



**Financial Statements**

December 31, 2010 and 2009

and

Independent Auditors' Report

SyCip Gorres Velayo & Co.

*Banking to a different beat.*

## 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, 2010 and 2009, 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, 2010 and 2009, 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 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 on taxes and licenses in Note 29 to the financial statements 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 of 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*

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June 1, 2009, Valid until May 31, 2012  
PTR No. 2641501, January 3, 2011, Makati City

April 1, 2011

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

### STATEMENTS OF FINANCIAL POSITION

	December 31	
	2010	2009 (as restated - Note9)
<b>ASSETS</b>		
Cash and Other Cash Items (Note 14)	₱625,873,173	₱249,011,034
Due from Bangko Sentral ng Pilipinas (Note 14)	636,104,375	644,268,650
Due from Other Banks	569,552,885	1,118,677,683
Interbank Loans Receivable and Securities Purchased Under Resale Agreements with the Bangko Sentral ng Pilipinas (Note 6)	1,620,000,000	910,000,000
Financial Assets at Fair Value through Profit or Loss (Note 7)	1,710,685,858	–
Available-for-Sale Investments (Note 7)	3,674,560,883	3,501,751,489
Held-to-Maturity Investments (Note 7)	130,889,290	138,208,840
Loans and Receivables (Note 8)	13,616,784,842	10,207,347,280
Property and Equipment (Note 10)	566,287,516	317,297,076
Investment Properties (Note 11)	128,139,399	122,449,200
Branch Licenses (Notes 9 and 12)	225,390,000	225,390,000
Other Assets (Note 13)	132,638,480	128,523,167
	<b>₱23,636,906,701</b>	<b>₱17,562,924,419</b>
<b>LIABILITIES AND EQUITY</b>		
<b>LIABILITIES</b>		
Deposit Liabilities (Note 14)		
Demand	₱3,137,521,048	₱2,434,707,062
Savings	863,256,296	888,697,858
Time	16,782,463,358	12,484,607,622
	<b>20,783,240,702</b>	<b>15,808,012,542</b>
Manager's Checks	63,324,279	79,132,385
Bills Payable (Note 15)	87,064,013	88,525,900
Accrued Interest, Taxes, and Other Expenses (Note 16)	131,281,954	103,816,362
Deferred Tax Liabilities - net (Note 22)	23,718,474	25,732,254
Other Liabilities (Note 17)	1,130,188,987	377,586,025
	<b>22,218,818,409</b>	<b>16,482,805,468</b>
<b>EQUITY</b>		
Common Stock (Note 23)	1,250,000,000	1,000,000,000
Deposits for Future Stock Subscription (Note 23)	250,000,000	250,000,000
Deficit	(38,487,436)	(156,410,240)
Net Unrealized Loss on Available-for-Sale Investments (Note 7)	(41,981,647)	(10,963,566)
Cumulative Translation Adjustment (Note 2)	(1,442,625)	(2,507,243)
	<b>1,418,088,292</b>	<b>1,080,118,951</b>
	<b>₱23,636,906,701</b>	<b>₱17,562,924,419</b>

See accompanying Notes to Financial Statements.

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

**STATEMENTS OF INCOME**

	Years Ended December 31	
	2010	2009 (as restated - Note9)
<b>INTEREST INCOME ON</b>		
Loans and receivables (Note 8)	<b>₱1,086,612,295</b>	₱802,079,916
Investment securities (Note 7)	<b>280,360,838</b>	162,324,434
Interbank loans receivable and securities purchased under resale agreements with the Bangko Sentral ng Pilipinas (Note 6)	<b>33,734,118</b>	66,579,053
Deposits in banks and others (Note 13)	<b>19,972,287</b>	19,803,551
	<b>1,420,679,538</b>	1,050,786,954
<b>INTEREST EXPENSE ON DEPOSIT LIABILITIES, BILLS PAYABLE and OTHERS (Notes 14, 15 and 17)</b>	<b>610,362,763</b>	550,493,920
<b>NET INTEREST INCOME</b>	<b>810,316,775</b>	500,293,034
Trading gain - net (Note 7)	<b>237,056,537</b>	257,811,535
Service charges, fees and commissions	<b>114,502,897</b>	65,928,245
Foreign exchange gain - net	<b>12,711,904</b>	386,711
Profit (loss) on assets sold or acquired (Notes 11 and 13)	<b>(8,313,085)</b>	27,645,308
Gain on a bargain purchase (Note 9)	<b>-</b>	10,593,034
Miscellaneous	<b>90,471</b>	4,223,959
<b>TOTAL OPERATING INCOME</b>	<b>1,166,365,499</b>	866,881,826
Compensation and fringe benefits (Notes 20 and 24)	<b>291,751,921</b>	225,225,913
Taxes and licenses	<b>138,391,598</b>	94,587,025
Depreciation and amortization (Notes 10, 11 and 13)	<b>125,902,984</b>	93,961,011
Provision for credit and impairment losses (Notes 8, 11 and 13)	<b>93,728,470</b>	39,641,063
Occupancy and equipment-related expenses (Note 19)	<b>87,976,993</b>	78,337,882
Entertainment, amusement and representation (Note 22)	<b>54,311,998</b>	40,435,835
Security, messengerial and janitorial	<b>47,805,575</b>	31,613,468
Insurance expense	<b>39,051,412</b>	30,673,419
Miscellaneous (Note 21)	<b>118,605,526</b>	88,703,667
<b>TOTAL OPERATING EXPENSES</b>	<b>997,526,477</b>	723,179,283
<b>INCOME BEFORE INCOME TAX</b>	<b>168,839,022</b>	143,702,543
<b>PROVISION FOR INCOME TAX (Note 22)</b>	<b>50,916,218</b>	55,089,206
<b>NET INCOME</b>	<b>₱117,922,804</b>	₱88,613,337

See accompanying Notes to Financial Statements.

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

**STATEMENTS OF COMPREHENSIVE INCOME**

	Years Ended December 31	
	2010	2009 (as restated - Note 9)
<b>NET INCOME</b>	<b>₱117,922,804</b>	₱88,613,337
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>		
Changes in fair value of available-for-sale investments (Note 7)	<b>(31,018,081)</b>	24,035,464
Income tax effect	<b>-</b>	1,221,261
Changes in fair value of available-for-sale investments, net of tax	<b>(31,018,081)</b>	25,256,725
Cumulative translation adjustment	<b>1,064,618</b>	(5,740,602)
<b>OTHER COMPREHENSIVE INCOME (LOSS) FOR THE YEAR, NET OF TAX</b>	<b>(29,953,463)</b>	19,516,123
<b>TOTAL COMPREHENSIVE INCOME</b>	<b>₱87,969,341</b>	₱108,129,460

See accompanying Notes to Financial Statements.

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

STATEMENTS OF CHANGES IN EQUITY

	Year Ended December 31, 2010 and 2009					Total Equity
	Common Stock (Note 23)	Deposits for Future Stock Subscription (Note 23)	Deficit	Net Unrealized Loss on Available-for-Sale Investments (Note 7)	Cumulative Translation Adjustment (Note 2)	
Balance at January 1, 2010, as previously reported	₱1,000,000,000	₱250,000,000	(₱167,003,274)	(₱10,963,566)	(₱2,507,243)	₱1,069,525,917
Prior-period adjustment - finalization of purchase price allocation (Note 9)	-	-	10,593,034	-	-	10,593,034
Balance at January 1, 2010, as restated	1,000,000,000	250,000,000	(156,410,240)	(10,963,566)	(2,507,243)	1,080,118,951
Total comprehensive income (loss)	-	-	117,922,804	(31,018,081)	1,064,618	87,969,341
Issuance of capital stock	250,000,000	(250,000,000)	-	-	-	-
Deposits for future stock subscription	-	250,000,000	-	-	-	250,000,000
<b>Balance at December 31, 2010</b>	<b>₱1,250,000,000</b>	<b>₱250,000,000</b>	<b>(₱38,487,436)</b>	<b>(₱41,981,647)</b>	<b>(₱1,442,625)</b>	<b>₱1,418,088,292</b>
Balance at January 1, 2009	₱1,000,000,000	-	(₱245,023,577)	(₱36,220,291)	₱3,233,359	₱721,989,491
Total comprehensive income (loss), as previously reported	-	-	78,020,303	25,256,725	(5,740,602)	97,536,426
Deposits for future stock subscription	-	250,000,000	-	-	-	250,000,000
Balance at December 31, 2009, as previously reported	1,000,000,000	250,000,000	(167,003,274)	(10,963,566)	(2,507,243)	1,069,525,917
Prior-period adjustment - finalization of purchase price allocation (Note 9)	-	-	10,593,034	-	-	10,593,034
<b>Balance at December 31, 2009, as restated</b>	<b>₱1,000,000,000</b>	<b>₱250,000,000</b>	<b>(₱156,410,240)</b>	<b>(₱10,963,566)</b>	<b>(₱2,507,243)</b>	<b>₱1,080,118,951</b>

See accompanying Notes to Financial Statements.

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

STATEMENTS OF CASH FLOWS

	Years Ended December 31	
	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Income before income tax	₱168,839,022	₱143,702,543
Adjustments for:		
Gain on sale of available-for-sale investments (Note 7)	(151,459,171)	(256,070,435)
Depreciation and amortization (Notes 10, 11 and 13)	125,902,984	93,961,011
Provision for credit and impairment losses (Notes 8, 11 and 13)	93,728,470	39,641,063
Unrealized loss on financial assets at fair value through profit or loss (Note 7)	32,826,909	-
Loss (Profit) from assets sold or acquired (Notes 11 and 13)	8,313,085	(27,645,308)
Amortization of premium on held-to-maturity investments	7,319,550	4,531,184
Gain on a bargain purchase (Note 9)	-	(10,593,034)
Calamity loss (Note 21)	-	6,155,354
Changes in operating assets and liabilities:		
Decrease (increase) in the amounts of:		
Financial assets at fair value through profit or loss	(1,743,512,767)	-
Loans and receivables	(3,635,803,733)	(3,368,714,974)
Other assets	44,902,890	2,460,853
Increase (decrease) in the amounts of:		
Deposit liabilities	4,975,228,160	7,433,337,650
Manager's checks	(15,808,106)	(445,426,996)
Accrued interest, taxes and other expenses	27,465,592	5,283,492
Other liabilities	752,602,962	226,125,834
Net cash generated from operations	690,545,847	3,846,748,237
Income taxes paid	(41,933,206)	(55,549,166)
Net cash provided by operating activities	648,612,641	3,791,199,071
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Acquisitions of:		
Available-for-sale investments	(9,295,325,421)	(7,594,978,876)
Property and equipment (Note 10)	(360,379,162)	(134,488,561)
Branch licenses (Notes 9 and 12)	-	(17,996,263)
Proceeds from:		
Sale of available-for-sale investments	9,242,957,117	5,108,401,928
Disposal of investment properties (Note 11)	45,704,193	-
Disposal of property and equipment (Note 10)	4,685,791	-
Additions to investment properties (Note 11)	(6,284,824)	-
Net cash used in investing activities	(368,642,306)	(2,639,061,772)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from:		
Payments of bills payable	(289,302,982)	(523,139,384)
Availments of bills payable	287,841,095	549,382,084
Deposits for future stock subscription (Note 23)	250,000,000	250,000,000
Net cash provided by financing activities	248,538,113	276,242,700
Effect of exchange rate changes in cash and cash equivalents	1,064,618	(5,740,602)
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>529,573,066</b>	<b>1,422,639,397</b>

(Forward)

	Years Ended December 31	
	2010	2009
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>		
Cash and other cash items	₱249,011,034	₱148,032,270
Due from Bangko Sentral ng Pilipinas	644,268,650	321,880,826
Due from other banks	1,118,677,683	279,077,146
Interbank loans receivable and securities purchased under resale agreements with the Bangko Sentral ng Pilipinas	910,000,000	750,327,728
	<b>2,921,957,367</b>	<b>1,499,317,970</b>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>		
Cash and other cash items	625,873,173	249,011,034
Due from Bangko Sentral ng Pilipinas	636,104,375	644,268,650
Due from other banks	569,552,885	1,118,677,683
Interbank loans receivable and securities purchased under resale agreements with the Bangko Sentral ng Pilipinas	1,620,000,000	910,000,000
	<b>₱3,451,530,433</b>	<b>₱2,921,957,367</b>

**OPERATING CASH FLOWS FROM INTEREST**

	Years Ended December 31	
	2010	2009
Interest received	₱1,387,292,018	₱989,182,298
Interest paid	608,371,233	526,648,071

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 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, 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 stocks (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% shares of stocks of CSB, BSP required the Bank to submit to the BSP 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, and resubmitted the documents on December 9, 2009 to reflect the changes prescribed by the Secretary General 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 the Articles of Merger on June 28, 2010.

On that date, the Bank and CSB merged with the SBA as the surviving entity. As a result of the merger, the Bank no longer prepares separate parent company financial statements in addition to consolidated financial statements. The financial statements of the Bank have been prepared as a continuation of the consolidated group, with the comparative information for the period ended December 31, 2009 reflecting the consolidated financial position, results of operations and cash flows of the Bank and CSB, the sole subsidiary.

**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) and available-for-sale (AFS) investments which have been measured at fair value. The financial statements are presented in Philippine peso.

The 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 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 (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).

#### Basis of Consolidation

As of December 31, 2009, the Bank's financial statements reflect the consolidated accounts of the Bank and its former sole subsidiary (see Note 1). The financial statements of the Bank and CSB had been prepared using uniform accounting policies for like transactions and other events in similar circumstances. Material intercompany balances and transactions have been eliminated in the consolidation. Unrealized gain arising from transactions with a subsidiary is eliminated to the extent of the Bank's interest in the subsidiary, against the investment in the subsidiary account. Unrealized loss is eliminated similarly but only to the extent that there is no evidence of impairment of the asset transferred.

