China Bank Savings, Inc.
(A Majority Owned Subsidiary of China Banking Corporation)

Financial Statements
December 31, 2017 and 2016
and for the years ended December 31, 2017, 2016 and 2015

and

Independent Auditor's Report

SGV
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BOA/PRC Reg. No. 0001,
December 14, 2015, valid until December 31, 2018
SEC Accreditation No. 0012-FR-4 (Group A),
November 10, 2015, valid until November 9, 2018

INDEPENDENT AUDITOR'S REPORT

The Stockholders and the Board of Directors
China Bank Savings, Inc.

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of China Bank Savings, Inc. (the Bank) (A majority-owned subsidiary of China Banking Corporation), which comprise the statements of financial position as at December 31, 2017 and 2016, and the statements of income, statements of comprehensive income, statements of changes in equity and statements of cash flows for each of the three years in the period ended December 31, 2017, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2017 and 2016, and its financial performance and its cash flows for each of the three years in the period ended December 31, 2017 in accordance with Philippine Financial Reporting Standards (PFRSs).

Basis for Opinion

We conducted our audits in accordance with Philippine Standards on Auditing (PSAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the Code of Ethics for Professional Accountants in the Philippines (Code of Ethics) together with the ethical requirements that are relevant to our audit of the financial statements in the Philippines, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. The other information comprises the information included in the SEC Form 20-IS (Definitive Information Statement), SEC Form 17-A and Annual Report for the year ended December 31, 2017, but does not include the financial statements and our auditor's report thereon. The SEC Form 20-IS (Definitive Information Statement), SEC Form 17-A and Annual Report for the year ended December 31, 2017 are expected to be made available to us after the date of this auditor's report.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audits of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audits, or otherwise appears to be materially misstated.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with PFRSs, 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.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with PSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with PSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on the Supplementary Information Required Under Revenue Regulations No. 15-2010

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information required under Revenue Regulations 15-2010 in Note 31 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 China Bank Savings, Inc. 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.

Ray Francis C. Balagtas

Ray Francis C. Balagtas
Partner
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February 14, 2018, valid until February 13, 2021
PTR No. 6621226, January 9, 2018, Makati City

March 15, 2018

CHINA BANK SAVINGS, INC.
(A Majority Owned Subsidiary of China Banking Corporation)

STATEMENTS OF FINANCIAL POSITION

	December 31	
	2017	2016
ASSETS		
Cash and Cash Equivalents (Notes 6 and 24)	**₱11,534,522,627**	₱10,876,942,004
Fair Value Through Profit and Loss Investments (Note 7)	**135,397,767**	471,016,949
Available-for-Sale Financial Assets (Notes 7 and 23)	**2,220,626,084**	2,146,737,715
Held-to-Maturity Financial Assets (Notes 7 and 23)	**3,502,817,726**	3,335,822,563
Loans and Receivables (Notes 8 and 24)	**63,144,324,080**	58,232,815,802
Non-current Assets Held for Sale (Note 9)	**212,031,191**	225,139,735
Property and Equipment (Note 10)	**1,248,751,066**	1,200,170,434
Investment Properties (Note 11)	**3,157,145,538**	3,209,192,907
Branch Licenses (Note 12)	**74,480,000**	74,480,000
Software Costs (Note 12)	**73,437,992**	77,034,023
Deferred Tax Asset (Note 22)	**338,324,894**	29,156,264
Other Assets (Notes 13 and 24)	**1,536,077,212**	1,371,927,152
	₱87,177,936,177	₱81,250,435,548
LIABILITIES AND EQUITY		
Liabilities		
Deposit Liabilities (Notes 15 and 24)		
Demand	**₱15,589,330,155**	₱13,094,377,769
Savings	**9,351,070,190**	9,081,655,844
Time	**51,496,682,275**	49,391,254,679
	76,437,082,620	71,567,288,292
Manager's Checks	**731,802,306**	584,201,621
Accrued Interest and Other Expenses (Note 16)	**266,842,282**	279,852,427
Income Tax Payable	**292,940**	–
Other Liabilities (Notes 16 and 24)	**1,375,852,104**	984,627,578
	78,811,872,252	73,415,969,918
Equity		
Capital stock (Note 18)	**10,043,579,100**	7,402,164,200
Additional paid-in capital (Note 18)	**490,049,814**	495,643,582
Deposit for stock subscription (Notes 18 and 24)	**–**	2,647,942,142
Other equity reserves (Note 29)	**(2,248,520,637)**	(2,248,520,637)
Surplus reserves (Notes 18 and 23)	**22,764,290**	22,585,422
Surplus (deficit) (Notes 18 and 23)	**242,276,780**	(259,086,569)
Remeasurement losses on retirement liability (Note 20)	**(66,964,439)**	(86,259,094)
Net unrealized losses on available-for-sale financial assets (Note 7)	**(132,516,533)**	(157,713,132)
Cumulative translation adjustment	**15,395,550**	17,709,716
	8,366,063,925	7,834,465,630
	₱87,177,936,177	₱81,250,435,548

See accompanying Notes to Financial Statements.

CHINA BANK SAVINGS, INC.
(A Majority Owned Subsidiary of China Banking Corporation)
STATEMENTS OF INCOME

	Years Ended December 31		
	2017	2016	2015
INTEREST INCOME			
Loans and receivables (Notes 8 and 24)	**₱4,269,523,330**	₱3,825,506,373	₱1,443,458,753
Investment securities (Note 7)	**262,808,362**	212,401,581	55,863,658
Interbank loans receivable and securities purchased under resale agreements (Note 6)	**91,952,398**	37,994,899	–
Due from Bangko Sentral ng Pilipinas and other banks (Notes 6 and 24)	**14,087,651**	64,555,954	35,524,560
	4,638,371,741	4,140,458,807	1,534,846,971
INTEREST EXPENSE			
Deposit liabilities (Notes 15 and 24)	**1,311,815,042**	1,205,860,728	425,528,702
Bills payable	**–**	10,917,524	–
	1,311,815,042	1,216,778,252	425,528,702
NET INTEREST INCOME	**3,326,556,699**	2,923,680,555	1,109,318,269
Service charges, fees and commissions	**239,452,223**	268,968,398	90,471,735
Gain (loss) on asset exchange (Note 9)	**120,530,783**	121,408,146	(24,467,051)
Trading and securities gains - net (Notes 7 and 24)	**68,871,922**	89,296,487	19,149,033
Income from property rentals (Notes 11, 21 and 24)	**27,847,995**	24,599,679	23,910,158
Trust fee income (Note 23)	**4,365,005**	4,288,480	3,988,465
Miscellaneous (Notes 13 and 19)	**86,189,578**	80,535,319	9,317,320
TOTAL OPERATING INCOME	**3,873,814,205**	3,512,777,064	1,231,687,929
Compensation and fringe benefits (Notes 20 and 24)	**1,167,316,193**	1,060,508,535	365,540,884
Depreciation and amortization (Note 10)	**345,824,017**	326,229,128	186,366,241
Provision for impairment and credit losses (Note 14)	**295,680,313**	305,000,666	292,558,154
Occupancy costs (Note 21)	**259,647,476**	246,382,130	139,689,904
Security, clerical, messengerial and janitorial	**254,444,223**	253,268,183	102,874,543
Taxes and licenses	**223,349,751**	222,971,604	78,513,991
Documentary stamp taxes	**198,543,153**	173,288,962	48,586,887
Insurance	**195,971,231**	170,572,121	70,810,538
Acquired asset and other litigation expense	**171,657,363**	93,038,714	7,477,876
Transportation and travel	**91,703,285**	82,338,949	29,939,856
Utilities	**88,691,492**	89,079,470	43,623,960
Entertainment, amusement and recreation (Note 22)	**86,039,178**	87,792,311	27,552,742
Stationery, supplies and postage	**36,402,353**	27,855,528	7,262,578
Data processing and information technology	**30,242,093**	52,177,381	11,895,569
Management and other professional fees	**11,844,995**	21,207,906	11,762,373
Miscellaneous (Notes 11 and 19)	**165,148,841**	149,341,960	33,098,809
TOTAL OPERATING EXPENSES	**3,622,505,957**	3,361,053,548	1,457,554,905
INCOME (LOSS) BEFORE INCOME TAX	**251,308,248**	151,723,516	(225,866,976)
PROVISION FOR (BENEFIT FROM) INCOME TAX (Note 22)	**(250,233,969)**	(81,810,726)	37,342,856
NET INCOME (LOSS)	**₱501,542,217**	₱233,534,242	(₱263,209,832)

See accompanying Notes to Financial Statements.

CHINA BANK SAVINGS, INC.
(A Majority Owned Subsidiary of China Banking Corporation)

STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31		
	2017	2016	2015
NET INCOME (LOSS)	**₱501,542,217**	₱233,534,242	(₱263,209,832)
OTHER COMPREHENSIVE INCOME (LOSS)			
Items that recycle to profit or loss in subsequent periods:			
Changes in net unrealized losses on available-for-sale financial assets (Note 7)	**25,196,599**	(133,786,521)	(14,479,742)
Cumulative translation adjustment	**(2,314,166)**	27,350,859	–
Items that do not recycle to profit or loss in subsequent periods:			
Remeasurement gain (loss) on retirement liability (Note 20)	**19,294,655**	(68,467,785)	39,852,078
	42,177,088	(174,903,447)	25,372,336
TOTAL COMPREHENSIVE INCOME (LOSS)	**₱543,719,305**	₱58,630,795	(₱237,837,496)

See accompanying Notes to Financial Statements.

CHINA BANK SAVINGS, INC.
(A Majority Owned Subsidiary of China Banking Corporation)
STATEMENTS OF CHANGES IN EQUITY

	Capital Stock (Note 18)	Additional Paid-in Capital (Note 18)	Deposit for Stock Subscription (Notes 18 and 24)	Other Equity Reserves (Note 29)	Surplus Reserves (Notes 18 and 23)	Surplus (Deficit) (Notes 18 and 23)	Remeasurement Losses on Retirement Liability (Note 20)	Net Unrealized Losses on Available-for-Sale Financial Assets (Note 7)	Cumulative Translation Adjustment	Total Equity
Balance at January 1, 2017	**₱7,402,164,200**	**₱495,643,582**	**₱2,647,942,142**	**(₱2,248,520,637)**	**₱22,585,422**	**(₱259,086,569)**	**(₱86,259,094)**	**(₱157,713,132)**	**₱17,709,716**	**₱7,834,465,630**
Application of deposit for future stock subscription to issued shares (Notes 18 and 24)	**2,641,414,900**	**(5,593,768)**	**(2,647,942,142)**	–	–	–	–	–	–	**(12,121,010)**
Total comprehensive income (loss) for the year	–	–	–	–	–	**501,542,217**	**19,294,655**	**25,196,599**	**(2,314,166)**	**543,719,305**
Transfer to surplus reserve	–	–	–	–	**178,868**	**(178,868)**	–	–	–	–
Balance at December 31, 2017	**₱10,043,579,100**	**₱490,049,814**	**₱–**	**(₱2,248,520,637)**	**₱22,764,290**	**₱242,276,780**	**(₱66,964,439)**	**(₱132,516,533)**	**₱15,395,550**	**₱8,366,063,925**
Balance at January 1, 2016	₱3,707,812,400	₱363,320,342	₱4,012,500,000	(₱2,248,520,637)	₱22,002,127	(₱492,037,516)	(₱17,791,309)	(₱23,926,611)	(₱9,641,143)	₱5,313,717,653
Application of deposit for future stock subscription to issued shares (Notes 18 and 24)	3,694,351,800	132,323,240	(3,864,557,858)	–	–	–	–	–	–	(37,882,818)
Deposit for future stock subscription (Note 18)	–	–	2,500,000,000	–	–	–	–	–	–	2,500,000,000
Total comprehensive income (loss) for the year	–	–	–	–	–	233,534,242	(68,467,785)	(133,786,521)	27,350,859	58,630,795
Transfer to surplus reserve	–	–	–	–	583,295	(583,295)	–	–	–	–
Balance at December 31, 2016	₱7,402,164,200	₱495,643,582	₱2,647,942,142	(₱2,248,520,637)	₱22,585,422	(₱259,086,569)	(₱86,259,094)	(₱157,713,132)	₱17,709,716	₱7,834,465,630
Balance at January 1, 2015	₱2,057,703,100	₱363,320,342	₱–	(₱303,957,448)	₱8,062,667	(₱228,827,684)	(₱24,013,450)	(₱9,636,153)	₱–	₱1,862,651,374
Reclassification of deposit for stock subscription to equity	–	–	312,500,000	–	–	–	–	–	–	312,500,000
Proceeds from stock subscription	–	–	2,000,000,000	–	–	–	–	–	–	2,000,000,000
Effect of merger (Note 29)	1,650,109,300	–	1,700,000,000	(1,944,563,189)	13,939,460	–	(33,629,937)	189,284	(9,641,143)	1,376,403,775
Total comprehensive income (loss) for the year	–	–	–	–	–	(263,209,832)	39,852,078	(14,479,742)	–	(237,837,496)
Balance at December 31, 2015	₱3,707,812,400	₱363,320,342	₱4,012,500,000	(₱2,248,520,637)	₱22,002,127	(₱492,037,516)	(₱17,791,309)	(₱23,926,611)	(₱9,641,143)	₱5,313,717,653

See accompanying Notes to Financial Statements.

CHINA BANK SAVINGS, INC.
(A Majority Owned Subsidiary of China Banking Corporation)

STATEMENTS OF CASH FLOWS

	Years Ended December 31		
	2017	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES			
Income (loss) before income tax	**₱251,308,248**	₱151,723,515	(₱225,866,976)
Adjustments for:			
Depreciation and amortization (Note 10)	**345,824,017**	326,229,128	186,366,241
Provision for impairment and credit losses (Note 14)	**295,680,313**	305,000,666	292,558,154
Loss (gain) on asset exchange (Note 9)	**(120,530,783)**	(121,408,146)	24,467,051
Realized trading gain on available-for-sale financial assets (Note 7)	**(63,355,179)**	(61,119,743)	(9,080,459)
Amortization of premium on investment securities	**47,877,645**	72,261,607	3,698,523
Amortization of unrealized loss on held-to-maturity financial assets reclassified from available-for-sale financial assets (Note 7)	**3,267,094**	471,298	–
Unrealized mark-to-market losses (gains) on fair value through profit or loss investments (Note 7)	**1,646,852**	(1,307,647)	733,991
Write-off of non-financial asset (Note 10)	**–**	10,743,845	2,024,745
Changes in operating assets and liabilities:			
Decrease (increase) in the amounts of:			
Loans and receivables	**(6,053,432,776)**	(8,373,484,271)	(1,472,877,384)
Fair value through profit and loss investments	**333,950,906**	283,866,837	(87,138,248)
Other assets (Notes 13 and 27)	**(254,786,332)**	(288,390,865)	(129,150,320)
Increase (decrease) in the amounts of:			
Deposit liabilities	**4,847,465,600**	5,183,739,638	3,972,041,224
Manager's checks	**147,600,685**	(87,696,522)	64,926,979
Accrued interest and other expenses	**(13,010,145)**	43,310,446	(20,745,970)
Other liabilities (Notes 16 and 27)	**415,581,452**	29,109,297	178,658,217
Net cash generated from (used in) operations	**185,087,597**	(2,526,950,917)	2,780,615,768
Income tax paid (Notes 22 and 27)	**(58,641,721)**	(56,176,004)	(16,267,700)
Net cash provided by (used in) operating activities	**126,445,876**	(2,583,126,921)	2,764,348,068
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisitions of:			
Available-for-sale financial assets	**(1,034,304,528)**	(2,923,590,088)	(1,459,560,008)
Property and equipment (Note 10)	**(343,660,006)**	(270,049,299)	(77,328,235)
Held-to-maturity financial assets	**(188,875,689)**	(480,256,847)	(81,741,912)
Software costs (Note 12)	**(16,544,421)**	(22,786,398)	(14,083,153)
Proceeds from sale of:			
Available-for-sale financial assets	**848,582,682**	1,785,042,827	718,432,186
Investment properties (Notes 9 and 11)	**547,300,236**	371,480,710	908,000
Non-current assets held for sale (Note 9)	**484,618,905**	110,631,995	137,253,527
Proceeds from disposal of property and equipment (Note 10)	**57,701,286**	–	–
Proceeds from maturity of:			
Available-for-sale financial assets	**170,250,000**	–	–
Held-to-maturity financial assets	**9,000,000**	80,909,497	–
Cash and cash equivalents acquired from merger (Note 29)	**–**	–	6,199,302,250
Net cash provided by (used in) investing activities	**534,068,465**	(1,348,617,603)	5,423,182,655

(Forward)

	Years Ended December 31		
	2017	2016	2015
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from capital infusion (Notes 18 and 24)	**₱–**	₱2,500,000,000	₱2,000,000,000
Settlement of bills payable	**–**	(662,530,655)	–
Net cash provided by financing activities	**–**	1,837,469,345	2,000,000,000
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENT	**(2,933,718)**	27,350,859	–
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**657,580,623**	(2,066,924,320)	10,187,530,723
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**10,876,942,004**	12,943,866,324	2,756,335,601
CASH AND CASH EQUIVALENTS AT END OF YEAR	**₱11,534,522,627**	₱10,876,942,004	₱12,943,866,324

OPERATIONAL CASH FLOWS FROM INTEREST			
Interest received	**₱4,421,272,502**	₱4,012,626,173	₱1,474,536,150
Interest paid	**1,294,064,555**	1,219,328,394	421,774,136

See accompanying Notes to Financial Statements.

