277	462,075,377
Accumulated Impairment					
Balance at beginning and end of year	–	2,667,217	–	–	2,667,217
Net Book Value at End of Year	₱164,344,500	₱190,275,729	₱129,955,895	₱119,869,528	₱604,445,652

	2011				Total
	Land	Building and Condominium Units	Furniture and Equipment	Leasehold Improvement	
Cost					
Balance at beginning of year	₱164,344,500	₱175,211,783	₱305,558,276	₱153,055,523	₱798,170,082
Additions	–	55,214,510	100,751,803	32,555,017	188,521,330
Disposal	–	–	(6,576,052)	–	(6,576,052)
Balance at end of year	164,344,500	230,426,293	399,734,027	185,610,540	980,115,360
Accumulated Depreciation and Amortization					
Balance at beginning of year	–	18,159,764	162,753,218	48,302,367	229,215,349
Depreciation and amortization	–	10,196,666	84,775,660	24,892,238	119,864,564
Disposal	–	–	(3,153,637)	–	(3,153,637)
Balance at end of year	–	28,356,430	244,375,241	73,194,605	345,926,276
Accumulated Impairment					
Balance at beginning and end of year	–	2,667,217	–	–	2,667,217
Net Book Value at End of Year	₱164,344,500	₱199,402,646	₱155,358,786	₱112,415,935	₱631,521,867

Gain from sale of property and equipment recognized under 'Profit from assets sold or acquired - net' in the statements of income amounted to ₱0.2 million and ₱0.4 million in 2012 and 2011, respectively. As of December 31, 2012 and 2011, the cost of fully depreciated assets still in use by the Bank amounted to ₱49.6 and ₱37.3 million, respectively.



12. Investment Properties

The composition of and movements in this account follow:

	2012		
	Land	Building Improvements	Total
Cost			
Balance at beginning of year	₱64,509,185	₱103,710,934	₱168,220,119
Additions	14,740,000	18,236,479	32,976,479
Disposal	(27,071,200)	(30,177,528)	(57,248,728)
Balance at end of year	52,177,985	91,769,885	143,947,870
Accumulated Depreciation and Amortization			
Balance at beginning of year	–	15,153,751	15,153,751
Depreciation and amortization	–	8,582,730	8,582,730
Disposal	–	(5,763,150)	(5,763,150)
Balance at end of year	–	17,973,331	17,973,331
Accumulated Impairment			
Balance at beginning of year	426,600	5,622,148	6,048,748
Disposal	–	(2,018,509)	(2,018,509)
Balance at end of year	426,600	3,603,639	4,030,239
Net Book Value at End of Year	₱51,751,385	₱70,192,915	₱121,944,300

	2011		
	Land	Building Improvements	Total
Cost			
Balance at beginning of year	₱69,963,745	₱73,256,648	₱143,220,393
Additions	15,704,800	38,780,569	54,485,369
Disposal	(21,159,360)	(8,326,283)	(29,485,643)
Balance at end of year	64,509,185	103,710,934	168,220,119
Accumulated Depreciation and Amortization			
Balance at beginning of year	–	7,204,686	7,204,686
Depreciation and amortization	–	9,123,869	9,123,869
Disposal	–	(1,174,804)	(1,174,804)
Balance at end of year	–	15,153,751	15,153,751
Accumulated Impairment			
Balance at beginning of year	2,254,160	5,622,148	7,876,308
Disposal	(1,827,560)	–	(1,827,560)
Balance at end of year	426,600	5,622,148	6,048,748
Net Book Value at End of Year	₱64,082,585	₱82,935,035	₱147,017,620

The Bank's investment properties include real estate properties acquired in settlement of loans and receivables. The difference between the fair value of the assets upon foreclosure and the carrying value of the loans amounting to ₱1.0 million in 2012 and ₱6.7 million in 2011 was recognized under 'Profit from assets sold or acquired - net' in the statements of income.



Annually, management reviews the recoverable amount of investment properties. Several factors are considered such as real estate prices and the physical condition of these properties. The aggregate market value of the Bank's investment properties as of December 31, 2012 and 2011 amounted to ₱167.2 million and ₱171.2 million, respectively, as determined by independent and/or in-house appraisers using market data approach. As of December 31, 2012 and 2011, the Bank's investment properties amounting to ₱22.9 and ₱36.4 million, respectively, are still subject to redemption. Gain on sale or redemption of investment properties amounting to ₱8.5 million in 2012 and ₱4.6 million in 2011 is included under 'Profit from assets sold or acquired - net' in the statements of income.

Direct operating expenses, pertaining to depreciation and amortization and repairs and maintenance, incurred on investment properties amounted to ₱23.1 million and ₱13.8 million, in 2012 and 2011, respectively.

13. Branch Licenses

On January 16, 2007, the Bank purchased from BPI Family Savings Bank fourteen (14) branch licenses amounting to ₱57.5 million, including ₱5.5 million licensing fees paid to the BSP. Seven (7) branch licenses are in restricted areas and the other seven (7) are in unrestricted areas. On May 16, 2007, the Monetary Board of the BSP approved the acquisition of these branches and granted the Bank the authority to operate under certain conditions.

On February 14, 2008, the Bank purchased additional branch licenses from the BSP amounting to ₱38.6 million.

In 2009, the Bank opened 5 additional branches in unrestricted areas and incurred licensing fees amounting to ₱1.3 million.

In 2009, the Bank acquired additional branch licenses amounting to ₱128.0 million as a result of its acquisition of CSB (see Note 1).

As of December 31, 2012 and 2011, the Bank has a total of 36 and 33 branches, respectively. Eighteen (18) of the branches as of December 31, 2012 and 2011 are in restricted areas.