A subsidiary is an enterprise that is controlled by the Bank and whose accounts are included in the Bank's financial statements. Subsidiaries are fully consolidated from the date on which control is transferred to the Bank. Control is achieved when the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Consolidation of a subsidiary ceases when control is transferred out of the Bank.

#### Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year except for the following amendments to existing Philippine Accounting Standards (PAS) and PFRS, and Philippine Interpretations adopted during the year:

##### New Standards and Interpretations

- PFRS 3, *Business Combinations* (Revised)
- PAS 27, *Consolidated and Separate Financial Statements* (Amended)
- Philippine Interpretation International Financial Reporting Interpretation Committee (IFRIC) 17, *Distributions of Non-Cash Assets to Owners*

##### Amendments to Standards

- PAS 39, *Financial Instruments: Recognition and Measurement*, Amendment - *Eligible Hedged Items*
- PFRS 2, *Share-based Payment*, Amendments - *Group Cash-settled Share-based Payment Transactions*

##### Improvements to PFRS 2008

- PFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*

##### Improvements to PFRSs 2009

- PFRS 2, *Share-based Payment*
- PFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*
- PFRS 8, *Operating Segments*
- PAS 1, *Presentation of Financial Statements*
- PAS 7, *Statement of Cash Flows*
- PAS 17, *Leases*
- PAS 36, *Impairment of Assets*
- PAS 38, *Intangible Assets*
- PAS 39, *Financial Instruments: Recognition and Measurement*
- Philippine Interpretation IFRIC 9, *Reassessment of Embedded Derivatives*
- Philippine Interpretation IFRIC 16, *Hedge of a Net Investment in a Foreign Operation*

Standards that have been adopted and that are deemed to have an impact on the financial statements or performance of the Group are described below:

##### PFRS 3, *Business Combinations* (Revised) and PAS 27, *Consolidated and Separate Financial Statements* (Amended)

PFRS 3 (Revised) introduces significant changes in the accounting for business combinations occurring after this becoming effective. Changes affect the valuation of non-controlling interest, the accounting for transaction costs, the initial recognition and subsequent measurement of a contingent consideration and business combinations achieved in stages. These changes will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs and future reported results.

PAS 27 (Amended) requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as a transaction with owners in their capacity as owners. Therefore, such transactions will no longer give rise to goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes by PFRS 3 (Revised) and PAS 27 (Amended) affect acquisitions or loss of control of subsidiaries and transactions with non-controlling interests after January 1, 2010.

The change in accounting policy was applied prospectively.

#### Foreign Currency Translation

The functional currency of the Bank's RBU and FCDU is the Philippine peso and USD, respectively.

#### Transactions and balances

The books of accounts of the RBU are maintained in Philippine peso, while those of the FCDU are maintained in USD. For financial reporting purposes, foreign currency-denominated monetary assets and liabilities in the RBU are translated 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 PDS weighted average rate (PDSWAR) for the year. Foreign exchange differences arising from foreign currency transactions and restatements of foreign currency-denominated assets and liabilities and nonmonetary assets, 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 was determined.

#### FCDU

Based on management's assessment, the FCDU's functional currency is the USD. The use of USD faithfully represents the economic effects of the underlying transactions, events and conditions that are relevant to FCDU. The Bank recognized the translation adjustment in 'Cumulative translation adjustment' amounting to ₱1.4 million and ₱2.5 million as of December 31, 2010 and 2009, respectively, under the equity section of the statement of financial position.

The assets and liabilities of the FCDU are translated to the Bank's presentation currency (the Philippine Peso) at the PDS closing rate prevailing at the statement of financial position date, and its income and expenses are translated at the PDSWAR for the year. The exchange differences arising on the translation of the FCDU accounts are taken directly to the statement of comprehensive 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.

#### 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 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.

#### Financial instruments - initial recognition and subsequent measurement

##### Date of recognition

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, loans and advances to banks are recognized when cash is received by the Bank or advanced to the borrowers.

##### Initial recognition of financial instruments

All financial instruments 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, held-to-maturity (HTM) investments, AFS 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 to 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.

#### *Held-for-trading (HFT) securities*

Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. HFT securities are recorded in the statement of financial position at fair value. These include government and private debt securities. Changes in fair value relating to the held-for-trading positions are recognized in 'Trading gain - net' in the statement of income. Interest earned is recorded in 'Interest income' in the statement of income.

#### *Derivative instruments*

Embedded derivatives are bifurcated from their host contracts and carried at fair value with fair value changes being reported in the statement of income, when the entire hybrid contracts (composed of both the host contract and the embedded derivative) are not accounted for as financial assets designated at FVPL, when their economic risks and characteristics are not closely related to those of their respective host contracts, and when a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative.

The Bank assesses the existence of an embedded derivative on the date it first becomes a party to the contract, and performs re-assessment only where there is a change to the contract that significantly modifies the contractual cash flows.

#### *Financial assets or financial liabilities designated at FVPL*

Financial assets or financial liabilities may be designated by management on initial recognition 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; or
- The assets and liabilities are part of a group of financial assets, financial liabilities or both which are managed and their performance are evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- The financial instruments contain 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.

#### *AFS investments*

AFS investments are those which are designated as such or do not qualify to be classified as designated as FVPL, HTM investments or loans and receivables. They are purchased and held indefinitely, and may be sold in response to liquidity requirements or changes in market conditions. These include government and private debt securities.

After initial measurement, AFS investments are subsequently measured at fair value. Gains or losses from changes in fair value of AFS investments are recognized in other comprehensive income, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognized. When the investment is disposed of, the cumulative gain or loss previously recognized in other comprehensive income is recognized as 'Trading gain - net' in the statement of income. Where the Bank holds more than one investment in the same security, these are deemed to be disposed of on a first-in first-out basis. Interest earned on holding AFS investments are reported as interest income using the effective interest rate (EIR). Any losses arising from impairment of such investments are recognized in the statement of income and removed from other comprehensive 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 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 and impairment losses' in the statement of income.

#### *Other financial liabilities*

Issued financial instruments or their components, which are not designated 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 order payable, due to Philippine Deposit Insurance Corporation (PDIC) or BSP and bills purchased-contra.

After initial measurement, financial liabilities not qualified as and not designated at FVPL, 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*

The Bank may reclassify, in certain circumstances, non-derivative financial assets out of the financial assets at FVPL category and into the AFS investments, loans and receivables or HTM investments categories. From this date it may also reclassify, in certain circumstances, financial instruments out of the AFS investment to loans and receivables category. Reclassifications are recorded at fair value at the date of reclassification, which becomes the new amortized cost.

The Bank may reclassify a non-derivative trading asset out of the financial assets at FVPL and into the loans and receivable category if it meets the definition of loans and receivables and the Bank has the intention and ability to hold the financial assets for the foreseeable future or until maturity. If a financial asset is reclassified, and if the Bank subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognized as an adjustment to the EIR from the date of the change in estimate.

For a financial asset reclassified out of the AFS investments category, any previous gain or loss on that asset that has been recognized in other comprehensive income is amortized to profit or loss over the remaining life of the investment using the effective interest method. Any difference between the new amortized cost and the expected cashflows 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. The Bank does not reclassify any financial instrument into the FVPL category after initial recognition.

#### *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:

1. the rights to receive cash flows from the asset have expired; or
2. 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
3. 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.

##### *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.

##### *Financial Guarantees*

In the ordinary course of business, the Bank provides financial guarantees. Financial guarantees are initially recognized in the financial statements 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 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 and impairment 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 and impairment losses' in the statement of income.

The present value of 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.

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.

*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, less any impairment loss on that investment previously recognized in the statement of income. 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.

Business Combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed and included in administrative expenses.

When the Bank acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through profit or loss.

Any contingent consideration to be transferred by the acquirer will be recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability will be recognized in accordance with PAS 39 either in profit or loss or as a change to other comprehensive income. If the contingent consideration is classified as equity, it should not be remeasured until it is finally settled within equity.

*Business combinations prior to January 1, 2010*

In comparison to the above-mentioned requirements, the following differences applied: Business combinations were accounted for using the purchase method. Transaction costs directly attributable to the acquisition formed part of the acquisition costs. The non-controlling interest (formerly known as minority interest) was measured at the proportionate share of the acquiree's identifiable net assets.

Business combinations achieved in stages were accounted for as separate steps. Any additional acquired share of interest did not affect previously recognized goodwill.

When the Bank acquired a business, embedded derivatives separated from the host contract by the acquiree were not reassessed on acquisition unless the business combination resulted in a change in the terms of the contract that significantly modified the cash flows that otherwise would have been required under the contract.

Contingent consideration was recognized if, and only if, the Bank had a present obligation, the economic outflow was more likely than not and a reliable estimate was determinable. Subsequent adjustments to the contingent consideration were recognized as part of goodwill.

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	Lease term

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 items of furniture, fixtures and equipment. The carrying values of furniture, fixtures and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying values may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash-generating units (CGU) are written down to their recoverable amount (see accounting policy on 'Impairment of Nonfinancial Assets').

Investment Properties

Investment properties include real properties acquired in settlement of loans and receivables.

*Real properties acquired*

Depreciable real properties acquired are initially 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 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 or CGU's 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 initially 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 estimated useful life of three 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 initially measured at fair value as of the date of acquisition and 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.

Intangible assets with indefinite useful life are tested for impairment annually either individually or at the cash generating unit level. Impairment is determined by assessing the recoverable amount of each cash-generating unit [or group of cash-generating units (CGUs)] to which the intangible asset relates. Recoverable amount is higher of the cash-generating unit's fair value less costs to sell and its value in use. Where the recoverable amount of the CGUs is less than its carrying amount, an impairment loss is recognized.

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 such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use or its fair value less costs to sell.

An impairment loss is recognized only if the carrying amount of an asset 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.

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.

#### 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. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options), including any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses. The adjusted carrying amount is calculated based on the original EIR. The change in carrying amount is recorded as 'Interest income' in the statement of income.

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 gain - net

Trading gain - 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, and gains and losses from disposal of AFS investments.

#### 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 when earned.

#### Profit (loss) from assets sold or acquired

Income from sale of properties acquired is recognized upon completion of the earning process and the collectibility 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.

#### 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:

- there is a change in contractual terms, other than a renewal or extension of the arrangement;
- a renewal option is exercised or extension granted, unless that term of the renewal or extension was initially included in the lease term;
- there is a change in the determination of whether fulfillment is dependent on a specified asset; or
- 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 defined benefit pension plans 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 a 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 and interpretations 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 its financial statements.

#### Effective in 2011

##### PAS 24 (Amended), *Related Party Disclosures*

The amended standard is effective for annual periods beginning on or after January 1, 2011. It clarified the definition of a related party to simplify the identification of such relationships and to eliminate inconsistencies in its application. The revised standard introduces a partial exemption of disclosure requirements for government-related entities. The Bank does not expect any impact on its financial position or performance. Early adoption is permitted for either the partial exemption for government-related entities or for the entire standard.

##### PAS 32, *Financial Instruments: Presentation (Amendment) – Classification of Rights Issues*

The amendment to PAS 32 is effective for annual periods beginning on or after February 1, 2010 and amended the definition of a financial liability in order to classify rights issues (and certain options or warrants) as equity instruments in cases where such rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, or to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. This amendment will have no impact on the Bank after initial application.

##### Philippine Interpretation IFRIC 14 (Amendment) – *Prepayments of a Minimum Funding Requirement*

The amendment to Philippine Interpretation IFRIC 14 is effective for annual periods beginning on or after January 1, 2011, with retrospective application. The amendment provides guidance on assessing the recoverable amount of a net pension asset. The amendment permits an entity to treat the prepayment of a minimum funding requirement as an asset.

##### Philippine Interpretation IFRIC 19, *Extinguishing Financial Liabilities with Equity Instruments*

Philippine Interpretation IFRIC 19 is effective for annual periods beginning on or after July 1, 2010. The interpretation clarifies that equity instruments issued to a creditor to extinguish a financial liability qualify as consideration paid. The equity instruments issued are measured at their fair value. In case that this cannot be reliably measured, the instruments are measured at the fair value of the liability extinguished. Any gain or loss is recognized immediately in profit or loss.

#### Effective in 2012

##### PFRS 7, *Financial Instruments: Disclosures (Amendments) – Disclosures – Transfers of Financial Assets*

The amendments to PFRS 7 are effective for annual periods beginning on or after July 1, 2011. The amendments will allow users of financial statements to improve their understanding of transfer transactions of financial assets (for example, securitizations), including understanding the possible effects of any risks that may remain with the entity that transferred the assets. The amendments also require additional disclosures if a disproportionate amount of transfer transactions are undertaken around the end of a reporting period.

##### PAS 12, *Income Taxes (Amendment) – Deferred Tax: Recovery of Underlying Assets*

The amendment to PAS 12 is effective for annual periods beginning on or after January 1, 2012. It provides a practical solution to the problem of assessing whether recovery of an asset will be through use or sale. It introduces a presumption that recovery of the carrying amount of an asset will normally be through sale.

##### Philippine Interpretation IFRIC 15, *Agreement for Construction of Real Estate*

This Interpretation, effective for annual periods beginning on or after January 1, 2012, covers accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. The Interpretation requires that revenue on construction of real estate be recognized only upon completion, except when such contract qualifies as construction contract to be accounted for under PAS 11, *Construction Contracts*, or involves rendering of services in which case revenue is recognized based on stage of completion. Contracts involving provision of services with the construction materials and where the risks and reward of ownership are transferred to the buyer on a continuous basis will also be accounted for based on stage of completion.