1. Corporate Information

China Bank Savings, Inc. (the Bank or CBS) reopened to the public on June 26, 1999 as a thrift bank in accordance with the Monetary Board (MB) Resolution No. 512 dated April 21, 1999. Under MB Resolution No. 512, the Bank was allowed to reopen its 72 branches as provided in the Bank's operating plan.

In 2007, China Banking Corporation (the Parent Bank or CBC) acquired the majority shareholdings of the Bank. Following the change in its majority owners, the Bank continues to operate as a thrift bank. In 2008, the Bank transferred its other existing branches and unused branch licenses to CBC to improve cost efficiency and branch networking. As of December 31, 2017 and 2016, the Bank has 160 and 150 branches, respectively.

The Bank's original Certificate of Incorporation was issued by the Philippine Securities and Exchange Commission (SEC) on May 23, 1960. On August 20, 2009, the Board of Directors (BOD) approved the amendment of the Bank's Articles of Incorporation to extend its corporate term for another fifty (50) years, from and after May 23, 2010, the end of the original term of the Bank's corporate existence. The amendment to the Articles of Incorporation to extend the Bank's corporate term was subsequently approved by the stockholders of the Bank, who own/represent at least two thirds (2/3) of the outstanding capital stock, at the Annual Stockholders' Meeting held in October 2009. The Amended Articles of Incorporation was approved by the SEC on March 25, 2010.

As of December 31, 2017 and 2016, CBC, the ultimate parent company, has ownership interest in the Bank of 99.22% and 98.29%, respectively.

The registered office address of the Bank is at CBS Building, 314 Sen. Gil Puyat Avenue, Makati City.

<u>Merger between the Bank and Unity Bank, A Rural Bank Inc.</u>
The BOD of the Bank and Unity Bank, A Rural Bank, Inc. (Unity Bank), in their meetings held last June 6, 2013 and June 11, 2013, respectively, approved the proposed merger with Unity Bank, with the Bank as the surviving entity. The Plan of Merger was approved by the stockholders of both banks in their meetings held on July 18, 2013 and July 19, 2013, respectively. Unity Bank is 99.95% owned by CBC, having acquired the former on November 20, 2012 under the Strengthening Program for Rural Banks (SPRB) Plus of the Bangko Sentral ng Pilipinas (BSP).

On December 10, 2013, the BSP approved the issuance of Certificate of Authority to register the approved Plan of Merger and Articles of Merger of the Bank and Unity Bank. Thereafter, on January 20, 2014, the SEC formally issued the Certificate of the Filing of Articles and Plan of Merger by and between the Bank (surviving corporation) and Unity Bank (absorbed corporation).

The merger was effected via a share-for-share exchange (Note 29).

<u>Merger between the Bank and Planters Development Bank (PDB)</u>
On June 26, 2014, the BOD of both the Bank and Planters Development Bank (PDB) approved the Plan and Articles of Merger of the Bank and PDB, with the former as the surviving entity. PDB is a 99.85% owned subsidiary of CBC. The stockholders of both PDB and the Bank approved, ratified

and confirmed the Plan and Articles of Merger on August 14, 2014. An amended Plan of Merger was approved by the BOD of both banks on January 29, 2015.

On August 19, 2015 and December 17, 2015, the MB of the BSP and the SEC approved the merger, respectively.

The salient provisions of the Articles of Merger are as follows:
a. Upon the effectivity date of the merger, PDB shall be merged with and into the Bank. The separate and distinct existence of PDB shall cease and terminate upon the effective date of merger.
b. The Bank shall be the surviving corporation.
c. As of the effective date, all common and preferred shares of PDB shall be converted into fully paid China Bank Savings common shares totaling to 16.5 million shares (see Note 29).

2. Accounting Policies

Basis of Preparation
The accompanying financial statements have been prepared on a historical cost basis except for fair value through profit or loss (FVPL) investments and available-for-sale (AFS) financial assets that have been measured at fair value and non-current assets held for sale (NCAHS) that have been measured at the lower of their carrying amount and fair value less cost to sell. All values are rounded to the nearest peso unless otherwise stated.

The accompanying financial statements of the Bank include the accounts maintained in the Regular Banking Unit (RBU) and Foreign Currency Deposit Unit (FCDU). The functional currency of the RBU and the FCDU is the Philippine peso and the 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 and transactions.

Statement of Compliance
The financial statements of the Bank have been prepared in accordance with Philippine Financial Reporting Standards (PFRSs).

Presentation of Financial Statements
The Bank presents its statement of financial position in order of liquidity. An analysis regarding recovery of assets or settlement of liabilities within twelve (12) months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in Note 17.

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position only when there is a legally enforceable right to offset the recognized amounts and there is intention to settle on a net basis, or to realize the assets and settle the liability simultaneously. The Bank assesses that it has a currently enforceable right of offset if the right is not contingent on a future event, and is legally enforceable in the normal course of business, event of default, and event of insolvency or bankruptcy of the Bank and all of the counterparties.

Income and expense are not offset in the statement of income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Bank.

Consolidation
Consolidated financial statements are prepared for the same reporting year as the parent company's using consistent accounting policies. All significant intra-group balances, transactions and income and expenses resulting from intra-group transactions are eliminated in full. Subsidiaries are consolidated from the date on which control is transferred to the parent company.

Principles of control are discussed under the accounting policy on investment in subsidiary. The subsidiaries are immaterial to the financial statements, hence the Bank did not prepare the consolidated financial statements.

Changes in Accounting Policies and Disclosures
The accounting policies adopted are consistent with those of the previous financial year, except for the following new, amendments and improvements to PFRSs and Philippine Accounting Standards (PAS) which became effective as of January 1, 2017. The adoption of the amended standards and annual improvements did not have any significant impact on the financial position or performance of the Bank.

New and Amended Standards
- PAS 7, *Statement of Cash Flows, Disclosure Initiative* (Amendments)
- PAS 12, *Income Taxes, Recognition of Deferred Tax Assets for Unrealized Losses* (Amendments)

Annual Improvements to PFRSs (2014 - 2016 Cycle)
- PFRS 12, *Clarification of the Scope of the Standard* (Amendments)

Significant Accounting Policies

Common Control Business Combinations
Where there are business combinations involving entities that are ultimately controlled by the same ultimate parent before and after the business combination and that the control is not transitory ("business combinations under common control"), the Bank accounts for such business combinations using pooling of interest method.

In applying the pooling of interest method, the Bank follows Philippine Interpretations Committee (PIC) Q&A No. 2012-01, *PFRS 3.2 Application of the Pooling of Interest Method for Business Combinations of Entities under Common Control in Consolidated Financial Statements*, which provides the following guidance:

- The assets and liabilities of the combining entities are reflected in the consolidated financial statements at their carrying amounts. No adjustments are made to reflect fair values, or recognize any new assets or liabilities, at the date of the combination. The only adjustments that are made are those adjustments to harmonize accounting policies.
- No new goodwill is recognized as a result of the combination. The only goodwill that is recognized is any existing goodwill relating to either of the combining entities. Any difference between the consideration paid or transferred and the equity acquired is reflected within equity as additional paid-in capital, i.e., either as contribution or distribution of equity.
- An entity has an option for restatement or non-restatement of financial information in the consolidated financial statements for the periods prior to the date of business combination.

In applying the above guidance, the Bank made the accounting policy choice of:

- Recognizing the assets acquired and liabilities assumed from the absorbed entity based on their respective carrying values as reported in the financial statements of the absorbed entity as of merger date and adjusted to harmonize with the accounting recognition and measurement policies of the Bank.
- Not restating the consolidated financial statements of the Bank for presentation of the merged balances for periods prior to the merger date.
- Recognizing equity reserves of the absorbed entity such as those arising from the remeasurement of AFS financial assets, retirement liability and cumulative translation adjustment, based on amounts reflected in the financial statements of the absorbed entity on merger date.

Accordingly, in 2015 and 2014, the income and expenses of PDB and Unity Bank, respectively, were directly closed against other equity reserves upon merger with CBS.

Foreign Currency Translation

RBU
As of reporting date, foreign currency-denominated monetary assets and monetary liabilities in the RBU are translated in Philippine peso based on the Philippine Dealing System (PDS) closing rate prevailing at end of year and foreign currency-denominated income and expenses based on the yearly PDS weighted average rate (PDSWAR). Foreign exchange differences arising from the restatement of foreign currency-denominated assets and liabilities in the RBU are credited to or charged against statement of income 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 of 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
As of reporting date, the assets and liabilities of the FCDU are translated into the Bank's presentation currency (the Philippine peso) at the PDS closing rate prevailing at the reporting date and its income and expenses are translated at PDSWAR for the year. Exchange differences arising on translation are taken directly to the statement of comprehensive income as 'Cumulative translation adjustment'. Upon actual remittance or transfer of the FCDU income to RBU, the related exchange difference arising from translation lodged under 'Cumulative translation adjustment' is recognized in the statement of income of the RBU books.

Fair Value Measurement
The Bank measures financial instruments, such as FVPL investments and AFS financial assets, at fair value at each reporting date. The fair values of financial instruments measured at amortized cost (or cost) and nonfinancial assets are disclosed in Note 4.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- in the principal market for the asset or liability, or
- in the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible to by the Bank. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

If a financial instrument measured at fair value has a bid price and an ask price, the price within bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value regardless of where the input is categorized within the fair value hierarchy.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 - Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

For assets and liabilities that are recognized in the financial statements on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

For purposes of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and fair value hierarchy as explained above.

<u>Cash and Cash Equivalents</u>
For purposes of reporting cash flows, cash and cash equivalents include cash and other cash items, due from BSP and other banks, and securities purchased under resale agreements (SPURA) that are convertible to known amounts of cash and which have original maturities of three months or less from dates of placements and that are subject to an insignificant risk of changes in value.

Due from BSP includes the statutory reserves required by the BSP which the Bank considers as cash equivalents wherein withdrawals can be made to meet the Bank's cash requirements as allowed by the BSP.

<u>SPURA</u>
The Bank enters into short-term purchases of securities under resale agreements of identical securities with the BSP. Resale agreements are contracts under which a party purchases securities and resells such securities to the same selling party at a specified future date at a fixed price. The amount of advances made under resale agreements are carried as SPURA in the statement of financial position. SPURA are carried at cost. Interest earned on resale agreements is reported as 'Interest income' in the statement of income.

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 settlement date. 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 such asset is delivered by the Bank. Deposits, amounts due from banks and customers and loans and receivables are recognized when cash is received by the Bank or advanced to the borrowers.

Initial recognition of financial instruments

Financial instruments are initially recognized at fair value. Except for financial assets and financial liabilities at FVPL, the initial measurement of financial instruments includes transaction costs. The Bank classifies its financial assets in the following categories: FVPL investments, held-to-maturity (HTM) financial assets, AFS financial assets, and loans and receivables while financial liabilities are classified as financial liabilities at FVPL and financial liabilities carried at amortized cost. The classification depends on the purpose for which the financial instruments were acquired and whether they are quoted in an active market. Management determines the classification of its financial instruments at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

'Day 1' difference

Where the transaction price in a non-active market is different from the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Bank recognizes the difference between the transaction price and the 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 the transaction price used is made of data which is not observable, the difference between the transaction price and model value is only recognized in the statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Bank determines the appropriate method of recognizing the 'Day 1' difference amount.

Financial assets and financial liabilities at FVPL

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

Financial instruments held for trading

Financial instruments held for trading (HFT) include government debt securities purchased and held principally with the intention of selling them in the near term.

These securities are carried at fair value, and the realized and unrealized gains and losses on these instruments are recognized as 'Trading and securities gains' in the statement of income. Interest earned or incurred on financial instruments held for trading is reported in the statement of income under 'Interest income' (for financial assets) and 'Interest expense' (for financial liabilities).

As of December 31, 2017 and 2016, all FVPL investments of the Bank are classified as HFT and consist of government debt securities.

HTM financial assets
HTM financial assets 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. Where the Bank would sell other than an insignificant amount of HTM financial assets, the entire category would be tainted and reclassified as AFS financial assets and the Bank would be prohibited from classifying any financial asset under HTM category during the current year and two succeeding years thereafter unless for sales or reclassifications that:

- are so close to maturity or the financial asset's call date (for example, less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;
- occur after the entity has collected substantially all of the financial asset's original principal through scheduled payments or prepayments; or
- are attributable to an isolated event that is beyond the entity's control, is non-recurring and could not have been reasonably anticipated by the entity.

After initial measurement, these investments are subsequently measured 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 effective interest rate (EIR). The amortization is included in 'Interest income' in the statement of income. Gains and losses are recognized in income when the HTM financial assets are derecognized and impaired, as well as through the amortization process. The losses arising from impairment of such investments are recognized in the statement of income under 'Provision for impairment and credit losses'. The effects of translation of foreign currency-denominated HTM financial assets are recognized in other comprehensive income (OCI). As of December 31, 2017 and 2016, this account consists of government and private debt securities.

Loans and receivables
This accounting policy relates to 'Due from BSP, 'Due from other banks', and 'SPURA' accounts reported under 'Cash and cash equivalents', 'Loans and receivables', and financial assets reported under 'Other assets'.

Loans and receivables are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market other than:

- those that the Bank intends to sell immediately or in the near term and those that the Bank upon initial recognition designates as at FVPL;
- those that the Bank, upon initial recognition, designates as AFS financial assets; or
- those for which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration.