For those branch licenses with fair value less cost-to-sell lower than the carrying amount, the Bank's impairment test is based on value-in-use calculations that use a discounted cash flow model. The respective branches have been identified as the CGU for purposes of impairment testing of branch licenses.

The recoverable amount of the CGU has been determined based on cash flow projections from financial budgets approved by senior management covering a five-year period. The discount rate applied to cash flow projections is 9.4% in 2012 and 10.1 % in 2011 and cash flows beyond the five year-period are extrapolated using a steady growth rate of 4.6% in 2012 and 3.7% in 2011, which does not exceed the long-term average growth rate for the industry.

The calculation of the value-in-use of the CGU is most sensitive to the following assumptions:

- Discount rates
- Steady growth rate used to extrapolate cash flows beyond the budget period
- Local inflation rates



With regard to the assessment of value-in-use of the CGU, management believes that no reasonably possible change in any of the above key assumptions would cause the carrying value of the branch licenses to materially exceed its recoverable amount.

14. Other Assets

This account consists of:

	2012	2011
Prepaid expenses	₱44,851,613	₱37,029,303
Refundable deposits	23,090,334	15,241,345
Chattel mortgage properties	22,435,023	51,694,304
Other investments	7,252,978	6,163,333
Documentary stamp tax	5,194,403	3,111,966
Recoverable tax payments	4,093,424	10,491,349
Deferred lease expense	3,054,255	3,670,492
Supplies on hand	1,017,298	667,326
RCOCI	309,567	1,446,600
Miscellaneous	9,234,566	6,255,721
	₱120,533,461	₱135,771,739

The movements in the Bank's chattel mortgage properties follow:

	2012	2011
Cost		
Balance at beginning of year	₱63,310,168	₱35,089,665
Additions	80,874,576	90,805,628
Disposals	(119,262,829)	(62,585,125)
Balance at end of year	24,921,915	63,310,168
Accumulated Depreciation		
Balance at beginning of year	11,615,864	5,446,807
Depreciation	15,888,595	17,237,253
Disposals	(25,017,567)	(11,068,196)
Balance at end of year	2,486,892	11,615,864
Accumulated Impairment		
Balance at beginning of year	-	707,162
Disposal	-	(707,162)
Balance at end of year	-	-
Net Book Value at End of Year	₱22,435,023	₱51,694,304

Chattel mortgage properties refer to automobiles acquired by the Bank in settlement of loans and receivables. The difference between the fair values upon foreclosure and the carrying value of the loans amounting to ₱15.2 million loss and ₱12.2 million loss in 2012 and 2011, respectively, are recognized under 'Profit from assets sold or acquired - net' in the statements of income. Gain on sale of chattel mortgage properties amounted to ₱8.6 million in 2012 and ₱8.7 million in 2011. This is also presented under 'Profit from assets sold or acquired - net' in the statements of income.



Recoverable tax payments represent the balance of the excess tax payments for the year 1999 for which the Bank has exercised its option to carry over and apply as tax credits in the succeeding taxable years. In a Petition for Review submitted by the Bank to the Court of Tax Appeals (CTA) on July 28, 2003, the Bank has claimed for a refund or issuance of a tax credit certificate in the amount of ₱27.1 million, representing overpaid income tax for the calendar year 1999. The Bank, however, has already exercised its option to carry over the 1999 excess tax credits to the succeeding year and is therefore, no longer entitled to claim for the refund or issuance of a tax credit certificate. The CTA cited the provision under Section 76 of the 1997 Tax Code which states that if a corporation exercises the option to carry over its excess tax credits to the succeeding years, the option becomes irrevocable for the taxable period and no application for cash refund or issuance of a tax credit certificate shall be allowed. The Bank, however, may still claim the excess income tax payments as a tax credit against future income tax liabilities.

Prepaid expenses include prepaid rentals, group life insurance and employee benefits related to the Bank's car plan for its officers, and retainers fee.

Refundable deposits include non-interest bearing rental deposits. Total discount on refundable deposits as of December 31, 2012 and 2011 amounted to ₱5.6 million and ₱7.9 million, respectively. Accretion of interest recognized under 'Interest income - deposits in banks and others' in the statements of income amounted to ₱0.8 million in 2012 and 2011.

Deferred lease expense pertains to the difference between the nominal value of the refundable deposit and its fair value at inception. This is expensed on a straight-line basis over the lease term.

Other investments include membership fees in Bancnet, Credit Management Association of the Philippines, and Avega Managed Care, Inc.

Miscellaneous assets consist mainly of deposit with a health care agency for the establishment of the Bank's employee health plan.

15. Deposit Liabilities

In 2012, BSP Circular 753 approved the unification of the liquidity and statutory reserves from 8.0% to 6.0% for deposit liabilities. Under existing BSP regulations in 2011, non-FCDU deposit liabilities are subject to liquidity reserves equivalent to 2.0% and statutory reserves equivalent to 6.0%. As of December 31, 2012 and 2011, the Bank is in compliance with such regulations.

As reported to the BSP, the available reserves as of December 31, 2012 and 2011 are as follows:

	2012	2011
Cash and other cash items	₱-	₱591,123,145
Due from BSP:		
Demand deposit account	1,269,551,219	959,501,244
Special deposit account	-	573,000,000
Reserve deposit account	-	380,000,000
	₱1,269,551,219	₱2,503,624,389

As of December 31, 2012 and 2011, the Bank's Due from BSP amounted to ₱2.0 billion and ₱1.9 billion, respectively. Interest income from deposits in BSP and other banks amounted to ₱19.5 million and ₱19.9 million in 2012 and 2011, respectively.