#### Effective in 2013

##### PFRS 9, *Financial Instruments: Classification and Measurement*

PFRS 9, as issued in 2010, reflects the first phase of the work on the replacement of PAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in PAS 39. The standard is effective for annual periods beginning on or after January 1, 2013 with early application permitted. In subsequent phases, hedge accounting and derecognition will be addressed. The completion of this project is expected in the middle of 2011. The adoption of the first phase of PFRS 9 will have an effect on the classification and measurement of the Bank's financial assets. The Bank will quantify the effect in conjunction with the other phases, when issued, to present a comprehensive picture.

#### Improvements to PFRSs 2010

*Improvements to IFRSs* is an omnibus of amendments to PFRSs. The amendments have not been adopted as they become effective for annual periods on or after either July 1, 2010 or January 1, 2011.

The amendments below, are considered to have a reasonable possible impact on the Bank:

- PFRS 7, *Financial Instruments: Disclosures*

The amendment emphasizes the interaction between quantitative and qualitative disclosures and the nature and extent of risks associated with financial instruments. The amendment is applicable for annual periods beginning January 1, 2011 and is applied retrospectively. Amendments to quantitative and credit risk disclosures are as follow:

- Clarify that only financial asset whose carrying amount does not reflect the maximum exposure to credit risk need to provide further disclosure of the amount that represents the maximum exposure to such risk.
- Require, for all financial assets, disclosure of the financial effect of collateral held as security and other credit enhancements regarding the amount that best represents the maximum exposure to credit risk (e.g., a description of the extent to which collateral mitigates credit risk).
- Remove the disclosure requirement of the collateral held as security, other credit enhancements and an estimate of their fair value for financial assets that are past due but not impaired, and financial assets that are individually determined to be impaired.
- Remove the requirement to specifically disclose financial assets renegotiated to avoid becoming past due or impaired.
- Clarify that the additional disclosure required for financial assets obtained by taking possession of collateral or other credit enhancements are only applicable to assets still held at the reporting date.

The Bank expects that the additional disclosure requirements to have minor impact as information are expected to be readily available.

The Bank expects no impact from the adoption of the following amendments to PFRS on its financial position or performance of the Bank.

- PFRS 3, *Business Combinations*
- PAS 1, *Presentation of Financial Statements*
- PAS 27, *Consolidated and Separate Financial Statements*
- Philippine Interpretation IFRIC 13, *Customer Loyalty Programmes*

### 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:

- 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 a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of liquidity and model inputs.

- 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 - for example, selling an insignificant amount close to maturity - 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.

*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 lease agreements, that all significant risks and rewards of ownership of the properties it leases are not transferable to the Bank.

*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 counsel 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 26).

*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.

**Estimates**

The key assumptions concerning the future and other key sources of estimation uncertainty at the statement of financial position date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

*a. Credit losses on loans and receivables*

The Bank reviews its individually significant loans and receivable at each 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 ₱85.1 million and ₱39.6 million in 2010 and 2009, respectively (see Note 8).

As of December 31, 2010 and 2009, loans and receivables of the Bank, net of allowance for credit losses and unearned discounts and deferred credits, amounted to ₱13.6 billion and ₱10.2 billion, respectively (see Note 8).

*b. Impairment of branch licenses and other nonfinancial assets*

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.

The Bank's impairment test for branch licenses with indefinite useful lives 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 cash generating unit 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.

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 Bank recognizes an impairment loss whenever the carrying amount of a nonfinancial asset exceeds its recoverable amount. The recoverable amount is computed based on the higher of the asset's fair value less cost to sell or value in use. Recoverable amounts

are estimated for individual nonfinancial assets or, if it is not possible, for the cash-generating unit to which the nonfinancial asset belongs. If there is no binding sale agreement or active market for an asset, the Bank considers the outcome of recent transactions for similar assets within the same industry.

As of December 31, 2010 and 2009, the total carrying value of the Bank's branch licenses amounted to ₱225.4 million (see Notes 9 and 12). No impairment loss was recognized on branch licenses in 2010 and 2009.

The carrying values of the Bank's other nonfinancial assets follow:

	2010	2009
Property and equipment (Note 10)	<b>₱566,287,516</b>	₱317,297,076
Investment properties (Note 11)	<b>128,139,399</b>	122,449,200
Chattel mortgage properties (Note 13)	<b>28,935,696</b>	8,503,466

*c. 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 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 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:

	2010	2009
Property and equipment (Note 10)	<b>₱401,943,016</b>	₱317,297,076
Investment properties (Note 11)	<b>60,429,814</b>	57,534,399
Chattel mortgage properties (Note 13)	<b>28,935,696</b>	8,503,466

*d. Recognition of deferred tax assets*

Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can 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, 2010 and 2009, the Bank's recognized deferred tax assets amounted to ₱21.5 million.

As of December 31, 2010 and 2009, the Bank did not recognize deferred tax assets on temporary differences totaling ₱413.0 million and ₱346.7 million, respectively (see Note 22).

*e. Present value of retirement obligation*

The cost of defined retirement plan and other post employment benefits is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. The assumed discount rates were determined using the market yields on Philippine government bonds with terms consistent with the expected employee benefit payout as of statement of financial position date.

As of December 31, 2010 and 2009, the accrued retirement obligation (included under 'Accrued interest, taxes and other expenses' in the statements of financial position) amounted to ₱13.3 million and ₱4.7 million, respectively (see Notes 16 and 20).

**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 board committees, which are responsible for developing, managing and monitoring risk management policies in their specified areas, include the following:

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

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

The RMG serves 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 compliance with the Bank's risk management policies and procedures, and 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 Internal Audit (IA). 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 responsible for ensuring that the Bank and all its legal vehicles maintain adequate liquidity, sufficient capital and the appropriate funding to meet all business requirements and comply with all regulatory requirements. It is also responsible to build 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 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 70.0% loan value; real estate loans are secured versus first real estate mortgage at 70.0% 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 60.0% 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 managing 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.

- 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 before collateral held or other credit enhancements

An analysis of the maximum exposure to credit risk, net of allowance for credit and impairment losses, to on-and-off-balance sheet credit risk exposures before taking into account any collateral held or other credit enhancements for the components of the statements of financial position is shown below:

	2010	2009
HFT securities (Note 7):		
Government securities	<b>₱1,233,142,025</b>	₱-
Private bonds	<b>477,543,833</b>	-
	<b>1,710,685,858</b>	-
AFS investments (Note 7):		
Government securities	<b>2,406,921,898</b>	2,538,384,799
Private bonds	<b>1,267,638,985</b>	963,366,690
	<b>3,674,560,883</b>	3,501,751,489
HTM investments (Note 7):		
Government securities	<b>130,889,290</b>	138,208,840
Loans and receivables:		
Due from BSP	<b>636,104,375</b>	644,268,650
Due from other banks	<b>569,552,885</b>	1,118,677,683
Interbank loans receivables and SPURA with the BSP	<b>1,620,000,000</b>	910,000,000
Loans and receivables (Note 8):		
Loans and discount:		
Corporate	<b>7,322,151,626</b>	5,671,438,662
Consumer	<b>4,223,950,648</b>	3,284,171,547
Bills purchased	<b>646,161,068</b>	2,076,176
Unquoted debt securities	<b>1,203,101,409</b>	1,060,646,469
Accrued interest receivable	<b>187,539,417</b>	155,070,860
Accounts receivable	<b>33,880,674</b>	33,943,566
	<b>13,616,784,842</b>	10,207,347,280
Other assets (Note 13):		
Returned checks and other cash items (RCOCI)	<b>7,854,846</b>	20,474,072
Refundable deposits	<b>11,550,705</b>	11,965,160
	<b>19,405,551</b>	32,439,232
<b>Total loans and receivables</b>	<b>16,461,847,653</b>	12,912,732,845
<b>Total financial assets</b>	<b>21,977,983,684</b>	16,552,693,174
Contingencies (Note 26):		
Outstanding guarantees issued - others	<b>102,000,000</b>	21,880,283
Domestic letters of credit	<b>29,452,369</b>	487,968
	<b>131,452,369</b>	22,368,251
<b>Total credit risk exposure</b>	<b>₱22,109,436,053</b>	₱16,575,061,425

*Concentration of risks of financial assets with credit risk exposure*

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

2010					
	Loans and Receivables	Loans and Advances to Banks*	Investment Securities**	Others***	Total
Financial intermediaries	₱899,348,662	₱2,825,657,260	₱1,745,182,818	₱131,452,369	₱5,819,439,622
Philippine government	1,203,101,409	-	3,770,953,213	-	4,756,256,109
Other community, social and personal activities	4,458,111,722	-	-	7,854,846	4,465,966,568
Real Estate, renting and business activities	2,617,691,323	-	-	11,550,705	2,629,242,028
Manufacturing	1,921,775,338	-	-	-	1,921,775,338
Wholesale and retail trade	1,480,673,769	-	-	-	1,480,673,769
Transportation, storage and communication	528,644,229	-	-	-	528,644,229
Construction	348,244,263	-	-	-	348,244,263
Agricultural, hunting and forestry	214,744,363	-	-	-	214,744,363
Mining and quarrying	70,810,802	-	-	-	70,810,802
Hotel and restaurants	38,143,813	-	-	-	38,143,813
	<b>13,781,289,693</b>	<b>2,825,657,260</b>	<b>5,516,136,031</b>	<b>150,857,920</b>	<b>22,273,940,904</b>
Less allowance for credit losses	164,504,851	-	-	-	164,504,851
<b>Total</b>	<b>₱13,616,784,842</b>	<b>₱2,825,657,260</b>	<b>₱5,516,136,031</b>	<b>₱150,857,920</b>	<b>₱22,109,436,053</b>

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

\*\* Comprised of HFT securities, AFS investments and HTM investments

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

2009					
	Loans and Receivables	Loans and Advances to Banks*	Investment Securities**	Others***	Total
Financial intermediaries	₱1,482,573,977	₱2,672,946,333	₱963,366,690	₱42,842,323	₱5,601,641,109
Philippine government	-	-	2,676,593,639	-	4,974,054,622
Other community, social and personal activities	2,936,269,729	-	-	-	2,936,269,729
Real Estate, renting and business activities	1,828,533,750	-	-	11,965,160	1,840,498,910
Manufacturing	2,002,561,826	-	-	-	2,002,561,826
Wholesale and retail trade	991,775,031	-	-	-	991,775,031
Transportation, storage and communication	229,467,216	-	-	-	229,467,216
Construction	265,764,800	-	-	-	265,764,800
Agricultural, hunting and forestry	321,500,000	-	-	-	321,500,000
Mining and quarrying	198,960,802	-	-	-	198,960,802
Hotel and restaurants	29,300,000	-	-	-	29,300,000
	<b>10,286,707,131</b>	<b>2,672,946,333</b>	<b>3,639,960,329</b>	<b>54,807,483</b>	<b>16,654,421,276</b>
Less allowance for credit losses	79,359,851	-	-	-	79,359,851
<b>Total</b>	<b>₱10,207,347,280</b>	<b>₱2,672,946,333</b>	<b>₱3,639,960,329</b>	<b>₱54,807,483</b>	<b>₱16,575,061,425</b>

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

\*\* Comprised of AFS investments and HTM investments and derivative asset

\*\*\* Comprised of RCOCI and 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 allowances 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.

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 financial investment securities is generally monitored through the external ratings of eligible external credit assessment 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 Rating:

Credit Quality	Rating			
High Grade	Aaa	Aa	A	Baa
Standard Grade	Ba	B		
Substandard Grade	Caa	Ca	C	
Impaired	D			

B. S&P Rating:

Credit Quality	Rating		
High Grade	AAA	AA	A
Standard Grade	BBB	BB	B
Substandard Grade	CCC	CC	C
Impaired	RD	D	

C. Fitch Rating:

Credit Quality	Rating		
High Grade	AAA	AA	A
Standard Grade	BBB	BB	B
Substandard Grade	CCC	CC	C
Impaired	RD	D	

D. Philratings:

Credit Quality	Rating		
High Grade	Aaa	Aa	A
Standard Grade	Baa	Ba	
Substandard Grade	B	Caa	Ca
Impaired	C		

For debt securities which are not rated by any rating agency, the Bank performs the credit review rating for the issuers of debt securities based on quantitative and qualitative analysis, the data of which is provided by the Treasury/Trust Group. Below is the guide 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 loan exposures, the credit quality is generally monitored using its 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 or counterparty risk.