After initial recognition, loans and receivables are subsequently measured at cost (or amortized cost) using the effective interest method, less allowance for impairment and 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 under 'Interest income' in the statement of income. The losses arising from impairment are recognized under 'Provision for impairment and credit losses' in the statement of income.

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

After initial measurement, AFS financial assets are subsequently measured at fair value. The effective yield component of AFS debt securities, as well as the impact of translation of foreign currency-denominated AFS debt securities, is reported in the statement of income. The unrealized gains and losses arising from the fair valuation of AFS financial assets are excluded, net of tax, from reported earnings and are included in 'Net unrealized losses on AFS financial assets' under OCI.

When the security is disposed of, the cumulative gain or loss previously recognized in OCI is recognized in 'Trading and securities gains' 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 specific identification basis. Interest earned on holding AFS debt securities are reported as 'Interest income' using the EIR. Dividends earned on holding AFS equity securities are recognized in the statement of income as 'Miscellaneous income' when the right to receive the payment has been established. The losses arising from impairment of such investments are recognized as 'Provision for impairment and credit losses' in the statement of income.

Other financial liabilities
This accounting policy relates to the statement of financial position captions 'Deposit liabilities', 'Manager's checks', 'Accrued interest and other expenses' and financial liabilities under 'Other liabilities'. These are issued financial instruments or their components which are not designated as at FVPL and 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. The components of issued financial instruments that contain both liability and equity elements are accounted for separately, with the equity component being assigned the residual amount after deducting from the instrument as a whole the amount separately determined as the fair value of the liability component on the date of issue.

After initial measurement, other financial liabilities not qualified and not designated as 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 rare circumstances, non-derivative financial assets out of the HFT investments category and into the AFS financial assets, Loans and receivables or HTM financial assets categories. The Bank may also reclassify, in certain circumstances, financial instruments out of the AFS financial assets to loans and receivables category. Reclassifications of financial assets carried at fair value 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 HFT investments and into the Loans and Receivable category if it meets the definition of loans and receivables, the Bank has the intention and ability to hold the financial assets for the foreseeable future or until maturity and only in rare circumstances. 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 financial assets category, any previous gain or loss on that asset that has been recognized in OCI 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 cash flows is also amortized over the remaining life of the asset using the effective interest method. If the asset is subsequently determined to be impaired then the amount recorded in OCI 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. An analysis of reclassified financial assets is disclosed in Note 7.

Derecognition of Financial Assets and Financial Liabilities

Financial assets

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

- The rights to receive cash flows from the asset have expired; or
- the Bank retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a “pass-through” arrangement; or
- the Bank has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained the risks and rewards of the asset but has transferred 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. In that case, the Bank also recognizes an associated liability. The transferred asset and associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

The transfer of risks and rewards is evaluated by comparing the Bank’s exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. The Bank has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer (e.g., because the entity has sold a financial asset subject to an agreement to buy it back at a fixed price or the sole price plus a lender’s return). The Bank has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset (e.g., because the entity has sold a financial asset subject only to an option to buy it back at its fair value at the time of repurchase or has transferred fully proportionate share of the cash flows from a larger financial asset in an agreement).

Whether the Bank has retained control of the transferred asset depends on the transferee’s ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control.

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 existing liability are substantially modified, such an exchange or modification is treated as 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.

Impairment of Financial Assets
The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Financial assets carried at amortized cost
For financial assets carried at amortized cost, which include 'Due from BSP', 'Due from other banks', 'SPURA', 'Loans and receivables', 'HTM financial assets' and financial assets recorded under 'Other assets', the Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If there is objective evidence that an impairment loss has been incurred, the amount of loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred). The present value of the estimated future cash flows is discounted at the financial asset's original EIR.

If a financial asset carried at amortized cost has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR, adjusted for the original credit risk premium. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. The carrying amount of the asset is reduced through the use of an allowance account and the amount of loss is charged to the statement of income under 'provision for impairment and credit losses'. Interest income continues to be recognized based on the original EIR of the asset. The financial assets, 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 the Bank determines that no objective evidence of impairment exists for individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses for impairment. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. 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 for impairment.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of such credit risk characteristics as industry, collateral type, past-due status and term. Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for 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 that did not affect the period 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 period to period (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the Bank and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is reduced by adjusting the allowance account. If a previous write-off is later recovered, any amount formerly charged is credited to 'Miscellaneous income' in the statement of income.

Financial assets carried at cost
If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, the amount of loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

AFS financial assets
For AFS financial assets, the Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. In the case of equity investments classified as AFS financial assets, this would include:

- A 'significant' or 'prolonged' decline in the fair value of the investments below its cost; and /or
- other information about the issuer that may negatively affect an equity issuer's performance

The Bank treats 'significant' generally as 20.00% and 'prolonged' generally as greater than one year. Where there is evidence of impairment, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the statement of income, is removed from the statement of comprehensive income and recognized in the statement of income.

Impairment losses on equity securities are not reversed through the statement of income. Increases in fair value after impairment are recognized directly in the statement of comprehensive income.

In the case of debt securities classified as AFS financial assets, impairment is assessed 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 previously recognized in profit or loss. 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 the subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the statement of income, the impairment loss is reversed through 'Miscellaneous income' in the statement of income.

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 past due. Management continuously reviews restructured loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original EIR. The difference between the recorded value of the original loan and the present value of the restructured cash flows, discounted at the original EIR, is recognized in 'Provision for impairment and credit losses' in the statement of income.
If modifications are substantial, the loan is derecognized as explained in the accounting policy for derecogniton of financial assets.

NCAHS
NCAHS include repossessed vehicles acquired in settlement of loans and receivable. The Bank classifies non-current assets as held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use.

NCAHS are measured at the lower of their carrying amount and fair value less costs to sell and are no longer depreciated or amortized. The criteria for NCAHS classification is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition.

Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

If the Bank decides to use an asset as property and equipment, the related asset ceases to qualify as NCAHS and is reclassified to property and equipment.

Upon reclassification, the Bank measures a non-current asset that ceases to be classified as held for sale at the lower of:

- its carrying amount before the asset was classified as held for sale, adjusted for any depreciation, amortization or revaluation that would have been recognized had the asset not been classified as held for sale, and
- its recoverable amount at the date of the subsequent reclassification.

Property and Equipment
Land is stated at cost less any impairment in value while depreciable properties including buildings and furniture, fixture and equipment are stated at cost less accumulated depreciation and amortization, and any impairment in value. Such cost includes the cost of replacing part of the property and equipment when that cost is incurred and if the recognition criteria are met, but excluding repairs and maintenance costs. Leasehold rights and improvements are stated at its net carrying amount after directly deducting amortization.

Depreciation and amortization is calculated using the straight-line method over the estimated useful life (EUL) of the depreciable assets as follows:

Condominium properties, buildings and improvements	20 to 40 years
Furniture, fixtures and equipment	2 to 10 years
Leasehold improvements	5 to 10 years or the related lease terms, whichever is shorter

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

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

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

Real properties acquired in settlement of loans and receivables
Real properties acquired in settlement of loans and receivables are booked under ROPA account as follows:

- upon the date of entry of judgment in case of judicial foreclosure; or
- upon the date of Sheriff's Certificate of Sale in case of extrajudicial foreclosure; or
- upon the date of notarization of the Deed of Dacion in case of dation in payment.

These properties are carried at cost, which is the fair value at acquisition date including certain transaction costs, less accumulated depreciation and 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 carrying values of the cost of the real properties acquired. Investment properties acquired through a nonmonetary asset exchange is measured initially at fair value unless (a) the exchange lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable, where the net carrying value of the related loans and receivables is used. The difference between the fair value of the foreclosed properties and the carrying value of the related receivables given up is recognized in 'Gain (loss) on asset exchange' account in the statement of comprehensive income. Subsequent to initial recognition, real properties acquired in settlement of loans and receivables are stated at cost less accumulated depreciation and any accumulated impairment in value. Depreciation is computed on a straight-line basis over the EUL from the time of acquisition of the investment properties but not to exceed 10 years.

Investments in real estate
Investments in real estate consist of investments in land and building. The Bank applies the cost model in accounting for investments in real estate. Investment in land is carried at cost less impairment in value. Building is carried at cost less accumulated depreciation and impairment in value. All costs that are directly attributable to the acquisition and development of property are capitalized, including borrowing costs incurred to finance the property development. Depreciation is computed on a straight-line basis between 20 to 40 years.

Subsequent measurement of investment properties
The EUL of investment properties 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 investment properties.

The carrying values of the investment properties are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. If any of such indication exists and where the carrying values exceed the estimated recoverable amount, the investment property or CGUs it is related to are written down to their recoverable amounts.

Investment properties are derecognized when they have either been disposed of or when they are permanently withdrawn from use and no future benefit is expected from its disposal. Any gains or losses on the retirement or disposal of investment properties are recognized in the statement of income in the year of retirement or disposal under 'Gain (loss) on asset exchange'.

Transfers are made to investment property when, and only when, there is a change in use, evidenced by ending of owner-occupation, commencement of an operating lease to another party or ending of construction or development. Transfers are made from investment property when, and only when, there is a change in use evidenced by commencement of owner occupation or commencement of development with a view to sale.

Intangible Assets

Intangible assets consist of software costs and branch licenses.

Software costs

Costs related to software purchased by the Bank for use in operations are recognized as 'Software costs' in the statement of financial position. Capitalized computer software costs are amortized on a straight-line basis over 3 to 7 years.

Branch licenses

These intangible assets were determined to have indefinite useful lives and are therefore not amortized. The useful life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis. Branch licenses are tested for impairment annually either individually or at the CGU level.

Impairment is determined by assessing the recoverable amount of the individual asset or CGU (or group of CGUs) to which the intangible asset relates. Recoverable amount is the higher of the individual asset's or CGU's fair value less cost to sell and its value in use. Where the recoverable amount of the CGU is less than its carrying amount, an impairment loss is recognized.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic life. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at each financial year-end. Changes in the expected useful life, or the expected pattern of consumption of future economic benefits embodied in the asset, are accounted for by changing the amortization period or methodology, as appropriate, which are then treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is presented as a separate line item in the statement of income.

Investment in a Subsidiary and an Associate

Investment in a subsidiary

A subsidiary pertains to an entity over which the Bank has control. Control is achieved when the Bank is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Investment in a subsidiary is carried at acquisition cost, less any impairment in value.

This policy relates to the Bank's investment in a 100% owned subsidiary recorded in 'Other equity investments' under 'Other assets'.

Investment in an associate
An associate pertains to an entity over which the Bank has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies. Investment in an associate is accounted for under the equity method of accounting.

Under the equity method, an investment in an associate is carried in the statement of financial position at cost plus post-acquisition changes in the Bank's share of the net assets of the associates. Goodwill, if any, relating to an associate is included in the carrying value of the investment and is not amortized. When the Bank increases its ownership interest in an associate that continues to be accounted for under the equity method, the cost for the additional interest is added to the existing carrying amount of the associate and the existing interest in the associate is not remeasured.

The Bank's share of its associate's post-acquisition profits or losses is recognized in the statement of income, and its share of post-acquisition movements in the associates' equity reserves is recognized directly in equity. When the Bank's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Bank does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate. Profits and losses resulting from transactions between the Bank and an associate are eliminated to the extent of the interest in the associate. Dividends received, if any, are treated as a reduction in the carrying value of the investment.

In cases where an associate is in a net liability position, the equity method requires the Bank to discontinue recognizing its share of further losses when its cumulative share in the losses of the associate equals or exceeds its interest in the associate, unless the Bank has incurred legal or constructive obligations or made payments on behalf of the associate, in which case a liability is recognized.

This policy relates to the Bank's investment in a 49%-owned investee company recorded in 'Other equity investments' under 'Other assets'.

As of December 31, 2017 and 2016, the investment in an associate, which was acquired as a result of merger with PDB, is fully impaired (Note 13).

Impairment of Nonfinancial Assets
At each reporting date, the Bank assesses whether there is any indication that its nonfinancial assets (i.e., property and equipment, investment properties, investment in a subsidiary and an associate, software cost) may be impaired. When an indicator of impairment exists or when an annual impairment testing for an asset is required, the Bank makes a formal estimate of recoverable amount.

Recoverable amount is the higher of an asset's or CGU's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those other assets or groups of assets, in which case the recoverable amount is assessed as part of the CGU to which it belongs. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset or CGU is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

An impairment loss is recognized only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged against the statement of income in the period in which it arises.

A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount, but not to an amount higher than the carrying amount that would have been determined (net of any depreciation) had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is credited to current operations.

After such a reversal, the depreciation expense is adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining life.

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

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the statement of income on a straight-line basis over the lease term and included in the statement of income as 'Occupancy cost'.

Bank as lessor

Leases where the Bank does not transfer substantially all the risks and benefits of ownership of the assets are classified as operating leases. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognized over the lease term on the same basis as the rental income. Contingent rents are recognized as revenue in the period in which they are earned.

Deposit for Future Stock Subscription

Deposit for future stock subscriptions (DFFS) pertains to capital infusions made by stockholders of the Bank on subscription to the increase in the authorized capital which cannot be directly credited to capital stock issued pending approval by the BSP and registration with the SEC of the amendment to the Articles of Incorporation for the proposed increase in capital stock. Under SEC Financial Reporting Bulletin 006 issued in 2012 and amended in 2013, an entity should not consider a DFFS as an equity instrument unless all of the following elements are present:

- There is a lack or insufficiency of authorized unissued shares of stock to cover the deposit;

- The entity's BOD and shareholders have approved an increase in capital stock to cover the shares corresponding to the amount of the deposit; and
- An application for the approval of the increase in capital stock has been filed with the SEC and BSP.

If any or all of the foregoing elements above are not present, the DFFS should be recognized as a liability.

Equity
Capital stock is measured at par value for all shares issued and outstanding. When the shares are sold at a premium, the difference between the proceeds and the par value is credited to 'Additional paid-in capital' account. Direct costs incurred related to equity issuance, such as underwriting, accounting and legal fees, printing costs and taxes are chargeable to 'Additional paid-in capital' account. If the 'Additional paid-in capital' is not sufficient, the excess is charged against the 'Surplus (deficit)'. The effect of positive (negative) equity adjustments arising from business combination under common control is included under 'Additional paid-in capital' ('Other equity reserves').

When the Bank issues more than one class of stock, a separate account is maintained for each class of stock and the number of shares issued.

Surplus (deficit)
Surplus (deficit) represents cumulative balance of periodic net income or loss, dividend declarations, prior period adjustments, effect of changes in accounting policy and other capital adjustments, if any.

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, regardless of when the payment is being made. Revenue is measured at fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duties.

The Bank assesses its revenue arrangements against specific criteria in order to determine if it is acting as a principal or agent.

The Bank has concluded that it is acting as a principal in all of its revenue arrangements. 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 FVPL investments and AFS financial assets, 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), includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, as applicable, 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'.

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.

Service fees and penalties
Service fees and penalties are recognized only upon collection or accrued where there is a reasonable degree of certainty as to their collectability.

Fee income forming an integral part of the corresponding financial instrument
Fees that the Bank considers to be an integral part of the corresponding financial instruments include: loan origination fees, loan commitment fees for loans that are likely to be drawn down and other credit related fees. The recognition of these fees (together with any incremental costs) form an integral part of the corresponding financial instruments and are recognized as interest income through an adjustment to the EIR (the exception is, when it is unlikely that a loan will be drawn down, the loan commitment fees are recognized as revenue on expiry).

Loan commitments that are within the scope of PAS 39 (i.e., are designated as FVPL, or are at a below market rate of interest, or are settled net) are accounted for as derivatives and measured at fair value through profit or loss.