Interest expense on deposit liabilities are as follows:

	2012	2011
Demand	₱15,790,275	₱15,117,035
Savings	15,025,143	10,478,353
Time	839,518,621	793,192,623
	₱870,334,039	₱818,788,011

As of December 31, 2012 and 2011, 75.0% and 79.0% of total deposit liabilities are subject to periodic interest repricing, respectively. Remaining fixed peso-denominated deposit liabilities bear annual fixed interest rates ranging from 0.5% to 5.5% and 0.5% to 6.4% in 2012 and 2011, respectively, while dollar-denominated deposit liabilities bear annual fixed interest rates ranging from 0.5% to 3.9% and 0.5% to 3.5% in 2012 and 2011, respectively.

16. Bills Payable

As of December 31, 2012 and 2011, bills payable consists of BSP rediscounted loans with interest rate of 3.5% in 2012 and 4.5% in 2011. Interest expense on bills payable amounted to ₱9.1 million in 2012 and ₱4.0 million in 2011.

17. Accrued Interest, Taxes and Other Expenses

This account consists of:

	2012	2011
Accrued other expenses		
Rent	₱32,073,002	₱29,804,101
Security, messengerial and janitorial	2,761,147	8,515,449
Travel and transportation	7,503,121	5,916,513
Professional fees	6,128,336	4,331,314
Utilities and leased line	4,984,809	3,703,334
Compensation and Other benefits	4,446,083	3,140,921
ATM	3,033,930	1,966,709
Others	6,332,678	2,086,134
Accrued interest payable	75,856,772	81,803,962
Retirement liability (Note 22)	41,726,410	26,868,778
Gross Receipts Tax	9,498,555	21,632,043
	₱194,344,843	₱189,769,258

Others pertain to accrued expenses for insurance, publications, repairs and maintenance and, other staff costs and expenses.



18. Unsecured Subordinated Debt

On January 5, 2012, the Monetary Board of the BSP, in its Resolution No. 30, approved the Bank's issuance of Unsecured Subordinated Debt with aggregate principal amount of ₱500.0 million. The unsecured subordinated debt, which was issued on May 30, 2012, bears interest of 6.125% per annum, payable quarterly.

The Unsecured Subordinated Debt will mature after 10 years from issuance date but may be called by the Bank on any interest payment date after the 5th year of issuance at principal amount plus accrued interest.

Interest expense in 2012 amounted to ₱18.1 million.

19. Other Liabilities

This account consists of:

	2012	2011
Accounts payable		
Cash cards	₱270,211,214	₱225,835,756
Chattel mortgage, insurance and loan service fees	93,002,053	110,069,670
Bancnet and VISA	15,225,430	27,946,944
Others	100,009,546	82,390,808
Bills purchased - contra (Note 10)	422,835,544	285,284,146
Deposits for future stock subscription (Note 25)	-	125,000,000
Due to PDIC	23,506,671	23,634,266
Withholding taxes payable	13,973,280	15,660,096
Marginal deposit	2,053,092	300,000
SSS, Medicare, Pagibig	1,801,486	1,688,575
Payment orders payable	637,733	2,131,098
Derivative liabilities (Note 5)	334,897	-
Miscellaneous	9,638,251	3,455,765
	₱953,229,197	₱903,397,124

Due to PDIC pertains to the Bank's insurance payable on deposit liabilities, which was subsequently paid a month after the statement of financial position date.

On July 19, 2011, the BOD approved the increase in authorized capital stock from ₱1.5 billion to ₱3.0 billion (see Note 25). As of December 31, 2011, deposits for future stock subscription pertain to the stockholders' planned additional capital investment in the Bank. The Bank booked such deposits under 'Other liabilities' account as it has no available unissued shares as of December 31, 2011. The Bank's application was approved by the SEC on March 31, 2012 and issuance of additional capital stock amounting to ₱125.0 million was made on May 17, 2012.



20. Maturity Profile of Assets and Liabilities

The following tables present the assets and liabilities as of December 31, 2012 and 2011 analyzed according to whether they are expected to be recovered or settled within twelve months or over twelve months from the statement of financial position date:

	2012			2011		
	Within twelve months	Over twelve months	Total	Within twelve months	Over twelve months	Total
Financial Assets						
Cash and other cash items	₱633,646,640	₱-	₱633,646,640	₱591,123,145	₱-	₱591,123,145
Due from BSP	2,029,551,219	-	2,029,551,219	1,912,501,244	-	1,912,501,244
Due from other banks	1,097,031,428	-	1,097,031,428	447,348,222	-	447,348,222
Interbank loans receivable and SPURA with BSP	295,177,246	-	295,177,246	1,933,909,546	-	1,933,909,546
Financial assets at FVPL (Note 7)	393,154,823	-	393,154,823	2,599,443,790	-	2,599,443,790
AFS investments (Note 8)	8,308,426	5,620,230,238	5,628,538,664	-	3,340,129,529	3,340,129,529
HTM investments (Note 9)	-	112,624,394	112,624,394	-	120,828,253	120,828,253
Loans and receivable - gross (Note 10)	10,124,976,773	6,163,944,872	16,288,921,645	3,582,538,386	11,334,487,410	14,917,025,796
Other assets (Note 14)	23,399,901	-	23,399,901	16,687,945	-	16,687,945
	14,605,246,456	11,896,799,504	26,502,045,960	11,083,552,278	14,795,445,192	25,878,997,470
Nonfinancial assets						
Property and equipment - cost (Note 11)	-	1,069,188,246	1,069,188,246	-	980,115,360	980,115,360
Investment properties - cost (Note 12)	-	143,947,870	143,947,870	-	168,220,119	168,220,119
Branch licenses (Note 13)	-	225,390,000	225,390,000	-	225,390,000	225,390,000
Other assets (Note 14)	72,211,645	27,408,807	99,620,452	67,389,490	63,310,168	130,699,658
	72,211,645	1,465,934,923	1,538,146,568	67,389,490	1,437,035,647	1,504,425,137
	₱14,677,458,101	₱13,362,734,427	₱28,040,192,528	₱11,150,941,768	₱16,232,480,839	₱27,383,422,607
Less allowance for credit and impairment losses (Note 10)	-	-	200,201,492	-	-	231,698,150
Accumulated depreciation and amortization (Notes 11, 12, 14)	-	-	482,535,600	-	-	372,695,891
Unearned discounts and capitalized interest (Note 10)	-	-	3,091,923	-	-	3,642,447
			685,829,015			608,036,488
			₱27,354,363,513			₱26,775,386,119
Financial liabilities						
Deposit liabilities:						
Demand	₱2,686,527,916	₱1,787,964,588	₱4,474,492,504	₱1,989,079,885	₱1,989,079,885	₱3,978,159,770
Savings	864,972,416	611,928,337	1,476,900,753	588,090,510	588,090,510	1,176,181,020
Time	14,069,937,723	3,348,870,738	17,418,808,461	8,244,948,007	10,490,858,008	18,735,806,015
	17,621,438,055	5,748,763,663	23,370,201,718	10,822,118,402	13,068,028,403	23,890,146,805
Manager's checks	60,842,543	-	60,842,543	78,024,579	-	78,024,579
Bills payable	297,251,097	-	297,251,097	121,492,338	-	121,492,338
Accrued interest, taxes and other expenses (Note 17)	143,119,878	-	143,119,878	141,268,437	-	141,268,437
Unsecured Subordinated Debt	-	500,000,000	500,000,000	-	-	-
Derivative liabilities (Note 5)	334,897	-	334,897	-	-	-
Other liabilities (Note 19)	924,989,981	-	924,989,981	722,586,253	-	722,586,253
	19,047,976,451	6,248,763,663	25,296,740,114	11,885,490,009	13,068,028,403	24,953,518,412
Nonfinancial liabilities						
Deferred tax liability - net	-	18,924,080	18,924,080	-	21,713,528	21,713,528
Accrued taxes and other expenses (Note 17)	9,498,555	41,726,410	51,224,965	21,632,043	26,868,778	48,500,821
Income tax payable	2,638,390	-	2,638,390	-	-	-
Other liabilities (Note 19)	27,904,319	-	27,904,319	55,810,871	125,000,000	180,810,871
	40,041,264	60,650,490	100,691,754	77,442,914	173,582,306	251,025,220
	₱19,088,017,715	₱6,309,414,153	₱25,397,431,868	₱11,962,932,923	₱13,241,610,709	₱25,204,543,632



21. Leases

The Bank leases the premises occupied by its branches for periods ranging from 5 to 12 years from the contract dates and are renewable under certain terms and conditions. The rent expense (included under 'Occupancy and equipment-related expenses' in the statements of income) amounted to ₱74.7 million in 2012 and ₱64.3 million in 2011.

The contracts require the Bank to pay the lessors security deposits, which are noninterest-bearing and are refundable upon termination of the lease agreements (see Note 14).

The following table presents the minimum lease payable of the Bank for non-cancellable leases:

	2012	2011
Within 1 year	₱14,382,952	₱15,115,415
More than 1 year but not more than 5 years	46,047,620	53,857,971
More than 5 years	1,542,036	8,114,637
	₱61,972,608	₱77,088,023

22. Retirement Plan

The Bank has an unfunded noncontributory defined benefit retirement plan covering all of its officers and regular employees. Under this retirement plan, all covered officers and employees are entitled to cash benefits after satisfying certain age and service requirements. The latest actuarial valuation study of the retirement plan is as of December 31, 2012.

The principal actuarial assumptions used in determining the retirement liability for the Bank's retirement plan as of December 31, 2012 and 2011 are shown below:

	2012	2011
Discount rate	6.11%	6.54%
Future salary increases	5.00%	5.00%
Average expected future years of service	26.3	26.5

The amounts recognized in the statements of financial position follow:

	2012	2011
Present value of retirement obligation	₱48,569,826	₱37,846,664
Unrecognized actuarial loss	(6,843,416)	(10,977,886)
Accrued retirement liability	₱41,726,410	₱26,868,778

The movements in the present value of retirement obligation are as follows:

	2012	2011
Balance at beginning of year	₱37,846,664	₱19,630,301
Current service cost	12,116,044	11,649,825
Interest cost	2,475,172	1,794,210
Actuarial loss (gain)	(3,868,054)	4,772,328
Balance at end of year	₱48,569,826	₱37,846,664



Actuarial loss (gain) consists of the following:

	2012	2011
Change in assumptions	(P6,372,835)	P4,473,926
Experience adjustment arising on plan liabilities	2,504,781	298,402
	(P3,868,054)	P4,772,328

The amounts included in 'Compensation and fringe benefits' in the statements of income follow:

	2012	2011
Current service cost	P12,116,044	P11,649,825
Interest cost	2,475,172	1,794,210
Actuarial loss recognized during the year	266,416	163,174
Retirement expense	P14,857,632	P13,607,209

The movements in the accrued retirement liability recognized in the statements of financial position follow:

	2012	2011
Balance at beginning of year	P26,868,778	P13,261,569
Retirement expense	14,857,632	13,607,209
Balance at end of year	P41,726,410	P26,868,778

Amounts for the current and previous periods follow:

	2012	2011	2010	2009	2008
Present value of retirement obligation	P48,569,826	P37,846,664	P19,630,301	P11,653,500	P1,943,500
Experience adjustments on plan liabilities	2,504,781	298,402	(3,033,767)	4,087,400	(1,981,700)

23. Other Expenses

Other expenses consist of:

	2012	2011
Fees and commission	P 37,729,496	P28,041,226
Postage	32,668,754	33,941,524
Promotions and advertising	28,440,483	13,278,110
Litigation	23,558,709	17,189,568
Repairs and maintenance	20,179,452	16,953,525
Transportation and travel	11,134,832	10,926,280
Supervision fees	7,282,037	5,581,943
Appraisal fees	6,499,708	7,604,407
Management and other professional fees	6,365,761	3,385,114
Stationery and supplies used	6,014,933	8,374,456
Membership fees and dues	1,074,131	1,099,767
Fines and penalties	653,135	429,813
Others	2,505,037	4,132,813
	P184,106,468	P150,938,546

'Others' includes check processing and courier fees, brokerage fees and notarial fees.