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

Description of the loan grades used by the Bank for receivable from customers follow:

Risk Rating	Classification	Credit Quality
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 a 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 decline 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;
- 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;
- 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 creditor 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;
- 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):

	2010					
	Neither past due nor impaired			Past due but not impaired	Impaired	Total
	High Grade	Standard Grade	Total			
HFT securities:						
Government securities	P-	P1,233,142	P1,233,142	P-	P-	P1,233,142
Private bonds	79,983	397,561	477,544	-	-	477,544
AFS investments:						
Government securities	-	2,406,922	2,406,922	-	-	2,406,922
Private debt securities	646,787	620,852	1,267,639	-	-	1,267,639
HTM investments:						
Government securities	-	130,889	130,889	-	-	130,889
Loans and receivables:						
Loans and discount:						
Corporate	2,718,620	4,412,618	7,131,238	-	271,683	7,402,921
Consumer	3,269,335	726,666	3,996,001	311,686	-	4,307,687
Bills purchased	-	646,161	646,161	-	-	646,161
Unquoted debt securities	1,203,101	-	1,203,101	-	-	1,203,101
Accrued interest receivable	187,539	-	187,539	-	-	187,539
Accounts receivable	33,881	-	33,881	-	-	33,881
Other assets:						
RCOCI	7,855	-	7,855	-	-	7,855
Refundable deposits	11,551	-	11,551	-	-	11,551
Loans and advances to banks:						
Due from BSP	-	636,104	636,104	-	-	636,104
Due from other banks	569,553	-	569,553	-	-	569,553
Interbank loans receivable and SPURA with the BSP	1,620,000	-	1,620,000	-	-	1,620,000
<b>Total</b>	<b>P10,348,205</b>	<b>P11,210,915</b>	<b>P21,559,120</b>	<b>P311,686</b>	<b>P271,683</b>	<b>P22,142,489</b>

	2009					
	Neither past due nor impaired			Past due but not impaired	Impaired	Total
	High Grade	Standard Grade	Total			
AFS investments:						
Government securities	P-	P2,538,385	P2,538,385	P-	P-	P2,538,385
Private bonds	963,366	-	963,366	-	-	963,366
HTM investments:						
Government securities	-	138,209	138,209	-	-	138,209
Loans and receivables:						
Loans and discount:						
Corporate	2,488,296	3,072,691	5,560,987	3,518	153,580	5,718,085
Consumer	2,538,723	520,534	3,059,257	257,628	-	3,316,885
Bills purchased	-	2,076	2,076	-	-	2,076
Unquoted debt securities	1,060,646	-	1,060,646	-	-	1,060,646
Accrued interest receivable	155,071	-	155,071	-	-	155,071
Accounts receivable	33,944	-	33,944	-	-	33,944
Other assets:						
RCOCI	20,474	-	20,474	-	-	20,474
Refundable deposits	11,965	-	11,965	-	-	11,965
Loans and advances to banks:						
Due from BSP	-	644,269	644,269	-	-	644,269
Due from other banks	1,118,678	-	1,118,678	-	-	1,118,678
Interbank loans receivable and SPURA with the BSP	910,000	-	910,000	-	-	910,000
<b>Total</b>	<b>P9,301,163</b>	<b>P6,916,164</b>	<b>P16,217,327</b>	<b>P261,146</b>	<b>P153,580</b>	<b>P16,632,053</b>

The succeeding tables show the gross amount of past due but not impaired loans and receivables per delinquency bucket of the Bank. Under PFRS, a financial asset is past due when the counterparty has failed to make a payment when contractually due (amounts in thousands).

	2010							Total
	Neither Past Due nor Impaired	Past Due but not Impaired					Impaired	
		Lests than 30 days	31 to 60 days	61 to 90 days	91 to 180 days	Over 180 days		
HFT securities:								
Government securities	P1,233,142	P-	P-	P-	P-	P-	P-	P1,233,142
Private bonds	477,544	-	-	-	-	-	-	477,544
AFS investments:								
Government debt securities	2,406,922	-	-	-	-	-	-	2,406,922
Private debt securities	1,267,639	-	-	-	-	-	-	1,267,639
HTM investments:								
Government debt securities	130,889	-	-	-	-	-	-	130,889
Loans and receivables:								
Loans and discount:								
Corporate	7,131,238	-	-	-	-	-	271,683	7,402,921
Consumer	3,996,001	27,095	22,910	27,068	63,232	171,381	-	4,307,687
Bills purchased	646,161	-	-	-	-	-	-	646,161
Unquoted debt securities	1,203,101	-	-	-	-	-	-	1,203,101
Accrued interest receivable	187,539	-	-	-	-	-	-	187,539
Accounts receivable	33,881	-	-	-	-	-	-	33,881
Other assets:								
RCOCI	7,855	-	-	-	-	-	-	7,855
Refundable deposits	11,551	-	-	-	-	-	-	11,551
Loans and advances to banks:								
Due from BSP	636,104	-	-	-	-	-	-	636,104
Due from other banks	569,553	-	-	-	-	-	-	569,553
Interbank loans receivable and SPURA with the BSP	1,620,000	-	-	-	-	-	-	1,620,000
<b>Total</b>	<b>P21,559,120</b>	<b>P27,095</b>	<b>P22,910</b>	<b>P27,068</b>	<b>P63,232</b>	<b>P171,381</b>	<b>P271,683</b>	<b>P22,142,489</b>

	2009							Total
	Neither Past Due nor Impaired	Less than 30 days	31 to 60 days	61 to 90 days	91 to 180 days	Over 180 days	Impaired	
<b>AFS investments:</b>								
Government securities	P2,538,385	P-	P-	P-	P-	P-	P-	P2,538,385
Private bonds	963,366	-	-	-	-	-	-	963,366
<b>HTM investments:</b>								
Government securities	138,209	-	-	-	-	-	-	138,209
<b>Loans and receivables:</b>								
<b>Loans and discount:</b>								
Corporate	5,560,987	3,518	-	-	-	-	153,580	5,718,085
Consumer	3,059,257	53,566	25,212	15,336	118,799	44,715	-	3,316,885
Bills purchased	2,076	-	-	-	-	-	-	2,076
Unquoted debt securities	1,060,646	-	-	-	-	-	-	1,060,646
Accrued interest receivable	155,071	-	-	-	-	-	-	155,071
Accounts receivable	33,944	-	-	-	-	-	-	33,944
<b>Other assets:</b>								
RCOCI	20,474	-	-	-	-	-	-	20,474
Refundable deposits	11,965	-	-	-	-	-	-	11,965
<b>Loans and advances to banks:</b>								
Due from BSP	644,269	-	-	-	-	-	-	644,269
Due from other banks	1,118,678	-	-	-	-	-	-	1,118,678
Interbank loans receivable and SPURA with the BSP	910,000	-	-	-	-	-	-	910,000
<b>Total</b>	<b>P16,217,327</b>	<b>P57,084</b>	<b>P25,212</b>	<b>P15,336</b>	<b>P118,799</b>	<b>P44,715</b>	<b>P153,580</b>	<b>P16,632,053</b>

**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 tables show the fair value of collateral held against loans and receivables of the Bank:

	2010		
	Against individually impaired	Against past due but not impaired	Against neither past due nor impaired
Properties	P-	P147,968,749	P7,124,719,101
Deposits	-	-	1,285,956,025
Equities	650,000	-	-
<b>Total</b>	<b>P650,000</b>	<b>P147,968,749</b>	<b>P8,410,675,126</b>

	2009		
	Against individually impaired	Against past due but not impaired	Against neither past due nor impaired
Properties	P-	P315,659,329	P6,351,641,474
Deposits	-	-	1,103,323,415
Equities	-	-	650,000
<b>Total</b>	<b>P-</b>	<b>P315,659,329</b>	<b>P7,455,614,889</b>

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 Treasury Bank 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 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 as of December 31, 2010 and 2009:

	2010						Total
	On demand	Within 30 Days	31 to 60 Days	61 to 180 Days	181 to 360 Days	Over 360 Days	
<b>Financial Assets</b>							
HFT securities	P-	P6,914,550	P9,026,925	P41,697,331	P53,369,886	P3,184,514,498	P3,295,523,190
AFS investments	-	19,528,925	8,081,600	116,386,028	148,745,192	6,603,044,466	6,895,786,211
HTM investments	-	-	4,789,520	397,300	5,186,820	292,977,240	303,350,880
<b>Loans and receivables:</b>							
COCI	625,873,173	-	-	-	-	-	625,873,173
Due from BSP	-	461,852,118	175,452,257	-	-	-	637,304,375
Due from other banks	-	569,552,885	-	-	-	-	569,552,885
Interbank loans receivable and SPURA with the BSP	-	1,620,360,000	-	-	-	-	1,620,360,000
<b>Loans and receivables:</b>							
Loans and discounts	-	1,364,431,867	946,468,359	2,552,289,635	2,102,563,195	5,226,510,286	12,192,263,342
Unquoted debt securities	-	-	18,258,750	-	18,258,750	1,271,518,278	1,308,035,778
Accrued interest receivable	-	117,586,105	25,310,801	44,642,511	-	-	187,539,417
Accounts receivable	-	6,140,391	951,546	3,806,182	5,709,273	17,273,282	33,880,674
<b>Total</b>	<b>P625,873,173</b>	<b>P4,166,366,841</b>	<b>P1,188,339,758</b>	<b>P2,759,218,987</b>	<b>P2,333,833,116</b>	<b>P16,595,838,050</b>	<b>P27,669,469,925</b>
<b>Financial Liabilities</b>							
<b>Deposit liabilities:</b>							
Demand	P-	P130,037,344	P132,037,344	P528,149,376	P792,224,065	P1,584,448,129	P3,166,896,258
Savings	-	38,595,181	38,595,181	150,495,333	208,258,734	435,944,430	871,888,859
Time	-	1,580,872,849	1,526,454,883	4,524,044,985	-	11,252,613,199	18,883,985,916
Manager's checks	-	63,324,279	-	-	-	-	63,324,279
Bills payable	-	1,372,123	15,931,704	71,047,954	-	-	88,351,781
Accrued interest and other expenses	-	32,677,766	3,594,095	11,194,539	13,291,782	48,134,621	108,892,803
Other liabilities*	-	1,090,104,883	196,086	-	-	-	1,090,300,969
<b>Total</b>	<b>P</b>	<b>P2,936,984,425</b>	<b>P1,716,809,293</b>	<b>P5,284,932,187</b>	<b>P1,013,774,581</b>	<b>P13,321,140,379</b>	<b>P24,273,640,865</b>
<b>Net financial assets (liabilities)</b>	<b>P625,873,173</b>	<b>P1,229,382,416</b>	<b>(P528,469,535)</b>	<b>(P2,525,713,200)</b>	<b>P1,320,058,535</b>	<b>P3,274,697,671</b>	<b>P3,395,829,060</b>

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

	2009							Total
	On demand	Within 30 Days	31 to 60 Days	61 to 180 Days	181 to 360 Days	Over 360 Days		
<b>Financial Assets</b>								
AFS investments	P-	P139,067,357	P15,148,804	P36,118,636	P597,315,786	P3,709,476,414	P4,497,126,997	
HTM investments	-	-	897,307	253,539	5,466,038	340,079,740	346,696,624	
Loans and receivables:								
COCI	249,011,034	-	-	-	-	-	249,011,034	
Due from BSP	-	504,449,206	70,221,181	70,416,889	-	-	645,087,276	
Due from other banks	-	1,118,677,683	-	-	-	-	1,118,677,683	
Interbank loans receivable and SPURA with the BSP	-	910,404,444	-	-	-	-	910,404,444	
Loans and receivables:								
Loans and discounts	-	926,727,351	953,487,488	1,406,459,005	2,451,255,698	3,302,813,007	9,040,742,549	
Unquoted debt securities	-	-	3,083,700	2,013,550	17,195,850	1,300,462,269	1,322,755,369	
Accrued interest receivable	-	25,582,102	38,960,335	25,787,801	14,836,824	49,903,798	155,070,860	
Accounts receivable	-	11,572,264	345,897	518,846	1,037,691	20,468,868	33,943,566	
	P249,011,034	P3,636,480,407	P1,082,144,712	P1,541,568,266	P3,087,107,887	P8,723,204,096	P18,319,516,402	
<b>Financial Liabilities</b>								
Deposit liabilities:								
Demand	P-	P103,484,632	P206,714,451	P309,434,644	P616,575,971	P1,229,584,559	P2,465,794,257	
Savings	-	38,291,350	76,466,583	114,149,053	225,800,669	470,317,392	925,025,047	
Time	-	2,881,853,495	2,896,614,188	2,887,090,697	50,742,813	4,300,845,592	13,017,146,785	
	-	3,023,629,477	3,179,795,222	3,310,674,394	893,119,453	6,000,747,543	16,407,966,089	
Manager's checks	-	79,132,385	-	-	-	-	79,132,385	
Bills payable	-	88,525,900	-	-	-	-	88,525,900	
Accrued interest and other expenses	-	9,961,614	13,806,103	13,806,103	-	57,269,245	94,843,065	
Other liabilities*	-	351,774,176	365,096	-	-	-	352,139,272	
	P-	P3,553,023,552	P3,193,966,421	P3,324,480,497	P893,119,453	P6,058,016,788	P17,022,606,711	
Net financial assets (liabilities)	P249,011,034	P83,456,855	(P2,111,821,709)	(P1,782,912,231)	P2,193,988,434	P2,665,187,308	P1,296,909,691	

\* 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 currency exchange rates, commodity prices, equity prices and other market changes. The Bank's market risk originates from its holdings in its 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 to 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 Board. The RMG regularly reports to ALCO and to the RMC, which is a sub-committee of the BOD.

The Treasury Group manages asset/liability risks arising from both normal banking operations and from trading operations in financial markets.

#### 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 variable held constant (amounts in millions).

	2010			
	Increase (Decrease) in Basis Points			
	50	100	(50)	(100)
Change in net interest income				
Loans and receivables	P30.6	P61.3	(P30.6)	(P61.3)
Deposit liabilities	(103.9)	(207.8)	103.9	207.8
As a percentage of the Bank's net interest income for the year	9.0%	18.1%	(9.0%)	(18.1%)
Change in trading gain from HFT securities	(P62.8)	(P122.0)	P66.8	P138.1
Change in equity*				
AFS investments	(82.1)	(142.7)	49.6	121.3

  

	2009			
	Increase (Decrease) in Basis Points			
	50	100	(50)	(100)
Change in net interest income				
Loans and receivables	P14.3	P28.6	(P14.3)	(P28.6)
Deposit liabilities	(78.8)	(157.6)	78.8	157.6
As a percentage of the Bank's net interest income for the year	(27.5%)	(54.9%)	27.5%	54.9%
Change in equity*				
AFS investments	(P69.6)	(P137.0)	(P72.2)	(P146.9)

\* The impact on the Bank's equity already excludes the impact on transactions affecting the profit and loss.