Gain (loss) on asset exchange
Gain (loss) on asset exchange transaction is recognized upon foreclosure of loan collaterals (see accounting policy on investment properties and NCAHS) or sale of such foreclosed properties. The gain or loss on foreclosure represents the difference between the fair value of the asset received and book value of the asset given up. Income (loss) from sale of foreclosed properties is recognized upon completion of the earnings process, the transfer of risk and rewards over the property to the buyer, and the collectability on the sales price is reasonably assured.

Trading and securities gains
Gain (loss) from investment securities arise from trading activities of FVPL instruments including all gains and losses from changes in fair value of financial assets held for trading. It also includes gains and losses realized from sale of AFS financial assets.

Rental income
Rental income arising from leased properties is accounted from on a straight-line basis over the lease terms on ongoing leases and is recorded in the statement of comprehensive income under 'Income from property rentals'.

Trust fee income
This arises from rendering of trust management services to the trust and managed funds of the Bank's Trust Department. Trust fee income is accrued as service is provided.

Dividend income
Dividend income are recognized under 'Miscellaneous income' when the Bank's right to receive payment is established, which is generally when the shareholders approve the dividend declarations.

Other income
Income from sale of services is recognized upon rendition of the service.

Expense Recognition
Expenses are recognized when it is probable that a decrease in future economic benefit related to a decrease in an asset or an increase of a liability has occurred and the decrease in economic benefits can be measured reliably. Expenses are recognized when incurred.

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

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

Taxes and licenses
These include all other taxes, local and national, including gross receipts tax (GRT), real estate taxes and licenses and permit fees which are recognized when incurred.

Retirement Benefits
The net defined benefit liability or asset is the aggregate of the present value of the defined benefit obligation at the reporting date reduced by the fair value of plan assets, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling. The defined benefit obligation is calculated annually by an independent actuary. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates on government bonds that have terms to maturity approximating the terms of the related retirement liability. The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The cost of providing benefits under the defined benefit plan is actuarially determined using the projected unit credit method.

Defined benefit costs comprise the following:
a. service cost;
b. net interest on the net defined benefit liability or asset; and
c. remeasurements of net defined benefit liability or asset.

Service costs which include current service costs, past service costs and gains or losses on non-routine settlements are recognized as expense in profit or loss. Past service costs are recognized when plan amendment or curtailment occurs.

Net interest on the net defined benefit liability or asset is the change during the period in the net defined benefit liability or asset that arises from the passage of time which is determined by applying the discount rate based on Philippine government bonds to the net defined benefit liability or asset. Net interest on the net defined benefit liability or asset is recognized as expense or income in profit or loss.

Remeasurements comprising actuarial gains and losses, return on plan assets and any change in the effect of the asset ceiling (excluding net interest on defined benefit liability) are recognized immediately in OCI in the period in which they arise. Remeasurements are not reclassified to profit or loss in subsequent periods.

Plan assets are assets that are held by a long-term employee benefit fund. Plan assets are not available to the creditors of the Bank, nor can they be paid directly to the Bank. Fair value of plan assets is based on market price information. When no market price is available, the fair value of plan assets is estimated by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligations).

The Bank's right to be reimbursed of some or all of the expenditure required to settle a defined benefit obligation is recognized as a separate asset at fair value when and only when reimbursement is virtually certain. If the fair value of the plan assets is higher than the present value of the defined benefit obligation, the measurement of the resulting defined benefit asset is limited to the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

Provisions and Contingencies
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. Where the Bank expects some or all of a provision to be reimbursed, for example, under 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, net of any reimbursement. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an interest expense.

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.

Income Taxes

Current tax
Current tax assets and current tax liabilities for the current period 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 substantively enacted as of the reporting date.

Deferred tax
Deferred tax is provided, using the balance sheet liability method, on all temporary differences at the reporting 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. Deferred tax assets are recognized for all deductible temporary differences, carryforward of unused tax credits from the excess of minimum corporate income tax (MCIT) over the regular corporate income tax (RCIT), and unused net operating loss carryover (NOLCO), to the extent that it is probable that sufficient taxable profit will be available against which the deductible temporary differences and carryforward of unused tax credits from MCIT and unused NOLCO can be utilized. Deferred tax assets and deferred tax liabilities, however, is not recognized on temporary differences that arise 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.

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

Deferred tax assets and deferred tax 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 reporting date.

Current tax and deferred tax relating to items recognized directly in equity is also recognized in equity and not in the statement of income.

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

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 where the Bank acts in a fiduciary capacity such as nominee, trustee or agent.

Events after the Reporting Date
Post year-end events that provide additional information about the Bank's position at the reporting date (adjusting events) is reflected in the financial statements. Any post-year-end event that is not an adjusting event is disclosed in the notes to the financial statements when material.

Standards Issued but not yet Effective
The standards and interpretations that are issued but not yet effective are listed below. Unless otherwise indicated, the Bank does not expect the future adoption of these standards and interpretations to have a significant impact on its financial statements. The Bank intends to adopt these standards when they become effective.

Effective beginning on or after January 1, 2018
- PAS 28, *Measuring an Associate or Joint Venture at Fair Value* (Part of *Annual Improvements to* PFRSs 2014 - 2016 Cycle) (Amendments)
- PAS 40, *Investment Property*, *Transfers of Investment Property* (Amendments)
- PFRS 2, *Share-based Payment*, *Classification and Measurement of Share-based Payment Transactions* (Amendments)
- PFRS 4, *Insurance Contracts*, *Applying* PFRS 9*, Financial Instruments, with* PFRS 4 (Amendments)

- PFRS 9, *Financial Instruments*

  PFRS 9 replaces PAS 39, *Financial Instruments: Recognition and Measurement* and is effective for annual periods beginning on or after January 1, 2018. Early application is permitted if an entity applies all the requirements of the standard.

  PFRS 9 is required to be applied on a retrospective basis, with certain exceptions. As permitted, the Bank will not restate the Bank prior period comparative financial statements when the Bank adopts the requirements of the new standard. Differences in the carrying amounts of financial instruments resulting from the adoption of PFRS 9 will be recognized in the opening January 1, 2018 surplus and OCI as if the Bank had always followed the new requirements.

  In the period of initial application, the requirements of PFRS 9 on the classification and measurement of financial assets and on the recognition of expected credit losses will have an impact on the Bank's financial statements. The opening January 1, 2018 surplus and OCI in the Bank's statement of financial position are expected to change as a result of applying PFRS 9's requirements on classification and measurement of financial assets. This change will result from reclassifications of financial assets depending on the Bank's application of its business models and its assessment of the financial assets' cash flow characteristics. The opening January 1, 2018 surplus and OCI in the Bank's statement of financial position are also expected to change as a result of applying PFRS 9's requirements on the recognition of expected credit losses. This change depends on whether there have been significant increases in the credit risk of the Bank's financial assets since initial recognition and on the Bank's evaluation of factors relevant to the measurement of expected credit losses such as a range of possible outcomes and information about past events, current conditions and forecasts of future economic conditions.

During 2018, PFRS 9's requirements will have an impact on the Bank's financial statements depending on certain factors such as the financial assets' corresponding business models, cash flow characteristics, and changes in credit risks. The Bank is still completing its assessment of the impact of PFRS 9.

In the period of initial application, the requirements of PFRS 9 on the classification and measurement of financial liabilities and on the application of hedge accounting are not expected to have an impact on the Bank's financial statements.

The key changes to the Bank's accounting policies resulting from the adoption of PFRS 9 are described below.

a. *Classification and measurement*
The PFRS 9 classification and measurement model requires that all debt financial assets that do not meet the "solely payment of principal and interest" (SPPI) test, including those that contain embedded derivatives, be classified at initial recognition as at fair value through profit or loss (FVPL). The intent of the SPPI test is to ensure that debt instruments that contain non-basic lending features, such as conversion options and equity linked pay-outs, are measured at FVPL. Subsequent measurement of instruments classified as FVPL under PFRS 9 operates in a similar manner to financial instruments held for trading under PAS 39.

For debt financial assets that meet the SPPI test, classification at initial recognition will be determined based on the business model under which these instruments are managed. Debt instruments that are managed on a "held for trading" or "fair value" basis will be classified as at FVPL. Debt instruments that are managed on a "hold to collect and for sale" basis will be classified as at fair value through OCI (FVOCI) for debt. Debt instruments that are managed on a "hold to collect" basis will be classified as at amortized cost. Subsequent measurement of instruments classified as at FVOCI and amortized cost classifications under PFRS 9 operate in a similar manner to AFS financial assets for debt financial assets and loans and receivables, respectively, under existing PAS 39, except for the impairment provisions which are discussed below.

For those debt financial assets that would otherwise be classified as at FVOCI or amortized cost, an irrevocable designation can be made at initial recognition to instead measure the debt instrument at FVPL under the fair value option (FVO) if doing so eliminates or significantly reduces an accounting mismatch.

All equity financial assets are required to be classified at initial recognition as at FVPL unless an irrevocable designation is made to classify the instrument as at FVOCI for equities. Unlike AFS for equity securities under PAS 39, the FVOCI for equities category results in all realized and unrealized gains and losses being recognized in OCI with no recycling to profit and loss. Only dividends will continue to be recognized in profit and loss.

The classification and measurement of financial liabilities remain essentially unchanged from the current PAS 39 requirements, except that changes in fair value of FVO liabilities attributable to changes in own credit risk are to be presented in OCI, rather than profit and loss.

b. *Impairment*
The new impairment guidance sets out an expected credit loss (ECL) model applicable to all debt instrument financial assets classified as amortized cost or FVOCI. In addition, the ECL model applies to loan commitments and financial guarantees that are not measured at FVPL.

Expected Credit Loss Methodology
The application of ECL will significantly change the Bank credit loss methodology and models. ECL allowances represent credit losses that reflect an unbiased and probability-weighted amount which is determined by evaluating a range of possible outcomes, the time value of money and reasonable and supportable information about past events, current conditions and forecasts of future economic conditions. ECL allowances will be measured at amounts equal to either: (i) 12-month ECL; or (ii) lifetime ECL for those financial instruments which have experienced a significant increase in credit risk (SICR) since initial recognition or when there is objective evidence of impairment. This compares to the present incurred loss model that incorporates a single best estimate, the time value of money and information about past events and current conditions and which recognizes lifetime credit losses when there is objective evidence of impairment and also allowances for incurred but not identified credit losses.

Stage Migration and Significant Increase in Credit Risk
Financial instruments subject to the ECL methodology are categorized into three stages. For non-impaired financial instruments: Stage 1 is comprised of all non-impaired financial instruments which have not experienced a SICR since initial recognition. Entities are required to recognize 12-month ECL for stage 1 financial instruments. In assessing whether credit risk has increased significantly, entities are required to compare the risk of a default occurring on the financial instrument as at the reporting date, with the risk of a default occurring on the financial instrument as at the date of initial recognition.

Stage 2 is comprised of all non-impaired financial instruments which have experienced a SICR since initial recognition. Entities are required to recognize lifetime ECL for stage 2 financial instruments. In subsequent reporting periods, if the credit risk of the financial instrument improves such that there is no longer a SICR since initial recognition, then entities shall revert to recognizing 12 months of ECL. In contrast to stage 1 and stage 2, inherent within the incurred loss methodology under PAS 39, allowances are provided for non-impaired financial instruments for credit losses that are incurred but not yet identified.

For impaired financial instruments
Financial instruments are classified as stage 3 when there is objective evidence of impairment as a result of one or more loss events that have occurred after initial recognition with a negative impact on the estimated future cash flows of a financial instrument or a portfolio of financial instruments. The ECL model requires that lifetime ECL be recognized for impaired financial instruments, which is similar to the current requirements under PAS 39 for impaired financial instruments.

The Bank has applied its existing governance framework to ensure that appropriate controls and validations are in place over key processes and judgments in implementing PFRS 9. The Bank is continuously refining its internal controls and processes which are relevant in the proper implementation of the PFRS 9.

- PFRS 15, *Revenue from Contracts with Customers*
  PFRS 15 establishes a new five-step model that will apply to revenue arising from contracts with customers. Under PFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in PFRS 15 provide a more structured approach to measuring and recognizing revenue.

  The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under PFRSs. Either a full or modified retrospective application is required for annual periods beginning on or after January 1, 2018. The Bank is currently assessing the impact of adopting this standard.

- Philippine Interpretation IFRIC 22, *Foreign Currency Transaction and Advance Consideration*

Effective beginning on or after January 1, 2019
- PAS 28, *Long-term Interests in Associates and Joint Ventures* (Amendments)
- PFRS 9, *Prepayment Features with Negative Compensation* (Amendments)

- PFRS 16, *Leases*
  Under the new standard, lessees will no longer classify their leases as either operating or finance leases in accordance with PAS 17, *Leases*. Rather, lessees will apply the single-asset model. Under this model, lessees will recognize the assets and related liabilities for most leases on their statements of financial position, and subsequently, will depreciate the lease assets and recognize interest on the lease liabilities in their profit or loss. Leases with a term of 12 months or less or for which the underlying asset is of low value are exempted from these requirements.

  The accounting by lessors is substantially unchanged as the new standard carries forward the principles of lessor accounting under PAS 17. Lessors, however, will be required to disclose more information in their financial statements, particularly on the risk exposure to residual value.

  Entities may early adopt PFRS 16 but only if they have also adopted PFRS 15. When adopting PFRS 16, an entity is permitted to use either a full retrospective or a modified retrospective approach, with options to use certain transition reliefs.

  The Bank is currently assessing the impact of adopting PFRS 16.

- Philippine Interpretation IFRIC 23, *Uncertainty over Income Tax Treatments*

Deferred effectivity
- PFRS 10, *Consolidated Financial Statements* and PAS 28, *Investments in Associates and Joint Ventures - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments)

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. 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.

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

a. *Fair value of financial instruments*
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 of whether quoted prices are readily and regularly available, and whether those prices represent actual and regularly occurring market transactions conducted on an arm's length basis.

Where the fair values of financial assets and financial liabilities recorded on the statement of financial position or disclosed in the notes to the financial statements cannot be derived from active markets, they are determined using discounted cash flow model, incorporating inputs such as current market rates of comparable instruments. The carrying values and corresponding fair values of financial assets and financial liabilities as well as the manner in which fair values were determined are discussed in Note 4.

b. *HTM financial assets*
The classification to HTM financial assets requires significant judgment. In making this judgment, the Bank evaluates its intention and ability to hold such investments to 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 part of AFS financial assets. The investments would therefore be measured at fair value and not at amortized cost.

Details of AFS financial assets reclassified to HTM financial assets are disclosed in Note 7.

c. *Classification of NCAHS*
The Bank classifies NCAHS if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use.

The criteria for NCAHS classification is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition.

d. *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 upon 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 (Note 25).

Estimates

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

a. *Credit losses on loans and receivables, HTM financial assets, AFS debt securities and financial assets under 'Other assets'*

The Bank reviews its loans and receivables, HTM financial assets, AFS debt securities and financial assets under 'Other assets' at each reporting date to assess whether an allowance for impairment and credit losses should be recorded in the statement of financial position and any changes thereto 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 level of allowance required. Such estimates are based on assumptions about a number of factors. Actual results may differ, resulting in future changes to the allowance.

In addition to specific allowance against individually significant financial assets, the Bank also makes a collective impairment assessment against exposures which, although not specifically identified as requiring an allowance, have a greater risk of default than when originally granted. This collective impairment assessment is based on any deterioration in the credit quality of a group of financial assets with similar credit risk characteristics. The collective impairment assessment considers factors such as deterioration in country risk, industry, and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

The carrying values of AFS debt securities and loans and receivables as of December 31, 2017 and 2016, are disclosed in Notes 7 and 8, respectively.