24. Income and Other Taxes

Provision for income tax consists of:

	2012	2011
Current:		
Final tax	₱69,915,829	₱62,293,471
MCIT	11,331,532	11,299,769
	81,247,361	73,593,240
Deferred	(2,789,448)	(2,004,946)
	₱78,457,913	₱71,588,294

Under Philippine tax laws, the Bank is subject to percentage and other taxes (presented as ‘Taxes and licenses’ in the statements of income) as well as income taxes. Percentage and other taxes paid consist principally of gross receipts tax (GRT), documentary stamp taxes and value added tax.

Provision for income tax include corporate income tax, as discussed below, and 20.0% final tax paid on gross interest income from government securities and other deposit substitutes.

Republic Act (RA) No. 9337, An Act Amending National Internal Revenue Code, provides that the RCIT rate shall be 30.0% and interest expense allowed as deductible expense shall be reduced by 33.0% of interest income subjected to final tax.

An MCIT of 2.0% on modified gross income is computed and compared with the RCIT. Any excess of the MCIT over the RCIT is deferred and can be used as a tax credit against future income tax liability for the next three years. In addition, the NOLCO is allowed as a deduction from the taxable income in the next three years from the year of inception. Current tax regulations also set a limit on the amount of entertainment, amusement and recreation (EAR) expenses that can be deducted for income tax purposes. EAR expenses are limited to 1.0% of net revenue for sellers of services.

RA No. 9294, which became effective in May 2004, provides that the income derived by the FCDU from foreign currency transactions with non-residents, off-shore banking units (OBUs), and local commercial banks, including branches of foreign banks, is tax-exempt while interest income on foreign currency-denominated loans from residents other than OBUs or other depository banks under the expanded system is subject to 10.0% income tax.

Details of the Bank’s MCIT and NOLCO follow:

MCIT

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
2009	₱4,723,990	₱4,723,990	₱–	2012
2010	10,100,787	–	10,100,787	2013
2011	11,299,769	–	11,299,769	2014
2012	11,331,532	–	11,331,532	2015
	₱37,456,078	₱4,723,990	₱32,732,088	



NOLCO

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
2009	₱62,683,791	₱62,683,791	₱—	2012
2011	21,181,377	—	21,181,377	2014
2012	216,275,087	—	216,275,087	2015
	₱300,140,255	₱62,683,791	₱237,456,464	

The Bank's 'Deferred tax liabilities - net' in the statements of financial position consists of:

	2012	2011
Deferred tax assets on:		
Allowance for credit and impairment losses	₱21,454,246	₱21,454,246
	21,454,246	21,454,246
Deferred tax liability on:		
Branch licenses acquired in business combination (Note 13)	(38,400,000)	(38,400,000)
Unrealized gain on foreclosure of acquired assets	(1,978,326)	(4,767,774)
	(40,378,326)	(43,167,774)
	(₱18,924,080)	(₱21,713,528)

As of December 31, 2012 and 2011, the Bank has not recognized deferred tax assets in respect of the following deductible temporary differences:

	2012	2011
NOLCO	₱237,456,464	₱83,865,168
Allowance for credit and impairment losses	128,687,339	160,183,997
Retirement liability	41,726,410	26,868,778
Carry forward benefits of MCIT	32,732,088	26,124,546
Accrued rent	32,073,002	29,804,101
Depreciation of investment properties and chattel mortgage properties	20,460,223	26,769,615
	₱493,135,526	₱353,616,205

The reconciliation between the statutory income tax rate and effective income tax rate follow:

	2012	2011
Statutory income tax rate	30.0%	30.0%
Tax effect of:		
Changes in unrecognized deferred tax assets	54.5	14.6
Nondeductible expense	35.5	21.8
Interest income from tax-paid and exempt	(26.2)	(4.4)
FCDU income	(19.2)	(10.7)
Non-taxable income	(12.5)	(14.2)
Others	0.7	(0.9)
Effective income tax rate	62.8%	36.2%



25. Capital Stock

	2012	2011	2012	2011
	Shares		Amount	
Common stock - ₱10 par value				
Authorized	300,000,000	150,000,000	₱3,000,000,000	₱1,500,000,000
Perpetual preferred stock - ₱10 par value				
Authorized	100,000,000	–	₱1,000,000,000	–
Issued and outstanding – Common stock				
Balance at beginning of year	150,000,000	125,000,000	1,500,000,000	1,250,000,000
Issuance – Common Stock	12,500,000	25,000,000	125,000,000	250,000,000
Balance at end of year	162,500,000	150,000,000	₱1,625,000,000	₱1,500,000,000
Issued and outstanding - Perpetual preferred stock	6,250,000	–	₱62,500,000	₱–

Common Stock

On September 15, 2009, the Bank's BOD and stockholders approved the application for the increase in authorized capital stock to ₱1.5 billion. The stockholders paid ₱250.0 million as deposits for future stock subscription in 2009.

The SEC approved the increase in authorized capital stock on July 27, 2010. The Bank issued common stock amounting to ₱250.0 million to the stockholders on July 30, 2010.

To meet regulatory capital requirements, the stockholders infused additional capital of ₱250.0 million in 2010. As of December 31, 2010, the subscription agreement was still being finalized, and so the additional capital was recorded under the 'Deposits for future stock subscription' account in the statement of financial position. The Bank issued the corresponding capital shares to these stockholders on March 31, 2011.