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 currency 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, 2010 and 2009, 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, 2010 and 2009. Included in the tables are the Bank assets and liabilities at carrying amounts, categorized by currency (amounts in Philippine Peso equivalent).

	2010			2009		
	USD	Others*	Total	USD	Others*	Total
<b>Financial Assets</b>						
Cash and cash equivalents	P226,055,567	P-	P226,055,567	P23,829,196	P-	P23,829,196
Due from other banks	360,975,186	15,356,922	376,332,108	920,800,298	63,958,692	984,758,990
HFT securities	657,027,984	-	657,027,984	-	-	-
AFS investments	1,624,071,402	-	1,624,071,402	1,103,102,326	-	1,103,102,326
HTM investments	130,889,290	-	130,889,290	138,208,840	-	138,208,840
Loans and receivables	189,768,859	-	189,768,859	253,885,316	-	253,885,316
Total financial assets	3,188,788,288	15,356,922	3,204,145,210	2,439,825,976	63,958,692	2,503,784,668
<b>Financial Liabilities</b>						
Deposit liabilities	3,053,592,543	-	3,053,592,543	2,211,562,522	-	2,211,562,522
Accrued interest and other expenses	12,727,369	-	12,727,369	9,161,095	-	9,161,095
Other liabilities	6,161,438	-	6,161,438	3,250,779	-	3,250,779
Total financial liabilities	3,072,481,350	-	3,072,481,350	2,223,974,396	-	2,223,974,396
<b>Net Exposure</b>	<b>P116,306,938</b>	<b>P15,356,922</b>	<b>P131,663,860</b>	<b>P215,851,580</b>	<b>P63,958,692</b>	<b>P279,810,272</b>

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

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):

	2010			
	Increase (Decrease) in Currency Rates			
	5.0%	10.0%	(5.0%)	(10.0%)
USD	P5.8	P11.6	P5.8	P11.6
	2009			
	Increase (Decrease) in Currency Rates			
	5.0%	10.0%	(5.0%)	(10.0%)
USD	P10.8	P21.6	P10.8	P21.6

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. Similarly, it is also exposed to market risk in its non-trading portfolio. Market risk is dimensioned and controlled in both the trading book and in the non-trading book. In the trading book, market risk is controlled by a daily analysis of the VaR of financial instruments under normal market conditions. The volatilities used for this regular analysis are those for a rolling one-year period. The risk amounts computed are for a 99.0% confidence level.

#### 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 models assume 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 moves 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. 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. For some instruments, the VaR figure is scaled up to a longer time horizon to take into account the longer defeasance period.

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 following table provides the VaR summary of the Bank for the years ended December 31, 2010 and 2009 (amounts in thousands):

	2010		2009	
	Foreign Exchange	Fixed Income	Foreign Exchange	Fixed Income
December 31	P294	P24,844	P204	P66,821
Average Daily	636	12,140	675	53,811
Highest	5,343	24,906	3,269	109,409
Lowest	1	6,285	1	22,355

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 the 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 an 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, 2010 and 2009, 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):

	2010	2009
Gross qualifying capital	P1,505,469	P1,121,435
Less: Required deductions	-	-
<b>Total qualifying capital</b>	<b>P1,505,469</b>	<b>P1,121,435</b>
<b>Risk weighted assets</b>	<b>12,978,432</b>	<b>9,551,383</b>
CAR	<b>11.6%</b>	<b>11.8%</b>

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 2010 and 2009.

## 5. Fair Value Measurement

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, 2010 and 2009:

	2010		2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial Assets</b>				
HFT securities:				
Government debt securities	<b>₱1,233,142,025</b>	<b>₱1,233,142,025</b>	₱-	₱-
Private bonds	<b>477,543,833</b>	<b>477,543,833</b>	-	-
	<b>1,710,685,858</b>	<b>1,710,685,858</b>	-	-
AFS investments:				
Government securities	<b>2,406,921,898</b>	<b>2,406,921,898</b>	2,538,384,799	2,538,384,799
Private bonds	<b>1,267,638,985</b>	<b>1,267,638,985</b>	963,366,690	963,366,690
	<b>3,674,560,883</b>	<b>3,674,560,883</b>	3,501,751,489	3,501,751,489
HTM investments:				
Government securities	<b>130,889,290</b>	<b>156,960,900</b>	138,208,840	154,041,634
Loans and receivables:				
COCI	<b>625,873,173</b>	<b>625,873,173</b>	249,011,034	249,011,034
Due from BSP	<b>636,104,375</b>	<b>636,104,375</b>	644,268,650	644,268,650
Due from other banks	<b>569,552,885</b>	<b>569,552,885</b>	1,118,677,683	1,118,677,683
Interbank loans receivable and SPURA with the BSP	<b>1,620,000,000</b>	<b>1,620,000,000</b>	910,000,000	910,000,000
Loans and receivables:				
Loans and discounts:				
Corporate	<b>7,322,151,626</b>	<b>7,327,163,651</b>	5,671,438,662	5,632,882,103
Consumer	<b>4,223,950,648</b>	<b>4,418,936,864</b>	3,284,171,547	2,961,589,221
Bills purchased	<b>646,161,068</b>	<b>646,161,068</b>	2,076,176	2,076,176
Unquoted debt securities	<b>1,203,101,409</b>	<b>1,164,646,797</b>	1,060,646,469	1,011,383,788
Accrued interest receivable	<b>187,539,417</b>	<b>187,539,417</b>	155,070,860	155,070,860
Accounts receivable	<b>33,880,674</b>	<b>33,880,674</b>	33,943,566	33,943,566
	<b>13,616,784,842</b>	<b>13,778,328,471</b>	10,207,347,280	9,796,945,714
Other assets:				
RCOCI	<b>7,854,846</b>	<b>7,854,846</b>	20,474,072	20,474,072
Refundable Deposits	<b>11,550,705</b>	<b>11,550,705</b>	11,965,160	11,965,160
	<b>19,405,551</b>	<b>19,405,551</b>	32,439,232	32,439,232
<b>Total loans and receivables</b>	<b>17,087,720,826</b>	<b>17,249,264,455</b>	13,161,743,879	12,751,342,313
	<b>₱22,603,856,857</b>	<b>₱22,791,472,096</b>	₱16,801,704,208	₱16,407,135,436
<b>Financial Liabilities</b>				
Other financial liabilities:				
Deposit liabilities:				
Demand	<b>₱3,137,521,048</b>	<b>₱3,137,521,048</b>	₱2,434,707,062	₱2,434,707,062
Savings	<b>863,256,296</b>	<b>863,256,296</b>	888,697,858	888,697,858
Time	<b>16,782,463,358</b>	<b>16,784,136,037</b>	12,484,607,622	12,653,531,261
	<b>20,783,240,702</b>	<b>20,784,913,381</b>	15,808,012,542	15,976,936,181
Manager's checks	<b>63,324,279</b>	<b>63,324,279</b>	79,132,385	79,132,385
Bills Payable	<b>87,064,013</b>	<b>87,064,013</b>	88,525,900	88,525,900
Accrued interest and other expenses (Note 16)	<b>108,892,803</b>	<b>108,892,803</b>	94,843,065	94,843,065
Other liabilities (Note 17):				
Accounts payable	<b>422,767,390</b>	<b>422,767,390</b>	329,266,161	329,266,161
Due to PDIC	<b>19,132,784</b>	<b>19,132,784</b>	14,962,470	14,962,470
Bills purchased - contra	<b>646,161,068</b>	<b>646,161,068</b>	3,977,516	3,977,516
Payment order payable	<b>2,239,727</b>	<b>2,239,727</b>	3,933,125	3,933,125
	<b>1,090,300,969</b>	<b>1,090,300,969</b>	352,139,272	352,139,272
	<b>₱22,132,822,766</b>	<b>₱22,134,495,445</b>	₱16,422,653,164	₱16,591,576,803

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, interbank loans receivable 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.

*Liabilities* - Fair values are estimated using the discounted cash flow methodology using the Bank's current incremental borrowing rates for similar borrowings with maturities consistent with those remaining for the liability being valued, if any. The carrying amount of demand and savings deposit liabilities, as well as manager's checks, accrued interest and other operating expenses and other liabilities, approximates fair value considering that these are due and demandable.

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: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use 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:

	2010		2009	
	Level 1	Level 2	Level 1	Level 2
<b>Financial Assets</b>				
HFT securities:				
Government securities	<b>₱1,233,142,025</b>	₱-	₱-	₱-
Private bonds	<b>477,543,833</b>	-	-	-
AFS investments:				
Government securities	<b>2,406,921,898</b>	-	2,538,384,799	-
Private bonds	<b>1,049,479,047</b>	<b>218,159,937</b>	963,366,690	-

As of December 31, 2010 and 2009, the Bank has no financial instruments measured using level 3 inputs. There were no transfers between levels of fair value measurements in 2010 and 2009.

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

As of December 31, 2010 and 2009, this account includes SPURA with the BSP amounting to ₱1.6 billion and ₱0.9 billion, respectively. SPURA with the BSP earned interest at 4.0% in 2010 and 2009. Interest income on SPURA with the BSP amounted to ₱32.7 and ₱63.1 million in 2010 and 2009, respectively.

The Bank extends short-term loans with maturities of up to three months to local banks with interest ranging from 0.25% and 4.00% in 2010 and 2009. Interest income on interbank loans receivable amounted to ₱1.0 million in 2010 and ₱3.5 million in 2009.

The Bank has no interbank loans outstanding as of December 31, 2010 and 2009.

## 7. Investment Securities

The Bank's investment securities consist of the following:

	2010	2009
Financial assets at FVPL	<b>₱1,710,685,858</b>	₱-
AFS investments	<b>3,674,560,883</b>	3,501,751,489
HTM investments	<b>130,889,290</b>	138,208,840
	<b>₱5,516,136,031</b>	₱3,639,960,329

As of December 31, 2010, the Bank's financial assets at FVPL consist of the following:

HFT securities:	
Government securities	<b>₱1,233,142,025</b>
Private bonds	<b>477,543,833</b>
	<b>₱1,710,685,858</b>

As of December 31, 2010, the Bank's net unrealized loss on HFT securities amounted to ₱32.8 million. Gains or losses from changes in fair value of HFT securities are included in 'Trading gain - net' in the statements of income.

The Bank's AFS investments consist of the following:

	<b>2010</b>	2009
Government securities	<b>₱2,406,921,898</b>	₱2,538,384,799
Private bonds	<b>1,267,638,985</b>	963,366,690
	<b>₱3,674,560,883</b>	₱3,501,751,489

On March 23, 2007, the Bank obtained an Overnight Clearing Line Agreement (the Agreement) with the BSP amounting to ₱155.2 million, which was secured by AFS government securities with total face value of ₱194.0 million. The Bank enters into new pledge transactions upon maturity of pledged government securities. As of December 31, 2010 and 2009, the total face value of AFS government securities pledged by the Bank amounted to ₱203.2 million and ₱203.3 million, respectively, with fair value amounting to ₱225.5 million and ₱210.6 million, respectively. As stated in the Deed of Pledge, if the Agreement is terminated and the Bank pays the BSP the sums of money which are advanced or which may become payable to the latter, then the pledged securities will be released. In addition, when the value of the pledged government securities declines, the Bank will deliver additional securities, and during the effectivity of the pledge, the said government securities will not be sold, alienated, or in any manner disposed of or hypothecated.

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

	<b>2010</b>	2009
Balance at beginning of year	<b>(₱10,963,566)</b>	(₱36,220,291)
Changes in fair value during the year	<b>119,806,670</b>	280,671,140
Unrealized gains taken to profit and loss	<b>(151,459,172)</b>	(256,070,435)
Amortization of unrealized losses on reclassified AFS investments	<b>634,421</b>	656,020
Subtotal	<b>(31,018,081)</b>	25,256,725
Balance at end of year	<b>(₱41,981,647)</b>	(₱10,963,566)

As of December 31, 2010 and 2009, net unrealized loss on AFS investments amounted to ₱42.0 million and ₱11.0 million, respectively, net of tax amounting to nil and ₱0.2 million, respectively (see Note 22). As of December 31, 2010 and 2009, the Bank's net unrealized loss on AFS investments includes unrealized losses on reclassified AFS investments amounting to ₱8.5 million and ₱9.1 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 US dollar-denominated investment securities with face amount totaling US\$2.3 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, 2010, the carrying amount and fair value of financial assets reclassified out of AFS investments to HTM investments amounted to ₱121.3 million and ₱145.6 million, respectively. As of December 31, 2009, the carrying amount and fair value of financial assets reclassified out of the AFS investments to HTM investments amounted to ₱128.6 million and ₱141.7 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 ₱15.8 million in 2010 and ₱4.0 million in 2009.

As of December 31, 2010 and 2009, the Bank expects to recover the entire cash flows of these reclassified financial assets.

The Bank's HTM investments consist of the following:

	<b>2010</b>	2009
Government securities:		
Face value	<b>₱111,792,000</b>	₱117,810,000
Unamortized premium	<b>19,097,290</b>	20,398,840
	<b>₱130,889,290</b>	₱138,208,840

HTM investments include Republic of the Philippine bonds and Landbank corporate bonds with maturities of February 2, 2030 and October 19, 2016, respectively.