As of December 31, 2017 and 2016 HTM financial assets were unimpaired. The carrying values of HTM financial assets are disclosed in Note 7.

b. *Impairment of non-financial assets*

Investment properties

The Bank assesses impairment on investment 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 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 an asset exceeds its recoverable amount. The recoverable amount is computed using the fair value less cost to sell for real properties. Recoverable amounts are estimated for individual assets or, if it is not possible, for the CGU which the asset belongs.

The carrying values of the Bank's investment properties are disclosed in Note 11.

Branch licenses
The Bank conducts an annual review for any impairment in the value of branch licenses. Branch licenses are written down for impairment where the recoverable value is insufficient to support their carrying value. The recoverable amount of branch licenses is based on its fair value less costs of disposal (Note 12).

c. *Recognition of deferred income taxes*
Deferred tax assets are recognized for all unused tax losses and deductible temporary differences 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 estimates of future taxable income indicate that certain temporary differences will be realized in the future. The recognized net deferred tax assets and unrecognized deferred tax assets are disclosed in Note 22.

d. *Net retirement liability and retirement expense*
The determination of the Bank's net retirement liability and annual retirement expense is dependent on the selection of certain assumptions used in calculating such amounts. These assumptions include, among others, discount rates and salary increase.

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 the reporting date. The salary projection rate was based on the historical trend of salary increase rate of the Company. Refer to Note 20 for the details on the assumptions used in calculating the defined benefit obligation.

The present value of the retirement obligation and fair value of plan assets are disclosed in Note 20.

4. Fair Value Measurement

The methods and assumptions used by the Bank in estimating the fair values of its assets and liabilities are:

Cash and cash equivalents, and financial assets recorded under 'Other assets' - The carrying amounts approximate their fair values in view of the relatively short-term maturities of these instruments.

FVPL investments and AFS and HTM debt securities - Fair values are generally based on quoted market prices. If the market prices are not readily available, fair values are estimated using adjusted quoted market prices of comparable investments or using the discounted cash flow methodology.

Unquoted AFS equity financial assets - Unquoted AFS financial assets are carried at cost less allowance for impairment losses due to the unpredictable nature of future cash flows and the lack of suitable method of arriving at a reliable fair value. Unquoted equity securities are not significant in relation to the Bank's portfolio of financial instruments.

Loans and receivables and unquoted debt securities - Fair values are estimated using the discounted cash flow methodology, using the Bank's current incremental lending rates for similar types of receivables or securities. The discount rates used in estimating the fair value of loans and receivables are the incremental lending rates ranging from 5.65% to 28.43% and 6.34% to 25.61% in 2017 and 2016, respectively.

The discount rates used in estimating the fair values of unquoted debt securities are the incremental lending rates ranging from 3.55% to 6.75% and 3.10% to 4.52% in 2017 and 2016, respectively.

Deposit liabilities - Fair values of time deposits 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. For demand and savings deposits, carrying amounts approximate fair values considering that these are currently due and demandable. The discount rates used in estimating the fair value of time deposits as of December 31, 2017 and 2016 are 0.25% to 4.75% and 0.25% to 5.75%, respectively.

Manager's checks, accrued interest and other expenses and other liabilities - Carrying amounts approximate fair values due to the short-term nature of the accounts.

NCAHS and Investment properties - The fair values of the Bank's NCAHS and investment properties have been determined based on valuations made by accredited independent or in-house appraisers on the basis of recent sales of similar properties in the same areas and taking into account the economic conditions prevailing at the time the valuations were made.

As of December 31, 2017 and 2016, the classification under the fair value hierarchy of the Bank's assets and liabilities measured at fair value or with disclosure of fair values are presented below:

	December 31, 2017				
	Carrying Value	**Level 1**	**Level 2**	**Level 3**	**Total**
Recurring fair value measurement					
FVPL investment					
Government debt securities	**₱135,397,767**	**₱84,908,783**	**₱50,488,984**	**₱–**	**₱135,397,767**
AFS financial assets					
Government debt securities	**1,734,267,611**	**1,443,080,297**	**291,187,314**	**–**	**1,734,267,611**
Private debt securities	**440,453,241**	**440,453,241**	**–**	**–**	**440,453,241**
	₱2,310,118,619	**₱1,968,442,321**	**₱341,676,298**	**₱–**	**₱2,310,118,619**
Fair values of assets carried at amortized cost					
HTM financial assets					
Government debt securities	**₱2,734,817,726**	**₱1,005,036,231**	**₱1,729,241,820**	**₱–**	**₱2,734,278,051**
Private debt securities	**768,000,000**	**–**	**756,201,297**	**–**	**756,201,297**
Loans and receivables					
Loans and discounts					
Corporate and commercial lending	**33,154,769,037**	**–**	**–**	**35,238,912,995**	**35,238,912,995**
Consumer lending	**29,119,090,672**	**–**	**–**	**32,343,165,606**	**32,343,165,606**
Others	**38,733,209**	**–**	**–**	**40,324,214**	**40,324,214**
Unquoted debt securities	**102,911,415**	**–**	**–**	**102,898,514**	**102,898,514**
Sales contract receivable	**728,819,747**	**–**	**–**	**791,950,511**	**791,950,511**
	₱66,647,141,806	**₱1,005,036,231**	**₱2,485,443,117**	**₱68,517,251,840**	**₱72,007,731,188**
Nonrecurring fair value measurement					
NCAHS	**₱212,031,191**	**₱–**	**₱–**	**₱250,414,894**	**₱250,414,894**
Fair values of assets carried at cost					
Investment properties					
Land	**₱2,337,789,063**	**₱–**	**₱–**	**₱3,049,029,030**	**₱3,049,029,030**
Buildings and improvements	**819,356,475**	**–**	**–**	**1,376,744,511**	**1,376,744,511**
	₱3,157,145,538	**₱–**	**₱–**	**₱4,425,773,541**	**₱4,425,773,541**
Fair values of liabilities carried at amortized cost					
Deposit liabilities - Time	**₱51,496,682,274**	**₱–**	**₱–**	**₱51,501,993,831**	**₱51,501,993,831**

	December 31, 2016				
	Carrying Value	Level 1	Level 2	Level 3	Total
Recurring fair value measurement					
FVPL investments					
Government debt securities	₱471,016,949	₱211,705,028	₱259,311,921	₱–	₱471,016,949
AFS financial assets					
Government debt securities	1,503,335,389	1,175,899,719	327,435,670	–	1,503,335,389
Private debt securities	585,602,110	585,602,110	–	–	585,602,110
	₱2,559,954,448	₱1,973,206,857	₱586,747,591	₱–	₱2,559,954,448
Fair values of assets carried at amortized cost					
HTM financial assets					
Government debt securities	₱2,685,822,563	₱1,047,613,084	₱1,611,721,157	₱–	₱2,659,334,240
Private debt securities	650,000,000	–	641,292,296	–	641,292,296
Loans and receivables					
Loans and discounts					
Corporate and commercial lending	33,972,181,993	–	–	35,974,063,830	35,974,063,830
Consumer lending	23,422,671,542	–	–	25,596,029,620	25,596,029,620
Others	66,923,547	–	–	60,940,178	60,940,178
Unquoted debt securities	103,040,790	–	–	106,010,137	106,010,137
Sales contract receivable	667,997,930	–	–	610,591,923	610,591,923
	₱61,568,638,365	₱1,047,613,084	₱2,253,013,453	₱62,347,635,688	₱65,648,262,224
Nonrecurring fair value measurement					
NCAHS	₱225,139,725	₱–	₱–	₱269,685,333	₱269,685,333
Fair values of assets carried at cost					
Investment properties					
Land	₱2,420,852,662	₱–	₱–	₱3,259,230,820	₱3,259,230,820
Buildings and improvements	788,340,245	–	–	1,570,583,741	1,570,583,741
	₱3,209,192,907	₱–	₱–	₱4,829,814,561	₱4,829,814,561
Fair values of liabilities carried at amortized cost					
Deposit liabilities - Time	₱49,391,254,679	₱–	₱–	₱49,553,112,756	₱49,553,112,756

There were no transfers between Level 1 and Level 2 fair value measurements and no transfers into and out of Level 3 fair value measurements in 2017.

The inputs used in the fair value measurement based on Level 2 are as follows:

Government securities - interpolated rates based on market rates of benchmark securities as of reporting date.

Private bonds and commercial papers - quoted market price of comparable investments with credit risk premium that is insignificant to the entire fair value measurement.

Inputs used in estimating fair values of financial instruments carried at amortized cost and categorized under Level 3 include risk-free rates and applicable risk premium.

Description of the valuation techniques and significant unobservable inputs (Note 11) used in the valuation of the Bank's NCAHS and investment properties are as follows:

<u>Valuation Techniques</u>

Market Data Approach	A process of comparing the subject property being appraised to similar comparable properties recently sold or being offered for sale.
Replacement Cost Approach	It is an estimate of the investment required to duplicate the property in its present condition. It is reached by estimating the value of the land and adding the depreciated cost of the improvement.

5. Financial Risk Management Objectives and Policies

The Bank's activities are principally related to the profitable use of financial instruments. Risks are inherent in these activities but are managed by the Bank through a rigorous, comprehensive and continuous process of identification, measurement, monitoring and mitigation of these risks, partly through the effective use of risk and authority limits, process controls and monitoring, and independent controls. As reflected in its corporate actions and organizational improvements, the Bank has placed due importance to expanding and strengthening its risk management process and considers it as a vital component to the Bank's continuing profitability and financial stability.

Central to the Bank's risk management process is its adoption of a risk management program intended to avoid unnecessary risks, manage and mitigate unavoidable risks and maximize returns from taking acceptable risks necessary to sustain its business viability and good financial position in the market.

The key financial risks that the Bank faces are: credit risk, market risk (i.e., interest rate risk), and liquidity risk. The Bank's risk management objective is primarily focused on controlling and mitigating these risks. The gravity of the risks, the magnitude of the financial instruments involved, and the regulatory requirements are the primary considerations to the scope and extent of the risk management processes put in place for the Bank.

Risk Management Structure

The BOD of the Bank has the primary responsibility for the establishment of a risk management system and is ultimately accountable for all risks taken within the Bank. The BOD has established, among others, the following committees to directly handle the Bank's risk management framework, policies and implementation in their respective risk management areas: the Executive Committee (ExeCom), Audit Committee (AudCom), Credit Committee (CreCom), Corporate Governance Committee (CGC) and the Risk Management Committee (RMC). All Board committees report regularly to the BOD on their activities as follows:

The Bank's risk management policies are established to identify and analyze the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Bank's RMC shall be responsible for the oversight and development of all risk management functions within the Bank. The RMC develops appropriate strategies through a written practical risk management plan for managing the major categories of risk events and minimizing the magnitude of expected losses, giving priority to the risk events with the largest expected losses. The Risk Management Unit assists the RMC with all of its responsibilities.

The Bank's AudCom, on the other hand, focuses on checking whether adequate process and operational controls are in place and functioning as designed, as well as monitoring compliance thereto by the business and support units. The role of the AudCom is very critical in the proper corporate governance and effective risk management because of its independence from the Bank's top and middle level management. The AudCom is comprised of independent directors who neither participate in the Bank's daily activities nor take decision-making responsibilities. The AudCom delegates its daily control and monitoring functions to the Internal Audit Department (IAD). The IAD is likewise independent from the business and support units and reports exclusively to the AudCom.

The IAD undertakes its control function through regular process, operational and financial audits which it conducts all throughout the year. The audit covers all processes and controls in the Head Office and the branches. The audit results and exceptions, including recommendations for their resolution or improvement, are discussed initially with the business units concerned before these are presented to the AudCom on a quarterly basis.

Risk Management Reporting
The RMC discusses risk management issues on a quarterly basis. The RMC discusses key risk indicators and specific risk management issues that would need resolution from top management. The key risk indicators were formulated on the basis of the financial risks faced by the Bank. The key risk indicators contain information from all business units that provide measurements on the level of the risks taken by the Bank with its transactions, products and financial structure. Among others, the report on key risk indicators includes information on the Bank's aggregate credit exposure, credit metric forecasts, market risk analysis, utilization of market and credit limits, liquidity ratios, overall loan loss provisioning and risk profile changes.

The CreCom reviews and resolves credit-related issues such as credit facility approval, credit and collection strategies on a particular account, and credit monitoring. Loan loss provisioning and credit limit utilization are also discussed in more detail in the CreCom. On a weekly basis, the CreCom discusses detailed reporting of industry, customer and geographic risks arising from the Bank's existing loan portfolio. A comprehensive risk report is submitted to the BOD every quarter for an overall assessment of the level of risks taken by the Bank.

Risk Mitigation
The Bank uses financial instruments to manage exposures resulting from changes in interest rates, foreign currencies, credit risks and exposures arising from forecast transactions. However, the nature and extent of use of these financial instruments to mitigate risks are limited to those allowed by the BSP for a thrift bank.

To further mitigate risk throughout its different business and supporting units, the Bank is in the continuous process of improving its existing risk management policies. These policies further serve as the framework and set the guidelines in the creation or revisions of operating policies and manuals for each business unit. In the process design and implementation, process controls are preferred over detection controls. Clear delineation of responsibilities and separation of incompatible duties among officers and staff as well as among business units are reiterated in these policies. To the extent possible, reporting and accounting responsibilities are segregated from units directly involved in operations and front line activities (i.e., players must not be scorers). This is to improve the credibility and accuracy of management information. Any inconsistencies in the operating policies and manuals with the risk framework established by risk management policies are taken up and resolved in the RMC and ExeCom.

Monitoring and controlling risks are primarily performed based on various limits established by the top management covering the Bank's transactions and dealings. These limits reflect the Bank's business strategies and market environment as well as the levels of risks that the Bank is willing to tolerate, with additional emphasis on selected industries. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Excessive Risk Concentration
Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or

other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines focusing on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

The Bank's AudCom is responsible for monitoring compliance with the risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Bank's AudCom is assisted in these functions by IAD. The IAD undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the AudCom.

Credit Risk
Credit Risk and Concentration of Assets and Liabilities and Off - Balance Sheet Items
Credit risk is the risk of financial loss due to one party to a financial product failing to discharge an obligation. The Bank faces potential credit risks every time it extends funds to borrowers, commits funds to counterparties, guarantees the paying performance of its clients, invests funds to issuers (i.e., investment securities issued by either sovereign or corporate entities) and through implied or actual contractual agreements (i.e., on or off-balance sheet exposures). The Bank manages its credit risk at various levels (i.e., strategic level, portfolio level down to individual credit or transaction).

Collateral and other credit enhancements
The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented with regard to the acceptability of types of collateral and valuation parameters.

The Bank has risk limits setting for purposes of monitoring and managing credit risk from individual counterparties and groups of counterparties. It also conducts periodic assessment of the creditworthiness of its counterparties. In addition, the Bank obtains collateral where appropriate, enters into master netting agreements and collateral arrangements with counterparties, and limits the duration of exposures.

The Bank adopted an internal credit scoring system for the purpose of measuring credit risk for retail borrowers in a consistent manner, as accurately as possible, and thereafter uses the risk information for business and financial decision making.