On July 19, 2011, the BOD approved the increase in authorized capital stock from ₱1.5 billion to ₱3.0 billion. The application for the increase in authorized capital stock was approved by the SEC on March 31, 2012. The Bank issued additional 125 million shares for ₱125.0 million on May 17, 2012.

Perpetual Preferred Stock

On December 13, 2011, the Bank's BOD and stockholders approved the Bank's application for issuance of perpetual and cumulative preferred stock amounting to ₱1.0 billion.

On March 30, 2012, the Bank received cash amounting to ₱62.5 million as subscription for its perpetual and cumulative preferred stock. The Bank's application for the issuance of the preferred stock was approved by the BSP on November 6, 2012.

On December 27, 2012, the SEC approved the increase of the Bank's authorized preferred stock amounting to ₱1.0 billion. On the same date, the Bank issued ₱62.5 million of its authorized perpetual preferred stock at par value.



26. Related Party Transactions

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subjected to common control or common significant influence. Related parties may be individuals or corporate entities. Transactions between related parties are based on terms similar to those offered to non-related parties.

In the ordinary course of business, the Bank can enter into loan and other transactions with its affiliates and with certain directors, officers, stockholders, and related interests (DOSRI). Under the Bank's policy, these loans and other transactions are made substantially on the same terms as with other individuals and businesses of comparable risks. The amount of individual loans to DOSRI, of which 70.0% must be secured, should not exceed the amount of their respective deposits and book value of their respective investments in the Bank. These limits do not apply to loans secured by assets considered as non-risk as defined in the regulations.

On January 31, 2007, BSP Circular No. 560 was issued providing the rules and regulations that shall govern loans, other credit accommodations and guarantees granted to subsidiaries and affiliates of banks and quasi-banks. Under the said circular, the total outstanding loans, credit accommodations and guarantees to each of the bank's subsidiaries and affiliates shall not exceed 10.0% of bank's net worth, the unsecured portion shall not exceed 5.0% of such net worth. Further, the total outstanding exposures shall not exceed 20.0% of the net worth of the lending bank. The said Circular became effective on February 15, 2007.

On March 15, 2004, the BSP issued Circular No. 423 which provides for the amended definition of DOSRI accounts. The following table shows information relating to DOSRI accounts of the Bank:

	2012	2011
Total outstanding DOSRI loans	₱17,861,417	₱4,746,190
Percent of DOSRI accounts granted under BSP Circular No. 423	0.12%	0.03%
Percent of DOSRI accounts to total loans	0.12%	0.03%
Percent of unsecured DOSRI accounts to total DOSRI loans	-	-
Percent of past due DOSRI accounts to total DOSRI loans	-	-
Percent of nonperforming DOSRI accounts to total DOSRI loans	-	-

Any violation of the provisions under Circular No. 423 is subject to regulatory sanctions. However, loans, other credit accommodations and guarantees, as well as availments of previously approved loans and committed credit lines that are not considered DOSRI (non-DOSRI) accounts prior to the issuance of Circular No. 423 are not covered by such sanctions for a transition period of two years from the effectivity of the Circular or until said loan, other credit accommodations and guarantees become past due, or are extended, renewed or restructured, whichever comes later.

Total interest income on DOSRI accounts amounted to ₱15.2 in 2012 and ₱14.8 million in 2011.



The effects of the foregoing transactions are shown under the appropriate accounts in the Bank's financial statements.

The significant transactions and account balances with respect to related parties that are included in the financial statements follow:

Transactions with Key Management Personnel:

December 31, 2012			
<u>Category</u>	<u>Amount/ Volume</u>	<u>Outstanding Balances</u>	<u>Terms and Conditions/Nature</u>
Loans and receivables		₱64,665,471	Secured by chattel, deposits and real estate properties. The loans have terms ranging from 1 to 3 years and bear interest rates ranging from 7.0% to 8.7%. No impairment.
Grants	₱64,794,400		
Settlements	49,828,929		
Accrued interest receivable	2,757,379	675,913	Interest income and accrued interest receivable.
Deposit liabilities		4,187,401	With interest rates ranging from 0.5% to 5.25%.
Deposits	1,693,784		
Withdrawals	45,390,546		
Accrued interest payable	559,518	999,140	Interest expense and accrued interest payable.
December 31, 2011			
<u>Category</u>	<u>Amount/ Volume</u>	<u>Outstanding Balances</u>	<u>Terms and Conditions/ Nature</u>
Loans and receivables		₱49,700,000	Secured by chattel, deposits and real estate properties. The loans have terms ranging from 1 to 3 year and bear interest rates ranging from 5.5% to 7.0%. No impairment.
Grants	₱49,700,000		
Settlements	6,700,000		
Accrued interest receivable	2,291,770	508,200	Interest income and accrued interest receivable.
Deposit liabilities		47,884,163	Interest rates ranging from 0.5% to 5.25%
Deposits	207,820,837		
Withdrawals	166,795,438		
Accrued interest payable	370,488	661,697	Interest expense and accrued interest payable.