#### Trading Gains and Interest Income on Investment Securities

'Trading gain - net' consists of:

	<b>2010</b>	2009
AFS investments	<b>₱151,459,172</b>	₱256,070,435
HFT securities	<b>85,597,365</b>	1,637,993
Unquoted debt securities	<b>-</b>	103,107
	<b>₱237,056,537</b>	₱257,811,535

Interest income on investment securities consists of:

	<b>2010</b>	2009
AFS investments	<b>₱221,296,272</b>	₱149,640,401
HFT securities	<b>48,897,164</b>	1,692,894
HTM investments	<b>10,167,402</b>	10,991,139
	<b>₱280,360,838</b>	₱162,324,434

Peso-denominated AFS investments bear effective interest rates ranging from 3.9% to 9.3% in 2010 and 4.8% to 9.3% in 2009, while foreign currency-denominated AFS investments bear effective interest rates ranging from 3.5% to 17.9% in 2010 and 5.5% to 18.2% in 2009.

Foreign currency-denominated HTM investments bear effective interest rates ranging from 7.5% to 10.3% in 2010 and 2009.

Peso-denominated HFT securities bear effective interest rates ranging from 4.5% to 8.1% in 2010 and 5.3% to 7.0% in 2009, while foreign currency-denominated HFT securities bear effective interest rates ranging from 2.0% to 14.1% in 2010 and 5.9% to 7.4% in 2009. The Bank has no outstanding HFT securities as of December 31, 2009 but it acquired and traded certain securities during the year.

## 8. Loans and Receivables

This account consists of:

	<b>2010</b>	2009
Loans and discounts		
Commercial	<b>₱7,408,884,602</b>	₱5,723,857,962
Consumer	<b>4,307,685,807</b>	3,316,884,587
Less unearned discounts and capitalized interest	<b>5,963,284</b>	5,772,489
	<b>11,710,607,125</b>	9,034,970,060
Bills purchased	<b>646,161,068</b>	2,076,176
	<b>12,356,768,193</b>	9,037,046,236
Unquoted debt securities	<b>1,203,101,409</b>	1,060,646,469
Accrued interest receivable	<b>187,539,417</b>	155,070,860
Accounts receivable	<b>33,880,674</b>	33,943,566
	<b>13,781,289,693</b>	10,286,707,131
Less allowance for credit losses	<b>164,504,851</b>	79,359,851
	<b>₱13,616,784,842</b>	₱10,207,347,280

Receivables from customers consist of:

	2010	2009
Loans and discounts	<b>₱11,221,288,178</b>	₱8,537,153,243
Customers' liabilities under letters of credit and trust receipts	<b>264,011,211</b>	252,541,450
Receivables purchased	<b>231,271,020</b>	251,047,856
Bills purchased	<b>646,161,068</b>	2,076,176
	<b>12,362,731,477</b>	9,042,818,725
Less unearned discounts and capitalized interest	<b>5,963,284</b>	5,772,489
	<b>₱12,356,768,193</b>	₱9,037,046,236

Unquoted debt securities consist of the following:

	2010	2009
Private bonds:		
Face value	<b>₱1,271,518,279</b>	₱1,136,935,000
Unamortized discount	<b>(68,416,870)</b>	(76,288,531)
	<b>₱1,203,101,409</b>	₱1,060,646,469

These bonds bear effective interest rates ranging from 4.1% to 9.7% in 2010 and 2009.

Accounts receivable includes amounts due from officers relating to the Bank's car plan.

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

	2010		
	Corporate Lending	Consumer Lending	Total
Balance at beginning of year	<b>₱46,646,811</b>	<b>₱32,713,040</b>	<b>₱79,359,851</b>
Provision during the year	<b>34,122,881</b>	<b>51,022,119</b>	<b>85,145,000</b>
Balance at end of year	<b>₱80,769,692</b>	<b>₱83,735,159</b>	<b>₱164,504,851</b>
Individual impairment	<b>₱79,190,146</b>	<b>₱-</b>	<b>₱79,190,146</b>
Collective impairment	<b>1,579,546</b>	<b>83,735,159</b>	<b>85,314,705</b>
	<b>₱80,769,692</b>	<b>₱83,735,159</b>	<b>₱164,504,851</b>
Gross amount of loans individually determined to be impaired	<b>₱271,683,337</b>	<b>₱-</b>	<b>₱271,683,337</b>

  

	2009		
	Corporate Lending	Consumer Lending	Total
Balance at beginning of year	₱37,088,526	₱2,630,262	₱39,718,788
Provision during the year	9,558,285	30,082,778	39,641,063
Balance at end of year	₱46,646,811	₱32,713,040	₱79,359,851
Individual impairment	₱46,228,067	₱-	₱46,228,067
Collective impairment	418,744	32,713,040	33,131,784
	₱46,646,811	₱32,713,040	₱79,359,851
Gross amount of loans individually determined to be impaired	₱153,579,878	₱-	₱153,579,878

**BSP Reporting**

The following table shows information relating to loans and discounts by collateral (at gross amounts):

	2010		2009	
	Amount	%	Amount	%
Secured by:				
Real estate mortgage	<b>₱1,722,308,146</b>	<b>13.9</b>	₱1,992,586,078	22.0
Chattel mortgage	<b>2,202,311,181</b>	<b>17.8</b>	1,807,634,361	20.0
Others	<b>1,304,700,052</b>	<b>10.6</b>	2,164,619,884	24.0
	<b>5,229,319,379</b>	<b>42.3</b>	5,964,840,323	66.0
Unsecured	<b>7,133,412,098</b>	<b>57.7</b>	3,077,978,402	34.0
	<b>₱12,362,731,477</b>	<b>100.0</b>	₱9,042,818,725	100.0

As of December 31, 2010 and 2009, information on the concentration of credit (at gross amounts) as to industry follow:

	2010		2009	
	Amount	%	Amount	%
Other community, social and personal activities	<b>₱4,242,654,915</b>	<b>34.3</b>	₱2,941,622,506	32.5
Real estate	<b>2,617,691,323</b>	<b>21.2</b>	1,828,533,750	20.2
Manufacturing (various industries)	<b>1,921,775,338</b>	<b>15.5</b>	2,002,561,826	22.1
Wholesale and retail trade	<b>1,480,673,769</b>	<b>12.0</b>	991,775,031	11.0
Financial intermediaries	<b>899,348,662</b>	<b>7.3</b>	233,332,794	2.6
Transportation, storage and communication	<b>528,644,229</b>	<b>4.3</b>	229,467,216	2.5
Construction	<b>348,244,263</b>	<b>2.8</b>	265,764,800	3.0
Agricultural, hunting and forestry	<b>214,744,363</b>	<b>1.7</b>	321,500,000	3.6
Mining and quarrying	<b>70,810,802</b>	<b>0.6</b>	198,960,802	2.2
Hotel and restaurants	<b>38,143,813</b>	<b>0.3</b>	29,300,000	0.3
Total	<b>₱12,362,731,477</b>	<b>100.0</b>	₱9,042,818,725	100.0

Thrifty 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, 2010 and 2009, the Bank's NPLs not fully covered by allowance for credit losses follow:

	2010	2009
Total NPLs	<b>₱572,749,760</b>	₱303,325,069
Less NPLs classified as loss by the BSP and are fully covered by allowance for credit losses	<b>31,618,555</b>	6,118,555
	<b>₱541,131,205</b>	₱297,206,514

Restructured loans which do not meet the requirements to be treated as performing receivables are also considered as NPLs. As of December 31, 2010 the Bank's restructured loan amounted to ₱13.1 million. Interest income on these restructured receivables amounted to ₱1.1 million in 2010.

The details of interest income on loans and receivables follow:

	2010	2009
Consumer loans	<b>₱507,016,544</b>	₱445,836,796
Corporate loans	<b>522,668,750</b>	311,109,774
Unquoted debt securities	<b>56,927,001</b>	45,133,346
	<b>₱1,086,612,295</b>	₱802,079,916

Of the total loans and receivables as of December 31, 2010 and 2009, 51.69% and 73.3%, respectively, are subject to periodic interest repricing. Remaining peso-denominated loans earn annual fixed interest rates ranging from 5.0% to 24.0% in 2010 and 4.2% to 18.0% in 2009. Dollar-denominated loans are subject to quarterly interest repricing.

## 9. Business Combination

### Acquisition of Centennial Savings Bank, Inc. (CSB)

As discussed in Note 1, on March 9, 2009, the Bank entered into a Share Purchase Agreement with AFPSLAI and AFPBMAI to buy the shares of stock of CSB, a banking corporation based in the Philippines.

On August 4, 2009, the BSP approved the Bank's acquisition of CSB and approved, in principle, the following merger incentives:

1. Relocation to restricted areas of the existing two (2) branches of CSB located in Baguio and Sta. Rosa, both non-restricted areas, within a period of one (1) year from date of BSP approval of such request for relocation pursuant to Section X112 of the MORB;
2. Establishment of three (3) additional branches in restricted areas within 6 months subject to the licensing requirements under Section X151 of the MORB, provided that the Bank shall comply with the submission of application for merger; and
3. Authority of the Bank's directors and officers to exercise concurrent functions as directors and officers of CSB, except for the President/Chief Executive Officer, Chief Operating Officer and Chief Financial Officer, from date of BSP approval up to the eventual effective merger of the 2 banks or up to a period of at least 6 months from date of approval.

On August 18, 2009, the Bank completed its acquisition of 100.0% of the voting shares of CSB.

In 2009, the Bank recorded its share in the identifiable assets and liabilities of CSB using provisional fair values due to unavailability of certain information to facilitate fair value computation of branch licenses. The fair value of the branch licenses could not be finalized because the valuation depends on the BSP's final approval of the merger incentives that would allow the Bank to relocate 2 CSB branches to restricted areas as well as to establish 3 new branches also in restricted areas.

On March 29, 2010, the Bank obtained final approval of the merger and the merger incentives from the BSP.

With the final approval of the merger and merger incentives, the Bank remeasured the 2 branch licenses in non-restricted areas that will be relocated and recognized the additional 3 branch licenses in restricted areas provided by the BSP. Branch licenses for restricted areas were valued using recent market transactions while those for non-restricted areas were based on the licensing fee required to be paid under BSP Circular No. 624 in establishing branches in non-restricted areas.

The Bank finalized the purchase price allocation and the purchase price consideration has been allocated to the assets and liabilities on the basis of fair values at the date of acquisition as follows:

	Fair Values (As restated)	Provisional Values
<b>Assets</b>		
Cash and cash equivalents	<b>₱62,003,737</b>	₱62,003,737
Loans and receivables	<b>7,493,890</b>	7,493,890
Property and equipment	<b>48,105,403</b>	48,105,403
Branch licenses	<b>128,000,000</b>	48,500,000
Other assets	<b>6,002,759</b>	6,002,759
	<b>251,605,789</b>	172,105,789
<b>Liabilities</b>		
Deposit liabilities	<b>82,301,353</b>	82,301,353
Accounts payable	<b>37,904,821</b>	37,904,821
Deferred tax liabilities	<b>38,400,000</b>	-
Other liabilities	<b>2,406,581</b>	2,406,581
	<b>161,012,755</b>	122,612,755
<b>Total identifiable net assets at fair value</b>	<b>90,593,034</b>	49,493,034
<b>Goodwill (Gain on a bargain purchase)</b>	<b>(10,593,034)</b>	30,506,966
<b>Cost of business combination</b>	<b>₱80,000,000</b>	₱80,000,000

The 2009 comparative information was restated to reflect the above adjustments. The value of the branch licenses was increased by ₱79.5 million. Deferred tax liabilities amounting to ₱38.4 million were recognized from temporary differences arising from fair value measurement. Goodwill amounting to ₱30.5 million was reversed since the final purchase price allocation resulted in a gain on a bargain purchase amounting to ₱10.6 million, which is recognized under 'Gain on a bargain purchase' in the statement of income.

Cash flow on acquisition follows:

Cash and cash equivalents acquired from CSB	₱62,003,737
Cash paid	(80,000,000)
<b>Net cash outflow</b>	<b>(₱17,996,263)</b>

From the date of acquisition to December 31, 2009, CSB contributed net loss and revenue of ₱6.0 million and ₱3.9 million, respectively, to the Bank. If the combination had taken place at the beginning of the year, net loss after tax contributed by CSB would have increased by ₱52.5 million.

Other costs incurred from the acquisition such as legal, audit and other professional fees are not material.

## 10. Property and Equipment

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

	2010				Total
	Land	Building and Condominium Units	Furniture and Equipment	Leasehold Improvement	
<b>Cost</b>					
Balance at beginning of year	₱-	₱63,614,091	₱216,424,611	₱211,311,302	₱491,350,004
Additions	164,344,500	76,998,998	93,206,889	25,828,775	360,379,162
Disposal	-	-	(8,482,870)	-	(8,482,870)
Reclassification	-	34,598,694	4,409,646	(84,084,554)	(45,076,214)
Balance at end of year	164,344,500	175,211,783	305,558,276	153,055,523	798,170,082
<b>Accumulated depreciation and amortization</b>					
Balance at beginning of year	-	13,636,573	97,079,371	60,669,767	171,385,711
Depreciation and amortization	-	4,523,191	68,836,472	37,311,638	110,671,301
Disposal	-	-	(3,797,079)	-	(3,797,079)
Reclassification	-	-	634,454	(49,679,038)	(49,044,584)
Balance at end of year	-	18,159,764	162,753,218	48,302,367	229,215,349
<b>Accumulated impairment</b>					
Balance at beginning and end of year	-	2,667,217	-	-	2,667,217
<b>Net book value at end of year</b>	<b>₱164,344,500</b>	<b>₱154,384,802</b>	<b>₱142,805,058</b>	<b>₱104,753,156</b>	<b>₱566,287,516</b>

	2009				Total
	Building and Condominium Units	Furniture and Equipment	Leasehold Improvement		
<b>Cost</b>					
Balance at beginning of year	₱-	₱198,840,633	₱165,483,401		₱364,324,034
Acquired from business combination	63,614,091	-	-	-	63,614,091
Additions	-	85,426,436	49,062,125		134,488,561
Write-off	-	(4,202,159)	(3,234,224)		(7,436,383)
Reclassification	-	(63,640,299)	-		(63,640,299)
Balance at end of year	63,614,091	216,424,611	211,311,302		491,350,004
<b>Accumulated depreciation and amortization</b>					
Balance at beginning of year	-	52,954,825	24,918,637		77,873,462
Beginning balance from business combination	12,841,471	-	-		12,841,471
Depreciation and amortization	795,102	53,317,393	35,751,130		89,863,625
Write-off	-	(1,281,029)	-		(1,281,029)
Reclassification	-	(7,911,818)	-		(7,911,818)
Balance at end of year	13,636,573	97,079,371	60,669,767		171,385,711
<b>Accumulated impairment</b>					
Acquired from business combination	2,667,217	-	-		2,667,217
<b>Net book value at end of year</b>	<b>₱47,310,301</b>	<b>₱119,345,240</b>	<b>₱150,641,535</b>		<b>₱317,297,076</b>

In 2010, the Bank acquired the land and building of its head office where the Bank has an existing lease contract. The lease contract was terminated and Bank obtained the title to the property. The Bank reclassified the net book value of the head office's leasehold improvements, which pertain primarily to construction and restoration costs, to 'Building and condominium units'.