The details of the composition of the loans and receivable and investment securities portfolios (net of unearned interest and discounts and allowance for impairment and credit losses) and the corresponding information on credit concentration as to industry are disclosed below (in thousands):

	2017						
	Loans and receivables	**%**	**Other financial assets***	**%**	**Off-balance sheet exposures**	**%**	**Total**
Real estate, renting and business services	**₱22,418,436**	**34.22**	**₱1,124,981**	**6.44**	**₱538**	**0.02**	**₱23,543,955**
Consumer	**17,243,260**	**26.32**	**149,360**	**0.85**	**–**	**–**	**17,392,620**
Government	**–**	**–**	**13,001,085**	**74.46**	**–**	**–**	**13,001,085**
Wholesale and retail trade	**7,713,385**	**11.77**	**152,179**	**0.87**	**1,331,867**	**52.26**	**9,197,431**
Financial intermediaries	**2,692,896**	**4.11**	**2,105,001**	**12.06**	**208,725**	**8.19**	**5,006,622**
Manufacturing	**4,027,113**	**6.15**	**14,756**	**0.08**	**77,400**	**3.04**	**4,119,269**

(Forward)

	2017						
	Loans and receivables	**%**	**Other financial assets***	**%**	**Off-balance sheet exposures**	**%**	**Total**
Transportation, storage and communication	**₱2,119,982**	**3.24**	**₱11,386**	**0.07**	**₱324,916**	**12.75**	**₱2,456,284**
Hotels and restaurant	**2,003,291**	**3.06**	**10,819**	**0.06**	**1,000**	**0.04**	**2,015,110**
Agriculture	**1,533,951**	**2.34**	**24,178**	**0.14**	**215,350**	**8.45**	**1,773,479**
Construction	**1,404,241**	**2.14**	**4,868**	**0.03**	**109,650**	**4.30**	**1,518,759**
Electricity, gas, steam and air-conditioning supply	**1,307,586**	**1.99**	**203,111**	**1.16**	**50,000**	**1.96**	**1,560,697**
Education	**1,040,148**	**1.59**	**125,029**	**0.72**	**–**	**–**	**1,165,177**
Other community, social and personal services	**554,961**	**0.85**	**–**	**–**	**–**	**–**	**554,961**
Health and social work	**536,777**	**0.82**	**1,763**	**0.01**	**2,000**	**0.08**	**540,540**
Fishing	**107,405**	**0.16**	**1,167**	**0.01**	**–**	**–**	**108,572**
Others	**811,737**	**1.24**	**530,495**	**3.04**	**226,978**	**8.91**	**1,569,210**
Total	**65,515,169**	**100.00**	**17,460,178**	**100.00**	**2,548,424**	**100.00**	**85,523,771**
Allowance for impairment and credit losses	**(2,338,301)**		**(562,769)**		**–**		**(2,901,070)**
Unearned interest and discount	**(32,544)**		**–**		**–**		**(32,544)**
Net	**₱63,144,324**		**₱16,897,409**		**₱2,548,424**		**₱82,590,157**

* *Other financial assets include the following: due from BSP, due from other banks, SPURA, FVPL investments, AFS financial assets, HTM financial assets and other financial assets.*

	2016						
	Loans and receivables	%	Other financial assets*	%	Off-balance sheet exposures	%	Total
Real estate, renting and business services	₱20,497,288	33.75	₱1,695,828	10.07	₱74,243	2.01	₱22,267,359
Consumer	13,500,062	22.23	136,219	0.81	–	–	13,636,281
Government	–	–	11,816,112	70.17	–	–	11,816,112
Wholesale and retail trade	8,522,213	14.03	27,054	0.16	1,660,377	44.97	10,209,644
Financial intermediaries	2,987,743	4.92	2,494,059	14.81	95,710	2.59	5,577,512
Manufacturing	4,235,814	6.97	18,436	0.11	695,465	18.84	4,949,715
Transportation, storage and communication	2,071,394	3.41	6,788	0.04	230,647	6.25	2,308,829
Hotels and restaurant	1,753,363	2.89	4,985	0.03	100,640	2.73	1,858,988
Agriculture	1,947,213	3.21	24,037	0.14	43,261	1.17	2,014,511
Construction	1,367,460	2.25	4,257	0.03	350,717	9.50	1,722,434
Electricity, gas, steam and air-conditioning supply	287,877	0.47	29,377	0.17	31,000	0.84	348,254
Education	1,033,673	1.70	4,819	0.02	10,647	0.29	1,049,139
Other community, social and personal services	1,052,900	1.73	2,534	0.02	11,985	0.32	1,067,419
Health and social work	491,628	0.81	1,142	0.01	39,000	1.05	531,770
Fishing	123,642	0.20	–	–	–	–	123,642
Others	870,429	1.43	574,710	3.41	348,583	9.44	1,793,722
Total	60,742,699	100.00	16,840,357	100.00	3,692,275	100.00	81,275,331
Allowance for impairment and credit losses	(2,460,326)		(461,722)		–		(2,922,048)
Unearned interest and discount	(49,557)		–		–		(49,557)
Net	₱58,232,816		₱16,378,635		₱3,692,275		₱78,303,726

* *Other financial assets include the following: due from BSP, due from other banks, SPURA, FVPL investments, AFS financial assets, HTM financial assets and other financial assets.*

Real estate, renting and business services include exposure to consumer housing loans amounting to ₱3.93 billion and ₱2.00 billion as of December 31, 2017 and 2016, respectively, which are mostly covered with retail loan guaranty from Home Guaranty Corporation (HGC). HGC guaranteed loans are considered as non-risk item for regulatory reporting purposes.

Maximum exposure to credit risk
The tables below provide the analysis of the maximum exposure to credit risk of the Bank's financial instruments.

	December 31, 2017		
	Gross maximum exposure	**Net exposure**	**Financial effect of collateral or credit enhancement**
Credit risk exposure relating to on-balance sheet items are as follows:			
SPURA	**₱1,404,323,202**	**₱–**	**₱1,404,323,202**
Loans and receivables			
Loans and discounts			
Corporate and commercial lending	**33,154,769,037**	**8,526,096,961**	**24,628,672,076**
Consumer loans	**29,119,090,672**	**19,062,625,005**	**10,056,465,667**
Others	**38,733,209**	**38,733,209**	**–**
Unquoted debt securities	**102,911,415**	**–**	**102,911,415**
Sales contract receivable	**728,819,747**	**–**	**728,819,747**
	₱64,548,647,282	**₱27,627,455,175**	**₱36,921,192,107**

	December 31, 2016		
	Gross maximum exposure	Net exposure	Financial effect of collateral or credit enhancement
Credit risk exposure relating to on-balance sheet items are as follows:			
SPURA	₱493,077,515	₱–	₱493,077,515
Loans and receivables			
Loans and discounts:			
Corporate and commercial lending	33,972,181,993	17,582,732,885	16,389,449,108
Consumer loans	23,422,671,542	12,652,907,211	10,769,764,331
Others	66,923,547	66,923,547	–
Unquoted debt securities	103,040,790	–	103,040,790
Sales contract receivable	667,997,930	–	667,997,930
	₱58,725,893,317	₱30,302,563,643	₱28,423,329,674

The maximum exposure to credit risks for the other financial assets is limited to the carrying value as of December 31, 2017 and 2016. The fair values of FVPL investments and AFS financial assets represent the credit risk exposure as of the reporting date but not the maximum risk exposure that could arise in the future as a result of changes in fair value of the said instruments.

The main types of collateral obtained are as follows:

- For securities lending and reverse repurchase transactions - cash or securities
- For consumer lending - real estate and chattel over vehicle
- For corporate and commercial lending - real estate, chattel over properties, assignment of deposits, shares of stocks, bonds, and guarantees

Foreclosed collateral
The Bank's policy is to determine whether a foreclosed collateral is best used for its internal operations or should be sold. Foreclosed collateral determined to be useful for the internal operations

are transferred to their relevant asset category at lower of their repossessed value or the carrying value of the original secured asset. Foreclosed collaterals that are determined better to be sold are immediately transferred to assets held for sale at fair value or fair value less cost to sell for non-financial assets at the repossession date in line with the Bank's policy. Foreclosed collaterals that pertain to real estate properties are accounted for as investment properties.

Collateral valuation
The Bank seeks to use collateral, where possible, to mitigate its risks on financial assets. The Bank collateral comes in various forms such as cash, securities, letter of credits/guarantees, real estate, receivables and other non-financial assets and credit enhancements. The fair value of collateral is generally assessed, at a minimum, at inception. To the extent possible, the Bank use active market data for valuing financial assets held as collateral. Other financial assets which do not have a readily determinable market value are valued using models. Non-financial collateral, such as real estate and chattel, is valued based on data provided by third parties such as independent appraisers.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment and credit losses.

It is the Bank's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In most cases, the Bank does not occupy repossessed properties for business use. Collaterals (i.e., NCAHS and ROPA) foreclosed in 2017 and 2016 that are still held by the Bank as of December 31, 2017 and 2016 amounted to ₱691.24 million and ₱538.13 million, respectively. These collaterals consist of real properties and vehicles.

Credit quality per class of financial assets
The tables below show the credit quality by class of financial assets as of December 31, 2017 and 2016 (gross of allowance for impairment and credit losses):

	December 31, 2017					
	Neither past due nor impaired					
	High grade	Standard Grade	Sub-Standard Grade	Past Due but Not Individually Impaired	Past Due and Individually Impaired	Total
Due from BSP	**₱6,772,976,958**	**₱–**	**₱–**	**₱–**	**₱–**	**₱6,772,976,958**
Due from other banks	**1,856,049,625**	–	–	–	–	**1,856,049,625**
SPURA	**1,404,323,202**	–	–	–	–	**1,404,323,202**
FVPL investments						
Government debt	**135,397,767**	–	–	–	–	**135,397,767**
AFS financial assets						
Quoted						
Government debt	**1,734,267,611**	–	–	–	–	**1,734,267,611**
Private debt	**440,453,241**	–	–	–	–	**440,453,241**
HTM financial assets						
Government debt	**2,734,817,725**	–	–	–	–	**2,734,817,725**
Private debt	**768,000,000**	–	–	–	–	**768,000,000**
Loans and receivables						
Loans and discounts						
Corporate and commercial lending	**31,251,016,950**	**66,801,139**	**176,435,213**	**1,076,220,173**	**1,997,786,528**	**34,568,260,003**
Consumer lending	**28,191,431,379**	**112,075,916**	**4,966,864**	**1,516,734,487**	**1,407,757**	**29,826,616,403**
Others	**11,426,785**	–	–	**6,264,298**	**21,042,126**	**38,733,209**
Unquoted debt securities	**102,911,415**	–	–	–	**151,836,309**	**254,747,724**
Sales contract receivable	**604,138,693**	–	–	**38,396,511**	**149,734,353**	**794,267,343**
Other financial assets*	**707,181,103**	**122,266,958**	**156,603,141**	**74,133,639**	**434,758,483**	**1,494,943,324**
Total	**₱76,714,392,454**	**₱301,144,013**	**₱338,005,218**	**₱2,711,749,108**	**₱2,756,565,556**	**₱82,823,854,135**

* *Other financial assets consist of accounts receivables, accrued interest receivables, and returned checks and other cash items*

	December 31, 2016					
	Neither past due nor impaired					
	High grade	Standard Grade	Sub-Standard Grade	Past Due but Not Individually Impaired	Past Due and Individually Impaired	Total
Due from BSP	₱6,657,366,683	₱–	₱–	₱–	₱–	₱6,657,366,683
Due from other banks	2,391,019,366	–	–	–	–	2,391,019,366
SPURA	493,077,515	–	–	–	–	493,077,515
FVPL investments						
Government debt	471,016,949	–	–	–	–	471,016,949
AFS financial assets						
Quoted						
Government debt	1,503,335,389	–	–	–	–	1,503,335,389
Private debt	585,602,110	–	–	–	–	585,602,110
HTM financial assets						
Government debt	2,685,822,563	–	–	–	–	2,685,822,563
Private debt	650,000,000	–	–	–	–	650,000,000
Loans and receivables						
Loans and discounts						
Corporate and commercial lending	29,489,163,588	7,472,080	162,627,628	3,558,078,475	2,203,515,784	35,420,857,555
Consumer lending	19,663,393,706	19,544,415	1,467,114	4,526,311,219	16,801,324	24,227,517,778
Others	34,576,102	–	13,355,546	10,925,603	8,066,295	66,923,546
Unquoted debt securities	103,040,790	–	–	–	151,836,309	254,877,099
Sales contract receivable	591,781,396	–	–	75,835,547	55,348,777	722,965,720
Other financial assets*	569,375,117	113,531,229	119,223,483	88,879,079	391,153,791	1,282,162,699
Total	₱65,888,571,274	₱140,547,724	₱296,673,771	₱8,260,029,923	₱2,826,722,280	₱77,412,544,972

* *Other financial assets consist of accounts receivables, accrued interest receivables, and returned checks and other cash items*

The credit quality of financial assets is managed by the Bank using the BSP guidelines in identifying and monitoring problematic loans and other risk assets particularly Appendix 18 of the Manual of Regulations for Banks.

For loans and receivables, risk rating is made based on the loan classification of BSP. High grade comprised of unclassified loans which may include technical past-due accounts, which under BSP regulations are not considered as outright past-due.

Standard grade comprised of loans that have loan classification of miscellaneous exception and loans especially mentioned. Standard grade may also include matured loans subject to renewal. Sub-standard grade are accounts that are watch listed based on internal credit assessment, accounts that have the tendency to turn past due and were initially assessed to be specifically impaired but in the end were collectively assessed for impairment. Loans with classification of doubtful and loss are included under past-due or individually impaired.

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The attributable risk ratings are assessed and updated regularly. The standard credit rating equivalent grades are relevant only for certain of the exposures in each risk rating class.

Due from BSP and due from other banks are classified as high grade since these are deposited in/or transacted with reputable banks which has low probability of insolvency. Quoted bonds which are either issued by the Philippine government or reputable companies are classified as High grade. Unquoted bonds are classified as standard grade based on the reputation of the counterparty and lack of marketability as compared with quoted investments.

The tables below show the aging analysis of gross past due but not individually impaired loans and receivables that the Bank held as of December 31, 2017 and 2016:

	December 31, 2017				
	Less than 30 days	**31 to 60 days**	**61 to 90 days**	**More than 90 days**	**Total**
Loans and receivables					
Loans and discounts					
Corporate and commercial lending	**₱176,439,628**	**₱64,340,942**	**₱84,878,919**	**₱750,560,684**	**₱1,076,220,173**
Consumer lending	**14,805,169**	**20,658,742**	**169,782,241**	**1,311,488,335**	**1,516,734,487**
Others	**204,681**	**172,281**	**291,869**	**5,595,467**	**6,264,298**
Sales contract receivable	**44,552**	**146,624**	**8,705,348**	**29,499,987**	**38,396,511**
Other assets					
Accrued interest receivable	**1,032,222**	**975,215**	**5,257,483**	**66,868,719**	**74,133,639**
	₱192,526,252	**₱86,293,804**	**₱268,915,860**	**₱2,164,013,192**	**₱2,711,749,108**

	December 31, 2016				
	Less than 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
Loans and receivables					
Loans and discounts					
Corporate and commercial lending	₱3,098,578,741	₱6,949,326	₱32,143,087	₱420,407,321	₱3,558,078,475
Consumer lending	2,624,452,894	60,149,944	115,683,293	1,726,025,088	4,526,311,219
Others	1,445,501	231,298	367,846	8,880,958	10,925,603
Sales contract receivable	73,050,219	1,371,888	1,413,440	–	75,835,547
Other assets					
Accrued interest receivable	39,451,341	8,191,533	41,236,205	–	88,879,079
	₱5,836,978,696	₱76,893,989	₱190,843,871	₱2,155,313,367	₱8,260,029,923

Impairment assessment
The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than ninety (90) days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed impairment and collectively assessed impairment.