Transactions with Officers and Employees:

December 31, 2012			
<u>Category</u>	<u>Amount/ Volume</u>	<u>Outstanding Balances</u>	<u>Terms and Conditions/ Nature</u>
Loans and receivables		₱71,972,814	Secured (chattel and real estate properties) and unsecured loans granted to officers and employees. The loans have terms ranging from 6 months to 20 years and bear interest rates ranging from 3.6% to 10.0%. No impairment
Grants	₱100,251,648		
Settlements	94,747,488		
Interest Income	4,498,871	-	Interest income earned



December 31, 2011

Category	Amount/ Volume	Outstanding Balances	Terms and Conditions/ Nature
Loans and receivables		₱66,468,654	Secured (chattel and real estate properties) and unsecured loans granted to officers and employees. The loans have terms ranging from 6 months to 20 years and bear interest rates ranging from 3.6% to 10.0%. No impairment
Grants	₱162,023,127		
Settlements	132,857,735		
Interest income	3,343,498	–	Interest income earned

Transactions with Affiliates:

December 31, 2012

Category	Amount/ Volume	Outstanding Balances	Terms and Conditions/ Nature
Loans and receivables		₱793,591,345	Secured (chattel and deposits) and unsecured loan with terms ranging from 1 to 5 years and bear interest rates ranging from 5.5% to 8.0%. No impairment.
Grants	₱15,662,719		
Settlements	1,945,691		
Accrued interest receivable	12,352,216	482,143	Interest income and accrued interest receivable
Deposit liabilities		1,293,609,371	Interest rates ranging from 0.5% to 5.25%
Deposits	52,066,621,793		
Withdrawals	51,880,462,012		
Accrued interest payable	10,650,066	3,426,842	Interest expense and accrued interest payable
Trust Fee	117,936	40,793	Fees charged for trust operations
Rent Expense	2,366,212	119,398	Lease of ATM and Branch premises for 5 years

December 31, 2011

Category	Amount/ Volume	Outstanding Balances	Terms and Conditions/ Nature
Loans and receivables		₱779,874,317	Secured (chattel and deposits) and unsecured loan with terms ranging from 1 to 5 years and bear interest rates ranging from 5.5% to 8.0%. No impairment.
Grants	₱–		
Settlements	5,296,395		
Accrued interest receivable	12,359,250	2,060,013	Interest income and accrued interest receivable
Deposit liabilities		1,107,449,590	Interest rates ranging from 0.5% to 5.25%
Deposits	26,793,223,493		
Withdrawals	26,865,194,838		
Accrued interest payable	8,786,240	2,167,504	Interest expense and accrued interest payable
Trust Fee	112,883	31,832	Fees charged for trust operations
Rent Expense	2,146,413	285,536	Lease of ATM and Branch premises for 5 years



Transactions with Parent:

December 31, 2012			
Category	Amount/ Volume	Outstanding Balances	Terms and Conditions/ Nature
Accounts receivable		₱5,606,432	Advances made by the Bank for documentary stamps, taxes and licenses expenditures which are to be reimbursed by the stockholders.
Deposit liabilities		673,030,677	Interest rates ranging from 0.5% to 5.25%
Deposits	₱1,043,512,431		
Withdrawals	746,004,823		
Accrued interest payable	5,814,012	80,238	Interest expense and accrued interest payable
December 31, 2011			
Category	Amount/ Volume	Outstanding Balances	Terms and Conditions/ Nature
Deposit liabilities		₱375,523,069	Interest rates ranging from 0.5% to 5.25%
Deposits	₱1,296,727,673		
Withdrawals	1,202,719,893		
Accrued interest payable	2,576,386	32,172	Interest expense and accrued interest payable

Transactions with Stockholders:

December 31, 2011			
Category	Amount/ Volume	Outstanding Balances	Terms and Conditions/ Nature
Loans and receivables		₱270,072	Secured by chattel with a term of 3 years and bears interest rate of 5.72%. No impairment.
Grants	₱-		
Settlements	601,801		
Accrued interest receivable	58,360	1,931	Interest income and accrued interest receivable
Accounts receivable		3,819,588	Advances made by the Bank for documentary stamps, taxes and licenses expenditures which are to be reimbursed by the stockholders.
Deposit liabilities		-	Interest rates ranging from 0.5% to 5.25%
Deposits	103,511,667		
Withdrawals	103,511,667		
Accrued interest payable	125,615	-	Interest income and accrued interest receivable
December 31, 2011			
Category	Amount/ Volume	Outstanding Balances	Terms and Conditions/ Nature
Loans and receivables		₱871,874	Secured by chattel with a term of 3 years and bears interest rate of 5.72%. No impairment.
Grants	₱-		
Settlements	498,603		
Accrued interest receivable	119,106	13,094	Interest income and accrued interest receivable
Deposit liabilities		-	Interest rates ranging from 0.5% to 5.25%
Deposits	33,025,833		
Withdrawals	33,025,833		
Accrued interest payable	52,253	-	Interest income and accrued interest receivable

As of December 31, 2012 and 2011, no provision for credit losses was recognized relating to the advances to related parties.



Compensation of key management personnel included under ‘Compensation and fringe benefits’ in the statements of income follows:

	2012	2011
Short-term employee benefits	₱105,502,661	₱107,756,588
Post-employment pension benefits	7,694,984	7,691,111
	₱113,197,645	₱115,447,699

27. Trust Operations

On May 21, 2008, the Bank was granted a license by the BSP to conduct its trust operations. The Bank started its trust operations on June 2, 2008.

Securities and other resources held by the Bank in fiduciary or agency capacity for its customers are not included in the accompanying statements of financial position since these are not assets of the Bank. Total assets held by the Bank’s Trust Department amounted to ₱1,750.2 million and ₱1,059.9 million as of December 31, 2012 and 2011, respectively.

In compliance with current banking regulations relative to the Bank’s trust function, government securities included under AFS investments with a total face value of ₱20.0 million and ₱10.0 million, as of December 31, 2012 and 2011 respectively, are deposited with the BSP.

In addition, 10.0% of the Bank’s net profit realized from its trust operations is appropriated to surplus reserve until such reserve for trust functions amounts to 20.0% of the Bank’s regulatory capital.

28. Commitments and Contingent Liabilities

In the normal course of the Bank’s operations, there are various outstanding commitments and contingent liabilities such as guarantees and commitments to extend credit, which are not reflected in the accompanying financial statements. The Bank does not anticipate significant losses as a result of these transactions.