In 2009, the Bank sustained calamity losses on some of its branches during a typhoon. The Bank wrote off the damaged property and equipment and recorded calamity loss amounting to ₱6.2 million, which is included under 'Miscellaneous expense' in the statement of income (see Note 21).

As of December 31, 2010, the cost of fully depreciated assets still in use amounted to ₱20.0 million.

## 11. Investment Properties

The composition of and movements in this account follow:

	2010		Total
	Land	Land Improvements	
<b>Cost</b>			
Balance at beginning of year	₱64,914,801	₱59,790,944	₱124,705,745
Additions	36,581,744	47,181,440	83,763,184
Disposal	(31,532,800)	(33,715,736)	(65,248,536)
Balance at end of year	69,963,745	73,256,648	143,220,393
<b>Accumulated depreciation</b>			
Balance at beginning of year	-	2,256,545	2,256,545
Depreciation	-	7,292,128	7,292,128
Disposal	-	(2,343,987)	(2,343,987)
Balance at end of year	-	7,204,686	7,204,686
<b>Accumulated impairment</b>			
Impairment losses	2,254,160	5,622,148	7,876,308
<b>Net book value at end of year</b>	<b>₱67,709,585</b>	<b>₱60,429,814</b>	<b>₱128,139,399</b>

  

	2009		Total
	Land	Land Improvements	
<b>Cost</b>			
Balance at beginning of year	₱-	₱-	₱-
Additions	64,914,801	59,790,944	124,705,745
Balance at end of year	64,914,801	59,790,944	124,705,745
<b>Accumulated depreciation</b>			
Depreciation	-	2,256,545	2,256,545
Balance at end of year	-	2,256,545	2,256,545
<b>Net book value at end of year</b>	<b>₱64,914,801</b>	<b>₱57,534,399</b>	<b>₱122,449,200</b>

The Bank's investment properties include real estate properties acquired in settlement of loans and receivables. The difference between the fair value upon foreclosure and the carrying value of the loan amounting to ₱17.1 million in 2010 and ₱31.3 million in 2009 is recognized under 'Profit (loss) from assets sold or acquired' in the statement of income. The Bank is exerting efforts to dispose these properties.

The Bank capitalized direct costs pertaining to capital gains tax paid on foreclosure of investment properties amounting to ₱6.3 million in 2010 and nil in 2009. The Bank allocated the amount to the land and land improvements of the related properties and depreciated the depreciable amount over the remaining life of the properties.

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, 2010 and 2009 amounted to ₱149.4 million and ₱124.7 million, respectively, as determined by independent and/or in-house appraisers using market data approach. As of December 31, 2010 and 2009, the Bank's investment properties amounting to ₱58.3 million and ₱122.4 million, respectively, are still subject to redemption. Loss on redemption of investment properties amounting to ₱17.2 million in 2010 is included under 'Profit (loss) from assets sold or acquired' in the statement of income. There was no redemption of investment properties in 2009.

Direct operating expenses, included under 'Depreciation and amortization' in the statements of income, arising from investment properties amounted to ₱7.3 million and ₱2.3 million, in 2010 and 2009, respectively.

## 12. Branch Licenses

On January 16, 2007, the Bank purchased from BPI Family Savings Bank 14 branch licenses amounting to ₱57.5 million, including ₱5.5 million licensing fees paid to the BSP. Seven branch licenses are in restricted areas and the other 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 2010, the Bank finalized the accounting for the acquired branch licenses from CSB amounting to ₱128.0 million (see Note 9).

As of December 31, 2010 and 2009, the Bank has a total of 28 and 23 branches, respectively. Fourteen and eleven of the branches as of December 31, 2010 and 2009, respectively, are in restricted areas.

## 13. Other Assets

This account consists of:

	2010	2009
Prepaid expenses	₱34,340,373	₱33,800,526
Chattel mortgage properties	28,935,696	8,503,466
Recoverable tax payments	21,281,328	32,278,120
Refundable deposits	11,550,705	11,965,160
RCOCI	7,854,846	20,474,072
Advances to contractors	6,839,200	-
Documentary stamp tax	6,085,421	2,376,118
Deferred lease expense	4,171,351	6,415,642
Other investments	4,163,333	4,010,000
Supplies on hand	1,364,826	3,266,096
Miscellaneous	6,051,401	5,433,967
	<b>₱132,638,480</b>	<b>₱128,523,167</b>

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, allegedly representing overpaid income tax for the calendar year December 31, 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. The Bank applied ₱9.6 million, ₱4.1 million and ₱2.0 million against its income tax liabilities in 2010, 2009 and 2008, respectively. As of December 31, 2010 and 2009, recoverable tax payments also include the Bank's excess income tax payments on FCDU amounting to ₱9.9 million and ₱11.3 million, respectively, which can be claimed as tax credit against future income tax liabilities. The Bank applied ₱1.4 million in 2010 against its income tax liabilities.

Prepaid expenses include prepaid rentals and prepaid employee benefits related to the Bank's car plan for its officers.

Refundable deposits include non-interest bearing rental deposits (see Note 19). Total discount on refundable deposits as of December 31, 2010 and 2009 amounted to ₱6.4 million and ₱6.2 million, respectively. Accretion income (included under 'Interest income - deposit in banks and others' in the statements of income) recognized in 2010 and 2009 amounted to ₱0.7 million and ₱0.5 million, respectively. Refundable deposits also include deposit with the Philippine Clearing House Corporation (PCHC).

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 PCHC.

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

	2010	2009
<b>Cost</b>		
Balance at beginning of year	P9,379,502	P1,877,556
Additions	64,669,063	25,923,818
Disposals	(38,958,900)	(18,421,872)
Balance at end of year	35,089,665	9,379,502
<b>Accumulated Depreciation</b>		
Beginning Balance	876,036	-
Depreciation	7,939,555	1,840,841
Disposals	(3,368,784)	(964,805)
Balance at end of year	5,446,807	876,036
<b>Accumulated Impairment</b>		
Impairment loss	707,162	-
Balance at end of year	707,162	-
<b>Net Book Value at End of Year</b>	<b>P28,935,696</b>	<b>P8,503,466</b>

Chattel mortgage properties refer to automobiles acquired by the Bank in settlement of loans and receivables. The difference between the fair value upon foreclosure and the carrying value of the loans amounting to (P12.2 million) in 2010 and (P4.7 million) in 2009 is recognized under 'Profit (loss) from assets sold or acquired' in the statements of income. The Bank is exerting efforts to dispose these properties. Gain on sale of chattel mortgage properties amounted to P4.0 million in 2010 and P1.0 million in 2009.

#### 14. Deposit Liabilities

Under existing BSP regulations, non-FCDU deposit liabilities are subject to 2.0% liquidity reserves and 4.0% statutory reserves. The Bank is in compliance with such regulations as of December 31, 2010 and 2009.

As reported to the BSP, the available reserves as of December 31, 2010 and 2009 follow:

	2010	2009
Cash and other cash items	P625,873,173	P249,011,034
Due from BSP:		
Demand deposit account	336,104,375	404,268,650
Reserve deposit account	300,000,000	240,000,000
	<b>P1,261,977,548</b>	<b>P893,279,684</b>

Interest expense on deposit liabilities consists of:

	2010	2009
Demand	P18,541,864	P11,474,210
Savings	13,161,366	15,706,512
Time	576,064,057	516,875,306
	<b>P607,767,287</b>	<b>P544,056,028</b>

As of December 31, 2010 and 2009, total deposit liabilities subjected to periodic interest repricing is 81.0% and 79.8%, respectively. Peso-denominated deposit liabilities incur annual fixed interest rates ranging from 1.5% to 6.0% and 1.0% to 5.8% in 2010 and 2009, respectively, while dollar-denominated deposit liabilities incur interest from 1.0% to 3.5% and 1.0% to 3.4% in 2010 and 2009, respectively.

#### 15. Bills Payable

As of December 31, 2010 and 2009, bills payable consists of BSP rediscounted loans with interest rates of 4.0% in 2010 and 3.5% to 4.8% in 2009. Interest expense on bills payable amounted to P2.3 million in 2010 and P4.7 million in 2009.

#### 16. Accrued Interest, Taxes and Other Expenses

This account consists of:

	2010	2009
Accrued interest payable	P61,244,478	P59,509,050
Accrued other expenses	47,648,325	35,334,015
Retirement obligation (Note 20)	13,261,569	4,685,900
Accrued taxes	9,127,582	4,287,397
	<b>P131,281,954</b>	<b>P103,816,362</b>

Accrued other expenses include accrued expenses for utilities and adjustments for straight-lining rental expenses under PAS 17.

#### 17. Other Liabilities

This account consists of:

	2010	2009
Bills purchased - contra	P646,161,068	P3,977,516
Accounts payable	422,767,390	329,266,161
Other deferred credits	25,265,559	10,363,174
Due to PDIC	19,132,784	14,962,470
Withholding taxes payable	12,070,394	11,260,349
Payment orders payable	2,239,727	3,933,125
Miscellaneous	2,552,065	3,823,230
	<b>P1,130,188,987</b>	<b>P377,586,025</b>

As of December 31, 2010 and 2009, accounts payable includes debit cards of the Bank with available balance of P207.3 million and P142.3 million, respectively. It also includes other obligations of the Bank under open-account arrangements such as payments on loans pending liquidation, registration fees and dealer commissions put on hold and indebtedness for purchases of office supplies, printed forms, furniture, fixtures and equipment and licensing fees.

In addition, accounts payable includes the Bank's non-interest bearing liability for computer software. Such liability was initially recognized at fair value. Accretion amounted to P0.3 million in 2010 and P1.8 million in 2009, which is included under 'Interest expense on deposit liabilities, bills payable and others' in the statements of income. As of December 31, 2010 and 2009, the outstanding balance is P2.2 million and P4.6 million, respectively. The liability is due in installments until 2012.

Due to PDIC pertains to the Bank's insurance payable on deposit liabilities, which was subsequently paid in January 2011 and 2010.

Other deferred credits refer to withholding tax payable on bond premiums.

## 18. Maturity Profile of Assets and Liabilities

The following tables present the assets and liabilities as of December 31, 2010 and 2009 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:

	2010			2009		
	Within twelve months	Over twelve months	Total	Within twelve months	Over twelve months	Total
<b>Financial Assets</b>						
Cash and other cash items	<b>₱625,873,173</b>	<b>₱-</b>	<b>₱625,873,173</b>	₱249,011,034	<b>₱-</b>	₱249,011,034
Due from BSP	<b>636,104,375</b>	-	<b>636,104,375</b>	644,268,650	-	644,268,650
Due from other banks	<b>569,552,885</b>	-	<b>569,552,885</b>	1,118,677,683	-	1,118,677,683
Interbank loans receivable and SPURA with BSP	<b>1,620,000,000</b>	-	<b>1,620,000,000</b>	910,000,000	-	910,000,000
HFT securities (Note 7)	<b>1,710,685,858</b>	-	<b>1,710,685,858</b>	-	-	-
AFS investments (Note 7)	<b>2,055,493,877</b>	<b>1,619,067,006</b>	<b>3,674,560,883</b>	346,033,588	3,155,717,901	3,501,751,489
HTM investments (Note 7)	<b>819,279</b>	<b>130,070,011</b>	<b>130,889,290</b>	-	138,208,840	138,208,840
Loans and receivable - gross (Note 8)	<b>8,414,091,644</b>	<b>5,373,161,333</b>	<b>13,787,252,977</b>	5,878,817,463	4,413,662,157	10,292,479,620
Other assets (Note 13)	<b>7,854,846</b>	<b>11,550,705</b>	<b>19,405,551</b>	20,474,072	11,965,160	32,439,232
	<b>15,640,475,937</b>	<b>7,133,849,055</b>	<b>22,774,324,992</b>	9,167,282,490	7,719,554,058	16,886,836,548
<b>Nonfinancial assets</b>						
Property and equipment - cost (Note 10)	-	<b>798,170,082</b>	<b>798,170,082</b>	-	491,350,004	491,350,004
Investment properties - cost (Note 11)	-	<b>143,220,393</b>	<b>143,220,393</b>	-	124,705,745	124,705,745
Branch licenses (Note 12)	-	<b>225,390,000</b>	<b>225,390,000</b>	-	225,390,000	225,390,000
Other assets (Note 13)	<b>45,163,143</b>	<b>74,223,755</b>	<b>119,386,898</b>	-	96,959,971	96,959,971
	<b>45,163,143</b>	<b>1,241,004,230</b>	<b>1,286,167,373</b>	-	938,405,720	938,405,720
	<b>15,685,639,080</b>	<b>8,374,853,285</b>	<b>24,060,492,365</b>	9,167,282,490	8,657,959,778	17,825,242,268
Less allowance for credit and impairment losses (Notes 8, 10, 11 and 13)			<b>175,755,538</b>			82,027,068
Accumulated depreciation and amortization (Notes 10, 11 and 13)			<b>241,866,842</b>			174,518,292
Unearned discounts and capitalized interest (Note 8)			<b>5,963,284</b>			5,772,489
			<b>423,585,664</b>			262,317,849
			<b>₱23,636,906,701</b>			₱17,562,924,419
<b>Financial liabilities</b>						
Deposit liabilities:						
Demand	<b>₱1,568,760,524</b>	<b>₱1,568,760,524</b>	<b>₱3,137,521,048</b>	₱1,217,353,531	₱1,217,353,531	₱2,434,707,062
Savings	<b>431,628,148</b>	<b>431,628,148</b>	<b>863,256,296</b>	444,348,929	444,348,929	888,697,858
Time	<b>7,405,612,729</b>	<b>9,376,850,629</b>	<b>16,782,463,358</b>	8,520,087,207	3,964,520,415	12,484,607,622
	<b>9,406,001,401</b>	<b>11,377,239,301</b>	<b>20,783,240,702</b>	10,181,789,667	5,626,222,875	15,808,012,542
Manager's checks	<b>63,324,279</b>	-	<b>63,324,279</b>	79,132,385	-	79,132,385
Bills payable	<b>87,064,013</b>	-	<b>87,064,013</b>	88,525,900	-	88,525,900
Accrued interest, taxes and other expenses (Note 16)	<b>60,758,182</b>	<b>48,134,621</b>	<b>108,892,803</b>	37,573,820	57,269,245	94,843,065
Other liabilities (Note 17)	<b>1,090,300,969</b>	-	<b>1,090,300,969</b>	352,139,272	-	352,139,272
	<b>10,707,448,844</b>	<b>11,425,373,922</b>	<b>22,132,822,766</b>	10,739,161,044	5,683,492,120	16,422,653,164
<b>Nonfinancial liabilities</b>						
Deferred tax liability - net	-	<b>23,718,474</b>	<b>23,718,474</b>	-	25,732,254	25,732,254
Accrued taxes and other expenses (Note 16)	<b>9,127,582</b>	<b>13,261,569</b>	<b>22,389,151</b>	4,287,397	4,685,900	8,973,297
Income tax payable	-	-	-	-	-	-
Other liabilities (Note 17)	<b>39,888,018</b>	-	<b>39,888,018</b>	25,446,753	-	25,446,753
	<b>49,015,600</b>	<b>36,980,043</b>	<b>85,995,643</b>	29,734,150	30,418,154	60,152,304
	<b>₱10,756,464,444</b>	<b>₱11,462,353,965</b>	<b>₱22,218,818,409</b>	₱10,768,895,194	₱5,713,910,274	₱16,482,805,468

## 19. Leases

The Bank leases the premises occupied by its head office and branches for periods ranging from 5 to 12 years from the dates of contracts 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 ₱67.4 million in 2010 and ₱63.7 million in 2009. The contracts require the Bank to pay the lessors security deposits, which are noninterest-bearing and are refundable upon termination of the lease agreements.

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

	2010	2009
Within 1 year	<b>₱26,999,537</b>	₱26,999,537
More than 1 year but not more than 5 years	<b>115,147,784</b>	121,039,817
More than 5 years	<b>23,643,456</b>	44,750,961
	<b>₱165,790,777</b>	₱192,790,315

## 20. Retirement Plan

The Bank has an unfunded noncontributory defined benefit retirement plan covering all 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 as of December 31, 2010 was made on March 24, 2011.

The principal actuarial assumptions used in determining the retirement liability for the Bank's retirement plan as of December 31, 2010 and 2009 are shown below:

	2010	2009
Discount rate	<b>9.14%</b>	10.0%
Future salary increases	<b>5.0%</b>	4.2%
Average expected future years of service	<b>26.9</b>	11.0

The amounts recognized in the statements of financial position follow:

	2010	2009
Present value of retirement obligation	<b>₱19,630,301</b>	₱11,653,500
Unrecognized actuarial loss	<b>(6,368,732)</b>	(6,967,600)
Accrued retirement liability	<b>₱13,261,569</b>	₱4,685,900

The movements in the present value of retirement obligation follow:

	2010	2009
Balance at beginning of year	<b>₱11,653,500</b>	₱1,943,500
Current service cost	<b>7,195,421</b>	1,783,400
Interest cost	<b>1,165,350</b>	316,200
Actuarial loss (gain)	<b>(383,970)</b>	7,610,400
Balance at end of year	<b>₱19,630,301</b>	₱11,653,500

Actuarial loss (gain) consists of the following:

	2010	2009
Experience adjustment arising on plan liabilities	<b>(₱3,033,767)</b>	₱4,087,400
Change in assumptions	<b>2,649,797</b>	3,523,000
	<b>(₱383,970)</b>	₱7,610,400

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

	2010	2009
Current service cost	<b>₱7,195,421</b>	₱1,783,400
Interest cost	<b>1,165,350</b>	316,200
Actuarial loss (gain) recognized during the year	<b>214,898</b>	(44,800)
Retirement expense	<b>₱8,575,669</b>	₱2,054,800

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

	2010	2009
Balance at beginning of year	<b>₱4,685,900</b>	₱2,631,100
Retirement expense	<b>8,575,669</b>	2,054,800
Balance at end of year	<b>₱13,261,569</b>	₱4,685,900

Amounts for the current and previous periods follow:

	2010	2009	2008
Present value of retirement obligation	<b>₱19,630,301</b>	₱11,653,500	₱1,943,500
Experience adjustments on plan liabilities	<b>(3,033,767)</b>	4,087,400	(1,981,700)

## 21. Miscellaneous Expenses

Miscellaneous expenses consist of:

	2010	2009
Postage	<b>₱22,507,239</b>	₱15,332,981
Fees and commission	<b>20,663,738</b>	12,902,714
Litigation	<b>12,042,677</b>	12,839,145
Repairs and maintenance	<b>12,721,767</b>	9,311,197
Promotions and advertising	<b>10,626,086</b>	6,170,551
Transportation and travel	<b>9,561,835</b>	6,817,886
Stationery and supplies used	<b>8,843,365</b>	8,246,034
Management and other professional fees	<b>4,399,512</b>	2,057,520
Supervision fees	<b>4,241,227</b>	2,529,920
Membership fees and dues	<b>1,318,649</b>	604,205
Fines and penalties	<b>357,511</b>	524,163
Calamity loss (Note 10)	-	6,155,354
Others	<b>11,321,920</b>	5,211,997
	<b>₱118,605,526</b>	₱88,703,667

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

## 22. Income and Other Taxes

Provision for income tax consists of:

	2010	2009
Current:		
Final tax	<b>₱42,829,211</b>	₱41,535,893
MCIT	<b>10,100,787</b>	4,766,813
	<b>52,929,998</b>	46,302,706
Deferred	<b>(2,013,780)</b>	8,786,500
	<b>₱50,916,218</b>	₱55,089,206

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, which is a final withholding tax 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
2007	₱578,977	₱578,977	₱-	2010
2008	2,234,337	-	2,234,337	2011
2009	4,723,990	-	4,723,990	2012
2010	10,100,787	-	10,100,787	2013
	<b>₱17,638,091</b>	<b>₱578,977</b>	<b>₱17,059,114</b>	

NOLCO				
Year Incurred	Amount	Used/Expired	Balance	Expiry Year
2007	₱61,425,896	₱61,425,896	₱-	2010
2008	175,203,344	-	175,203,344	2011
2009	62,683,791	-	62,683,791	2012
	<b>₱299,313,031</b>	<b>₱61,425,896</b>	<b>₱237,887,135</b>	

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

	2010	2009
	(As restated - see Note 9)	
Deferred tax assets on:		
Allowance for credit and impairment losses	<b>₱21,454,246</b>	₱21,259,679
Unrealized loss on AFS investments (Note 7)	-	194,567
	<b>21,454,246</b>	21,454,246
Deferred tax liability on:		
Branch licenses acquired in business combination (Note 9)	<b>(38,400,000)</b>	(38,400,000)
Unrealized gain on foreclosure of acquired assets	<b>(4,887,273)</b>	(8,786,500)
Capitalization of capital gains tax	<b>(1,885,447)</b>	-
	<b>(45,172,720)</b>	(47,186,500)
	<b>(₱23,718,474)</b>	(₱25,732,254)

As of December 31, 2010 and 2009, deferred tax assets of the Bank that have not been recognized in respect of the deductible temporary differences follow:

	2010	2009
NOLCO	<b>₱237,887,135</b>	₱299,313,031
Allowance for credit and impairment losses	<b>104,241,385</b>	11,161,471
Straight-line method per PAS 17	<b>27,914,739</b>	20,827,577
Carry forward benefits of MCIT	<b>17,059,114</b>	7,537,304
Retirement liability	<b>13,261,569</b>	4,685,900
Depreciation of investment properties and chattel mortgage properties	<b>12,651,493</b>	3,132,581
	<b>₱413,015,435</b>	₱346,657,864

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

	2010	2009
Statutory income tax rate	<b>30.0%</b>	30.0%
Tax effect of:		
Changes in unrecognized deferred tax assets	<b>26.0</b>	29.0
Interest income from tax-paid and exempt	<b>(20.0)</b>	(13.2)
Nondeductible expense	<b>17.5</b>	17.6
FCDU income	<b>(12.9)</b>	(24.9)
Nontaxable income	<b>(9.2)</b>	-
Others	<b>(1.2)</b>	(0.2)
Effective income tax rate	<b>30.2%</b>	38.3%

### 23. Equity

	2010	2009	2010	2009
Common stock - ₱10 par value				
Authorized	150,000,000	100,000,000	₱1,500,000,000	₱1,000,000,000
Issued and outstanding Balance at beginning of year	100,000,000	100,000,000	1,000,000,000	1,000,000,000
Issuance	25,000,000	-	250,000,000	-
Balance at end of year	125,000,000	100,000,000	1,250,000,000	1,000,000,000

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.

### 24. 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 subsidiary and 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:

	2010	2009
Total outstanding DOSRI loans	₱6,541,189	₱39,384,398
Percent of DOSRI accounts granted under BSP Circular No. 423	0.05%	0.39%
Percent of DOSRI accounts to total loans	0.05%	0.39%
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 ₱13.2 million in 2010 and ₱10.6 million in 2009.

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

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

	2010	2009
Short-term employee benefits	₱89,902,720	₱65,744,656
Post-employment pension benefits	6,446,111	1,500,900
	₱96,348,831	₱67,245,556

### 25. Trust Operations

On May 21, 2008, the Bank was granted a license 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 ₱545.8 million and ₱165.3 million as of December 31, 2010 and 2009, respectively (see Note 26).

As of December 31, 2010 and 2009, government securities (shown under AFS investments) owned by the Bank with total face value of ₱5.0 million and ₱1.0 million respectively are deposited with the BSP in compliance with requirements of the General Banking Law relative to the Bank's trust functions.

Additionally, 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.

### 26. 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, 2010 and 2009, 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:

	2010	2009
Spot exchange	₱665,268,613	₱877,800,000
Investment management account (Note 25)	458,233,587	111,208,361
Outstanding guarantees issued - others	102,000,000	21,880,283
Trust department accounts (Note 25)	87,544,453	54,148,656
Items held in trust	83,434,826	-
Domestic letters of credit	29,452,369	487,968
Items held for safekeeping	180,334	85,947
Items held as collateral	258,829	1,182

### 27. Financial Performance

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

	2010	2009
Return on average equity	10.4%	8.0%
Return on average assets	0.6	0.6
Net interest margin on average earning assets	4.5	3.7

### 28. Approval Release of the Financial Statements

The accompanying financial statements were authorized for issue by the BOD on April 1, 2011.

## 29. Supplementary Information Required Under Revenue Regulations 15-2010

On November 25, 2010, the Bureau of Internal Revenue issued Revenue Regulations (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 2010:

### 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 2010 are as follows:

	GRT	GRT tax base
Interest income	₱60,003,542	₱1,255,119,428
Other income	15,928,000	42,325,608
	<b>₱75,931,542</b>	<b>₱1,297,445,036</b>

### Taxes and Licenses

This includes all other taxes, local and national, incurred in 2010 and lodged under the 'Taxes and licenses' account in the statement of income, as follows:

	Amount
GRT	₱75,931,542
Documentary stamp taxes	54,210,463
Fringe benefit taxes	1,769,914
Mayor's permit and real estate taxes	5,302,290
Land Transportation Office and registration	105,919
Other taxes	1,071,470
	<b>₱138,391,598</b>

Documentary stamp taxes paid relating to time deposits and additional capitalization amounted to ₱53.0 million and ₱1.2 million, respectively.

### Withholding taxes

Details of total remittances in 2010 and balances as of December 31, 2010 follow:

	Total Remittance	Balance
Withholding taxes on compensation and benefits	₱46,246,600	₱3,083,924
Expanded withholding taxes	15,610,847	1,325,467
Final withholding taxes	89,100,126	7,661,003
	<b>₱150,957,573</b>	<b>₱12,070,394</b>

### Tax Assessments and Cases

As of December 31, 2010, the Bank has no deficiency tax assessments and has no tax cases, litigation and/or prosecution in courts or bodies outside the BIR.