Individually assessed impairment
The Bank determines the allowances appropriate for each significant loan or advances on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realizable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed impairment
Allowances are assessed collectively for losses on loans and advances that are not individually significant (including residential mortgages and unsecured consumer lending) and for individually significant loans and advances that have no objective evidence as a result of individual impairment assessment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no objective evidence of impairment yet in an individual assessment.

Impairment losses are estimated by taking the following information into consideration: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired.

Management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

Credit Review
In accordance with BSP Circular 855, credit reviews are conducted on loan accounts to evaluate whether loans are granted in accordance with the Bank's policies, to assess loan quality and appropriateness of classification and adequacy of loan loss provisioning. Results of credit reviews are promptly reported to management to apprise them of any significant findings for proper corrective actions.

Market Risk
Market risk is the risk of loss that may result from changes in the price of a financial product. The value of a financial product may change as a result of changes in interest rates, foreign exchange rates, commodity prices, equity prices and other market changes. The Bank's market risk originates from its holdings of foreign exchange instruments and debt securities.

a. *Interest rate risk*
The Bank's interest rate risk originates from its holdings of interest rate sensitive assets and interest rate sensitive liabilities. The Bank follows prudent policies in managing its exposures to interest rate fluctuations, and constantly monitors its assets and liabilities.

The table below presents the interest rate sensitive loans' composition as to maturity as of December 31, 2017 and 2016:

	2017	2016
Long-term retail loans with monthly amortization	**45.24%**	29.46%
Commercial loans with monthly or quarterly amortization	**43.24%**	68.36%
Commercial loans payable at maturity (mostly maturing for less than 6 months)	**11.52%**	2.18%
	100.00%	100.00%

The table below represents the percentage of interest bearing demand, savings and time deposit accounts over total deposit liabilities for the year ended December 31, 2017 and 2016:

	2017	2016
Demand	**20.01%**	17.86%
Savings	**12.23%**	12.69%
Time	**67.37%**	69.01%
	99.61%	99.56%

Interest rates on savings accounts are set by reference to prevailing market rates, while interest rates on time deposits and special savings accounts are usually priced by reference to prevailing rates of short-term government bonds and other money market instruments or, in the case of foreign currency deposits, inter-bank deposit rates and other benchmark deposit rates in international money markets with similar maturities.

The Bank is likewise exposed to fair value interest rate risk due to its holdings of fixed rate government bonds as part of its FVPL and AFS portfolio. Market values of these investments are sensitive to fluctuations in interest rates.

The asset-liability gap analysis method is used by the Bank to measure the sensitivity of its assets and liabilities to interest rate fluctuations. This analysis measures the Bank's susceptibility to changes in interest rates. The repricing gap is calculated by first distributing the assets and liabilities contained in the Bank's statement of financial position into tenor buckets according to the time remaining to the next repricing date (or the time remaining to maturity if there is no repricing), and then obtaining the difference between the total of the repricing (interest rate sensitive) assets and the total of repricing (interest rate sensitive) liabilities.

A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities.

Accordingly, during a period of rising interest rates, a bank with a positive gap would be in a position to invest in higher yielding assets earlier than it would need to refinance its interest rate sensitive liabilities. During a period of falling interest rates, a bank with a positive gap would tend to see its interest rate sensitive assets repricing earlier than its interest rate sensitive liabilities, restraining the growth of its net income or resulting in a decline in net interest income.

The following table sets forth the repricing gap position of the Bank as of December 31, 2017 and 2016 (in millions):

	December 31, 2017					
	Up to 1 Month	**>1 to 3 Months**	**>3 to 6 Months**	**>6 to 12 Months**	**>12 Months**	**Total**
Financial Assets						
Loans and receivables	**₱14,806**	**₱6,919**	**₱4,646**	**₱4,657**	**₱28,521**	**₱59,549**
Investment securities	**–**	**–**	**–**	**–**	**1,929**	**1,929**
Total financial assets	**14,806**	**6,919**	**4,646**	**4,657**	**30,450**	**61,478**
Financial Liabilities						
Deposit liabilities	**56,620**	**8,840**	**995**	**1,099**	**7,925**	**75,479**
Repricing gap	**(₱41,814)**	**(₱1,921)**	**₱3,651**	**₱3,558**	**₱22,525**	**(₱14,001)**

	December 31, 2016					
	Up to 1 Month	>1 to 3 Months	>3 to 6 Months	>6 to 12 Months	>12 Months	Total
Financial Assets						
Loans and receivables	₱5,624	₱7,713	₱6,438	₱5,556	₱29,682	₱55,013
Investment securities	–	–	32	36	1,789	1,857
Total financial assets	5,624	7,713	6,470	5,592	31,471	56,870
Financial Liabilities						
Deposit liabilities	45,845	13,245	2,122	894	9,149	71,255
Repricing gap	(₱40,221)	(₱5,532)	₱4,348	₱4,698	₱22,322	(₱14,385)

The Bank also monitors its exposure to fluctuations in interest rates by using scenario analysis to estimate the impact of interest rate movements on its interest income. This is done by modeling the impact to the Bank's interest income and interest expenses of different parallel changes in the interest rate curve, assuming the parallel change only occurs once and the interest rate curve after the parallel change does not change again for the next twelve months.

The following table sets forth the estimated change in the Bank's annualized net interest income due to a parallel change in the interest rate curve as of December 31, 2017 and 2016 (amounts in thousands):

	December 31, 2017			
	Change in interest rates (in basis points)			
	100bp rise	**50bp rise**	**50bp fall**	**100bp fall**
Change in annualized net interest income	**(₱253,455)**	**(₱126,728)**	**₱126,728**	**₱253,455**
As a percentage of the Bank's net interest income	**(7.62%)**	**(3.81%)**	**3.81%**	**7.62%**

	December 31, 2016			
	Change in interest rates (in basis points)			
	100bp rise	50bp rise	50bp fall	100bp fall
Change in annualized net interest income	(₱245,096)	(₱122,548)	₱122,548	₱245,096
As a percentage of the Bank's net interest income	(8.38%)	(4.19%)	4.19%	8.38%

The table below demonstrates the sensitivity, to a reasonably possible change in interest rates with all other variables held constant, of the Bank's net income before tax through the impact on unrealized gain/loss on FVPL investments and the Bank's equity through the impact on unrealized gain/loss on AFS financial assets in fixed rate debt securities (amounts in thousands).

	December 31, 2017			
	Change in interest rates (in basis points)			
	25bp rise	**10bp rise**	**10bp fall**	**25bp fall**
Change in income	**(₱766)**	**(₱304)**	**₱321**	**₱795**
Change in equity	**(32,827)**	**(13,246)**	**13,317**	**33,587**

	December 31, 2016			
	Change in interest rates (in basis points)			
	25bp rise	10bp rise	10bp fall	25bp fall
Change in income	(₱8,049)	(₱4,500)	₱321	₱4,003
Change in equity	(19,485)	(1,219)	23,555	42,457

b. *Foreign currency risk*

The Bank's foreign exchange risk originates from its holdings of foreign currency-denominated assets and liabilities (foreign exchange assets and liabilities). Foreign currency risk is the risk to earnings or capital arising from changes in the foreign exchange rates.

The Bank's policy is to maintain foreign currency exposure within existing regulations, and within acceptable risk limits. The Bank believes in ensuring its foreign currency is at all times within limits prescribed for financial institutions who are engaged in the same types of businesses in which the Bank is engaged.

The monetary assets and liabilities carried in the RBU and FCDU books are all denominated in their respective functional currencies, except for small non-recurring other monetary items. Thus, risk is minimal.

Liquidity Risk and Funding Management

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 become due without incurring unacceptable losses or costs.

The Bank's liquidity management involves maintaining funding capacity to accommodate fluctuations in asset and liability levels due to changes in the Bank's business operations or unanticipated events created by customer behavior or capital market conditions. The Bank seeks to ensure liquidity through a combination of active management of liabilities, a liquid asset portfolio composed substantially of deposits in primary and secondary reserves, and the securing of money market lines and the maintenance of repurchase facilities to address any unexpected liquidity situations.

Liquidity risk is monitored and controlled primarily by a gap analysis of maturities of relevant assets and liabilities reflected in the maximum cumulative outflow report, as well as an analysis of available liquid assets. Furthermore, monthly internal liquidity ratio equivalent to the ratio of volatile deposits has been set to determine sufficiency of liquid assets over deposit liabilities.

Liquidity is managed by the Bank on a daily basis, while scenario stress tests are conducted monthly. The tables below show the maturity profile of the Bank's financial assets and financial liabilities, based on contractual undiscounted cash flows:

	December 31, 2017			
	On demand	**Within 1 year**	**Over 1 year***	**Total**
Financial Assets				
Cash and cash equivalents				
Cash and other cash items	**₱1,501,172,842**	**₱–**	**₱–**	**₱1,501,172,842**
Due from BSP	**6,772,976,958**	**–**	**–**	**6,772,976,958**
Due from other banks	**1,295,937,378**	**563,856,540**	**–**	**1,859,793,918**
SPURA	**–**	**1,404,674,283**	**–**	**1,404,674,283**
FVPL investments	**–**	**141,272,757**	**–**	**141,272,757**
AFS financial assets	**–**	**95,392,107**	**2,335,286,754**	**2,430,678,861**
HTM financial assets	**–**	**179,014,447**	**3,879,617,576**	**4,058,632,023**
Loans and receivables	**–**	**25,025,570,186**	**54,609,209,908**	**79,634,780,094**
Other assets				
Accounts receivable	**–**	**713,387,674**	**–**	**713,387,674**
Accrued interest receivable	**–**	**685,256,474**	**–**	**685,256,474**
Returned checks and other cash items	**–**	**96,299,176**	**–**	**96,299,176**
Total financial assets	**₱9,570,087,178**	**₱28,904,723,644**	**₱60,824,114,238**	**₱99,298,925,060**
Financial Liabilities				
Deposit liabilities				
Demand	**₱15,589,330,155**	**₱–**	**₱–**	**₱15,589,330,155**
Savings	**9,351,070,190**	**–**	**–**	**9,351,070,190**
Time	**–**	**43,737,970,618**	**10,016,816,338**	**53,754,786,956**
Manager's checks	**731,802,306**	**–**	**–**	**731,802,306**
Accrued interest and other expenses	**–**	**266,559,551**	**–**	**266,559,551**
Other liabilities				
Accounts payable	**–**	**889,378,524**	**–**	**889,378,524**
Other credits - dormant	**–**	**–**	**83,919,568**	**83,919,568**
Due to the Treasurer of the Philippines	**–**	**9,224,406**	**–**	**9,224,406**
Bills purchased	**–**	**7,842,548**	**–**	**7,842,548**
Security deposit	**–**	**–**	**3,885,646**	**3,885,646**
Other payable	**–**	**5,437,792**	**–**	**5,437,792**
Total financial liabilities	**₱25,672,202,651**	**₱44,916,413,439**	**₱10,104,621,552**	**₱80,693,237,642**

	December 31, 2016			
	On demand	Within 1 year	Over 1 year	Total
Financial Assets				
Cash and cash equivalents				
Cash and other cash items	₱1,335,478,440	₱–	₱–	₱1,335,478,440
Due from BSP	5,707,366,683	950,329,861	–	6,657,696,544
Due from other banks	2,216,221,314	175,071,174	–	2,391,292,488
SPURA	–	493,324,054	–	493,324,054
FVPL investments	–	471,016,949	–	471,016,949
AFS financial assets	–	69,601,750	2,744,532,404	2,814,134,154
HTM financial assets	–	9,023,343	4,536,653,819	4,545,677,162
Loans and receivables	–	33,197,750,301	33,907,812,069	67,105,562,370
Other assets				
Accounts receivable	–	748,318,527	–	748,318,527
Accrued interest receivable	–	519,301,975	–	519,301,975
Returned checks and other cash items	–	14,542,197	–	14,542,197
Total financial assets	₱9,259,066,437	₱36,648,280,131	₱41,188,998,292	₱87,096,344,860
Financial Liabilities				
Deposit liabilities				
Demand	₱13,094,377,769	₱–	₱–	₱13,094,377,769
Savings	9,081,655,844	–	–	9,081,655,844
Time	–	40,358,983,570	14,326,200,067	54,685,183,637
Manager's checks	584,201,621	–	–	584,201,621
Accrued interest and other expenses	–	279,852,427	–	279,852,427
Other liabilities				
Accounts payable	–	691,493,796	–	691,493,796
Other credits - dormant	–	–	81,790,086	81,790,086
Due to the Treasurer of the Philippines	–	3,470,735	–	3,470,735
Bills purchased	–	13,364,731	–	13,364,731
Security deposit	–	–	3,368,425	3,368,425
Other payable	–	4,676,234	–	4,676,234
Total financial liabilities	₱22,760,235,234	₱41,351,841,493	₱14,411,358,578	₱78,523,435,305

6. Cash and Cash Equivalents

	2017	2016
Cash and other cash items	**₱1,501,172,842**	₱1,335,478,440
Due from BSP (Note 15)	**6,772,976,958**	6,657,366,683
Due from other banks (Notes 24 and 28)	**1,856,049,625**	2,391,019,366
SPURA (Note 28)	**1,404,323,202**	493,077,515
	₱11,534,522,627	₱10,876,942,004

Due from BSP
Due from BSP represents the Bank's placements in the term deposit facilities (TDF) of the BSP that have original maturity of one (1) to seven (7) days and the demand deposits maintained by the Bank in compliance with the BSP's reserve requirement (Note 15).

As of December 31, 2017 and 2016, the Bank's demand deposits with the BSP amounted to ₱6.77 billion and ₱5.71 billion, respectively. TDF deposit accounts earn an annual interest rate of 2.50% in 2017, 2016 and 2015.

Due from other banks
Due from other banks represent savings and demand deposits. USD-denominated deposits amounted to USD8.86 million (₱442.26 million) and USD19.89 million (₱988.93 million) as of December 31, 2017 and 2016, respectively.

Peso denominated deposits earn interest at annual rates ranging from 0.10% to 1.25% in 2017, from 0.10% to 1.50% in 2016 and from 0.13% to 1.50% in 2015. USD-denominated deposits earn interest at annual rates ranging from 0.25% to 1.63% in 2017 and 2016 and from 0.25% to 1.85% in 2015.

SPURA
Deposits in reverse repurchase facility, classified as SPURA, amounted to ₱1.40 billion and ₱0.49 billion as of December 31, 2017 and 2016, respectively. SPURA earns interest at an annual rate of 3.00% in 2017 and 2016 with tenor of five (5) days.

Interest Income
Total interest income earned on deposits with BSP and other banks amounted to ₱14.09 million, ₱64.56 million and ₱35.52 million in 2017, 2016 and 2015, respectively. Interest income earned from SPURA amounted to ₱91.95 million and ₱37.99 million in 2017 and 2016, respectively.

7. Investment Securities

FVPL Investments
As of December 31, 2017 and 2016, FVPL investments pertain to the peso-denominated and USD-denominated government securities of the Bank. Peso-denominated government securities amounted to ₱100.57 million and ₱307.46 million, while USD-denominated government securities amounted to USD0.70 million (₱34.83 million) and USD3.29 million (₱163.56 million) as of December 31, 2017 and December 31, 2016, respectively.

The carrying amount of FVPL investments includes unrealized gain of ₱4.20 million and unrealized loss of ₱12.91 million as of December 31, 2017 and 2016, respectively.