As of December 31, 2012 and 2011, the Bank has several suits and claims that remain pending before various courts. Management believes, based on the opinion of its legal counsels, that the ultimate outcome of such cases and claims will not have a material effect on the Bank’s financial position and financial performance.

The following is a summary of the Bank’s commitments and contingent liabilities at their equivalent peso contractual amounts:

	2012	2011
Investment management account (Note 27)	₱1,031,249,993	₱834,823,658
Spot exchange	1,026,250,000	399,642,792
Trust department accounts (Note 27)	718,975,192	225,100,751
Outstanding guarantees issued - others	38,542,287	12,952,000
Sight/Usage LC -Foreign	11,032,803	-
Domestic letters of credit	6,000,000	9,895,980

(Forward)



	2012	2011
Sight LC -Domestic	₱2,456,767	₱-
Late payment deposit/payment received	595,394	51,685
Items held for safekeeping	125,804	127,213
Items held as collateral	3,213	3,158
Outward bills for collection	1	5,572

29. Financial Performance

The following basic ratios measure the financial performance of the Bank:

	2012	2011
Return on average equity	2.64%	8.45%
Return on average assets	0.17	0.50
Net interest margin on average earning assets	3.42	3.77

30. Approval of Release of the Financial Statements

The accompanying financial statements were authorized for issue by the BOD on March 26, 2013.

31. Supplementary Information Required Under Revenue Regulations 19-2011

On December 9, 2011, the Bureau of Internal Revenue (BIR) issued Revenue Regulations (RR) 19-2011 which prescribes the new annual income tax forms that will be used for filing effective taxable year 2011. Specifically, companies are required to disclose certain tax information in their respective notes to financial statements. For the taxable year ended December 31, 2012, the Bank reported the following revenues and expenses for income tax purposes:

Schedule of sales/revenues/receipts fees for the year-end December 31, 2012:

	RBU	FCDU
Sale of services	₱1,233,540,957	₱46,088,526
Non-operating and taxable other income		
Fees and commissions	151,004,189	4,748,815
Trading gains	131,057,846	1,254,707
Foreign exchange gains	36,565,147	691,473
Others	(15,902,758)	-
	₱1,536,265,381	₱52,783,521

Schedule of cost of services for the year ended December 31, 2011:

	RBU	FCDU
Direct charges - Salaries, wages and benefits	₱240,564,571	₱-
Direct charges - Outside services	45,784,650	-
Direct charges - Others	683,339,575	27,086,489
	₱969,688,796	₱27,086,489



Computation of itemized deductions for the year ended December 31, 2012:

	RBU	FCDU
Taxes and licenses	₱168,802,586	₱11,072,966
Write off	107,489,288	–
Depreciation	106,442,476	13,561,252
Salaries and allowances	86,020,528	35,767,161
Rental	60,059,436	7,932,870
Communication, light and water	48,840,305	6,221,977
Security services	26,519,243	3,378,671
Commission	29,312,487	892,212
Janitorial and messengerial services	19,462,721	2,479,639
Repairs and maintenance	16,824,535	2,143,522
Representation and entertainment	14,935,023	1,361,087
Fringe benefits	15,149,391	5,891,548
Advertising	23,712,520	3,021,033
Office supplies	5,014,926	638,924
Fuel and oil	5,278,742	672,536
Transportation and travel	4,004,878	510,239
Insurance	3,257,863	5,315,071
Management and consultancy fee	5,307,427	676,190
SSS, GSIS, Philhealth, HDMF and Other Contributions	3,807,616	2,364,914
Miscellaneous	9,050,972	1,748,869
Others	23,558,709	–
Total	₱782,851,672	₱105,650,681

32. Supplementary Information Required Under Revenue Regulations 15-2010

On November 25, 2010, the BIR issued RR 15-2010 to amend certain provisions of RR 21-2002. The Regulations provide that starting 2010, the notes to financial statements shall include information on taxes and licenses paid or accrued during the taxable year.

The Bank reported and/or paid the following types of taxes in 2012:

Gross Receipt Tax (GRT)

The Bank is subject to GRT on its gross income from Philippine sources. GRT is imposed on interest, fees and commissions from lending activities at 5.0% or 1.0%, depending on the loan term, and at 7.0% on non-lending fees and commissions, trading and foreign exchange gains and other items constituting gross income.

In FCDU, income classified under Others is subject to corporate income tax.

The details of the Bank's GRT expense and corresponding GRT tax base in 2012 are as follows:

	GRT	GRT tax base
Interest income	₱74,460,019	₱1,601,520,473
Other income	38,546,238	576,439,654
	₱113,006,257	₱2,177,960,127



Taxes and Licenses

This includes all other taxes, local and national, incurred in 2012 and lodged under the ‘Taxes and licenses’ account in the statement of income, as follows:

	Amount
GRT	₱113,006,257
Documentary stamp taxes	64,153,496
Mayor’s permit and real estate taxes	5,793,055
Fringe benefit taxes	2,962,025
Land Transportation Office registration	2,527,764
Other taxes	34,000
	<u>₱188,476,597</u>

Documentary stamp taxes paid relating to time deposits and additional capitalization amounted to ₱64 million and ₱71 thousand, respectively.

Withholding Taxes

Details of total remittances in 2012 and balances as of December 31, 2012 follow:

	Total Remittance	Balance
Final withholding taxes	₱125,898,272	₱8,856,994
Withholding taxes on compensation and benefits	68,960,474	1,615,042
Expanded withholding taxes	17,881,223	3,501,244
	<u>₱212,739,969</u>	<u>₱13,973,280</u>

Tax Assessments and Cases

As of December 31, 2012 the Bank has no deficiency tax assessments and has no tax cases, litigation and/or prosecution in courts or bodies outside the BIR.