AFS Financial Assets
This account consists of:

	2017	2016
Quoted		
Government debt securities (Note 23)	**₱1,734,267,611**	₱1,503,335,389
Private debt securities	**440,453,241**	585,602,110
	2,174,720,852	2,088,937,499
Unquoted securities	**118,948,359**	120,953,971
	2,293,669,211	2,209,891,470
Allowance for impairment losses (Note 14)	**(73,043,127)**	(63,153,755)
	₱2,220,626,084	₱2,146,737,715

The movements in net unrealized losses on AFS financial assets, including those reclassified to HTM, follow:

	2017	2016	2015
Balance at beginning of year	**₱157,713,132**	₱23,926,611	₱9,636,153
Net unrealized loss (gain) on changes in fair value of AFS financial assets	**(85,284,684)**	73,138,076	5,399,283
Net realized gain on sale of AFS financial assets	**63,355,179**	61,119,743	9,080,459
Amortization of unrealized gain of AFS financial assets reclassified to HTM financial assets	**(3,267,094)**	(471,298)	–
	(25,196,599)	133,786,521	14,479,742
Effect of merger (Note 29)	–	–	(189,284)
Balance at end of year	**₱132,516,533**	₱157,713,132	₱23,926,611

AFS quoted government debt securities have effective interest rates ranging from 2.73% to 4.50%, 1.45% to 3.84% and 1.35% to 6.60% in 2017, 2016 and 2015, respectively. These investments have maturity dates ranging from 2 to 24 years, 1 to 18 years and 1 to 25 years, in 2017, 2016 and 2015, respectively.

Quoted private debt securities earn effective interest rate ranging from 3.89% to 6.72% in 2017, from 3.89% to 6.73% in 2016 and from 5.87% to 6.73% in 2015. These securities have maturity dates ranging from 2 to 8 years, from 6 to 10 years and from 1 to 4 years, for 2017, 2016 and 2015, respectively.

Unquoted securities include shares of stocks of various unlisted private corporations. As of December 31, 2017 and 2016, these securities are carried at cost, net of allowance for impairment losses of ₱57.10 million.

HTM Financial Assets

As of December 31, 2017 and 2016, peso-denominated government securities and private bonds amounted to ₱1.91 billion and ₱1.74 billion, respectively (Note 23). These financial assets carry a yield-to-maturity ranging from 2.40% to 4.62%, from 2.26% to 7.25% and from 2.73% to 8.25% in 2017, 2016 and 2015, respectively, with maturities ranging from 1 to 20 years for 2017 and from 1 to 22 years for 2016 and 2015.

As of December 31, 2017 and 2016, USD-denominated government securities and private bonds amounted to USD31.95 million (₱1.59 billion) and USD32.00 million (₱1.59 billion), respectively. These financial assets carry a yield-to-maturity ranging from 3.01% to 4.62% in 2017, from 2.36% to 4.08% in 2016 and from 3.11% to 3.81% in 2015, with maturities ranging from 3 to 20 years for 2017 and from 1 to 22 years for 2016 and 2015.

As of December 31, 2017 and 2016, government securities with face and carrying value of ₱250.00 million and ₱252.50 million and ₱250.00 million and ₱253.78 million, respectively, are pledged to CBC in compliance with DOSRI rules.

Reclassification of Financial Assets

2016 Reclassification

On November 18, 2016, the Bank reclassified certain AFS financial assets with fair value of ₱274.12 million and USD 8.72 million (₱434.29 million) for peso-denominated and USD-denominated government bonds, respectively. The decision to effect this transfer was reached by balancing the need to reduce the market risk sensitivity of the statement of financial position without reducing the Bank's portfolio of liquid assets. The previous valuation losses amounting to ₱11.86 million and USD 0.92 million (₱45.94 million) that have been recognized in OCI will be amortized to profit or loss over the remaining life of the HTM financial assets using the effective interest rates ranging from 4.21% to 5.04% and from 3.72% to 3.85% for peso-denominated and USD-denominated government bonds, respectively.

As of December 31, 2017 and 2016, the transferred assets had the following balances:

	2017					
	Face Value at reclassification Date	**Carrying Value at reclassification Date**	**Carrying Value as of December 31**	**Fair Value as of December 31**	**Unamortized Net Unrealized Loss in Equity**	**Amortization**
(in original currency)						
Philippine peso-denominated government bonds	**₱250,000,000**	**₱274,122,724**	**₱273,035,350**	**₱261,817,072**	**(₱10,881,112)**	**₱822,974**
US dollar-denominated government bonds	**USD6,500,000**	**USD8,724,285**	**USD8,617,548**	**USD8,778,600**	**(USD868,065)**	**USD48,730**

	2016					
	Face Value at reclassification Date	Carrying Value at reclassification Date	Carrying Value as of December 31	Fair Value as of December 31	Unamortized Net Unrealized Loss in Equity	Amortization
(in original currency)						
Philippine peso-denominated government bonds	₱250,000,000	₱274,122,724	₱274,024,778	₱269,225,028	(₱11,704,086)	₱162,307
US dollar-denominated government bonds	USD6,500,000	USD8,724,285	USD8,712,920	USD8,529,165	(USD916,795)	USD6,195

Had these securities not been transferred to HTM financial assets, the statement of comprehensive income would have decreased from fair value loss by ₱7.40 million and ₱4.80 million on peso-denominated government bonds in 2017 and 2016, respectively, and increased from fair value gain by USD0.23 million (₱11.48 million) and USD0.18 million (₱8.72 million) on USD-denominated government bonds in 2017 and 2016, respectively.

The effective interest rates on the reclassified financial assets at reclassification date range from 4.21% to 5.04% for peso-denominated government bonds. The effective interest rates on the reclassified financial assets range from 3.72% to 3.85% for USD-denominated bonds at the time of their reclassification. The Bank expects to recover 100.00% of the principal and the interest due on these reclassified financial assets. These securities are also unimpaired as of December 31, 2017 and 2016.

Interest Income on Investment Securities

Interest income on investment securities follows:

	2017	2016	2015
HTM financial assets	**₱147,744,287**	₱98,071,192	₱4,385,614
AFS financial assets	**102,951,714**	88,855,071	51,478,044
FVPL investments	**12,112,361**	25,475,318	–
	₱262,808,362	₱212,401,581	₱55,863,658

Trading and Securities Gains
Details of trading and securities gains are as follows:

	2017	2016	2015
Net unrealized gain (loss) on changes in fair value of FVPL investments	**(₱1,646,852)**	₱1,307,647	(₱733,991)
Net realized gain on sale of:			
FVPL investments	**7,163,595**	26,869,097	10,802,565
AFS financial assets	**63,355,179**	61,119,743	9,080,459
	₱68,871,922	₱89,296,487	₱19,149,033

8. **Loans and Receivables**

This account consists of:

	2017	2016
Loans and discounts		
Corporate and commercial lending	**₱34,585,719,879**	₱35,444,699,640
Consumer lending	**29,841,681,350**	24,253,223,373
Others	**38,752,773**	66,932,667
	64,466,154,002	59,764,855,680
Unearned interest and discounts	**(32,544,387)**	(49,556,801)
	64,433,609,615	59,715,298,879
Unquoted debt securities	**254,747,724**	254,877,099
Sales contracts receivable	**794,267,343**	722,965,720
	65,482,624,682	60,693,141,698
Allowance for credit losses (Note 14)	**(2,338,300,602)**	(2,460,325,896)
	₱63,144,324,080	₱58,232,815,802

As of December 31, 2017 and 2016, 47.91% and 42.65% of the total loans and receivables, respectively, are subject to periodic interest repricing. In 2017, 2016 and 2015, the remaining loans and receivables bear annual fixed interest rates ranging from 2.00% to 39.43%, from 3.25% to 39.43% and from 1.50% to 39.43%, respectively.

Unquoted debt securities
Included in unquoted debt securities are notes issued by First Sovereign Asset Management Inc. (FSAMI) as part of the payment it made to the Bank in exchange for selected investment properties, non-performing loans, AFS financial assets and other assets of the latter as identified in the Omnibus Agreement.

Under the Omnibus Agreement dated July 2, 2007, the purchase price for the assets sold, transferred and conveyed by the Bank to FSAMI aggregated to ₱2.21 billion, payable as follows:

First Tranche	₱10,000,000
Second Tranche	1,676,000,000
Third Tranche	528,758,638
	₱2,214,758,638

The first two tranches have been settled by FSAMI on June 25, 2007 and July 2, 2007.

The third tranche was partially collected on October 31, 2007 in the amount of ₱188.76 million and the remaining balance of ₱340.00 million was paid through issuance of a new promissory note with final maturity date of June 26, 2017 and the following mandatory principal repayments and principal payment dates:

a) 50.00% of the principal amount plus accrued interest on or before June 26, 2012 (which was subsequently extended to June 16, 2014); and
b) the balance of 50.00% of the principal amount plus accrued interest payable on June 26, 2017.

On February 11, 2015, the Bank collected the amount of ₱10.00 million out of the ₱340.00 million promissory note issued by FSAMI. On March 5, 2015, the promissory note for the remaining balance of ₱330.00 million was renewed by FSAMI and which was approved by the ExeCom of the Bank on the same date the promissory note was renewed. The repayment proposal is as follows:

a. quarterly principal payment of ₱30.00 million starting by July 2015; and
b. monthly interest payment based on current loan balance, initially at 6.45% subject to quarterly repricing for downward adjustment and allows prepayment of loan without penalties, charges and fees.

The promissory note is secured by real estate properties mortgaged by FSAMI to the Bank with total appraised value of ₱474.89 million. In 2016, the remaining receivables from FSAMI with carrying amount of ₱240.00 million were collected.

Regulatory Reporting
The BSP considers that loan concentration exists when total loan exposure to a particular industry or economic sector exceeds 30.00% of total loan portfolio. Identified concentration of credit risks are managed and controlled (Note 5).

Information on the amounts of secured and unsecured loans and receivables (gross of unearned interests and discounts and allowance for credit losses) follows:

	2017		2016	
	Amounts	**%**	Amounts	%
Loans secured by				
Real estate	**₱28,980,785,226**	**44.24**	₱25,764,704,385	42.42
Chattel mortgage	**13,374,018,339**	**20.41**	10,186,280,369	16.77
Deposit hold out and others	**2,225,876,981**	**3.40**	2,911,432,059	4.79
	44,580,680,546	**68.05**	38,862,416,813	63.98
Unsecured loans	**20,934,488,523**	**31.95**	21,880,281,686	36.02
	₱65,515,169,069	**100.00**	₱60,742,698,499	100.00

Nonperforming Loans
Generally, nonperforming loans (NPLs) refer to loans whose principal and/or interest is unpaid for thirty (30) days or more after due date or after they have become past due in accordance with existing BSP rules and regulations. This shall apply to loans payable in lump sum and loans payable in quarterly, semi-annual, or annual installments, in which case, the total outstanding balance thereof shall be considered nonperforming. Under BSP Circular No. 772, which was issued on October 16, 2012, gross NPLs include NPLs that are covered with 100% allowance.

In the case of loans payable in monthly installments, the total outstanding balance thereof shall be considered non-performing when three (3) or more installments are in arrears.

In the case of loans payable daily, weekly or semi-monthly installment, the total outstanding balance thereof shall be 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 shall be considered as past due when the total amount of arrearages reaches twenty percent (20.00%) of the total loan balance.

Loans are classified as nonperforming in accordance with BSP regulations, or when, in the opinion of management, collection of interest or principal is doubtful. Loans are not reclassified as performing until interest and principal payments are brought current or the loans are restructured in accordance with existing BSP regulations, and future payments appear assured.

As of December 31, 2017 and 2016, NPLs of the Bank not fully covered by allowance for credit losses follow:

	2017	2016
Total NPLs	**₱3,926,539,784**	₱4,372,357,172
NPLs fully covered by allowance for credit losses	**(1,534,335,467)**	(1,755,800,395)
	₱2,392,204,317	₱2,616,556,777

As of December 31, 2017 and 2016, secured and unsecured NPLs of the Bank follow:

	2017	2016
Secured	**₱2,745,788,782**	₱2,473,413,247
Unsecured	**1,180,751,002**	1,898,943,925
	₱3,926,539,784	₱4,372,357,172

Interest Income on Loans and Receivables

Interest income on loans and receivables consist of interest income on:

	2017	2016	2015
Loans and discounts			
Consumer lending	**₱2,237,979,198**	₱2,303,853,620	₱1,225,952,373
Corporate and commercial lending	**1,945,444,015**	1,411,825,952	182,125,014
Others	**2,011,277**	882,422	970,431
Unquoted debt securities	**6,076,951**	9,294,803	20,018,373
Sales contract receivable	**78,011,889**	99,649,576	14,392,562
	₱4,269,523,330	₱3,825,506,373	₱1,443,458,753

9. Non-current Assets Held for Sale

Non-current assets held for sale consist of vehicles foreclosed in settlement of loans receivable which are expected to be sold within one year from the reporting date.

	2017	2016
Balance at beginning of year	**₱225,139,735**	₱77,051,290
Additions	**556,689,819**	273,162,692
Disposals	**(569,798,363)**	(125,074,247)
Balance at end of year	**₱212,031,191**	₱225,139,735

Gain (loss) on asset exchange
Gain (loss) on asset exchange includes:

	2017	2016	2015
NCAHS			
Loss on foreclosure	**₱45,211,019**	₱57,458,603	₱18,000,538
Loss on sale	**85,179,458**	14,442,252	15,413,785
	130,390,477	71,900,855	33,414,323
Investment properties (Note 11)			
Gain on foreclosure	**112,233,652**	68,214,992	9,159,818
Gain (loss) on sale	**138,687,608**	125,094,009	(212,546)
	250,921,260	193,309,001	8,947,272
	₱120,530,783	₱121,408,146	(₱24,467,051)

10. Property and Equipment

The composition of and movements in this account follow:

	December 31, 2017				
	Land	**Condominium Properties, Buildings and Improvements**	**Furniture, Fixtures and Equipment**	**Leasehold Improvements**	**Total**
Cost					
Balance at beginning of year	**₱390,937,334**	**₱857,231,899**	**₱1,080,062,273**	**₱267,476,886**	**₱2,595,708,392**
Additions	**–**	**33,378,466**	**188,885,440**	**121,396,100**	**343,660,006**
Disposal	**–**	**(18,763,249)**	**(105,574,350)**	**(9,993,887)**	**(134,331,486)**
Balance at end of year	**390,937,334**	**871,847,116**	**1,163,373,363**	**378,879,099**	**2,805,036,912**
Accumulated Depreciation					
Balance at beginning of year	**–**	**490,430,979**	**809,593,963**	**95,513,016**	**1,395,537,958**
Depreciation and amortization	**–**	**43,164,253**	**126,338,667**	**67,875,168**	**237,378,088**
Disposal	**–**	**(3,835,003)**	**(72,795,197)**	**–**	**(76,630,200)**
Balance at end of year	**–**	**529,760,229**	**863,137,433**	**163,388,184**	**1,556,285,846**
Net Book Value at End of Year	**₱390,937,334**	**₱342,086,887**	**₱300,235,930**	**₱215,490,915**	**₱1,248,751,066**

	December 31, 2016				
	Land	Condominium Properties, Buildings and Improvements	Furniture, Fixtures and Equipment	Leasehold Improvements	Total
Cost					
Balance at beginning of year	₱392,716,334	₱845,985,337	₱927,459,595	₱184,381,626	₱2,350,542,892
Additions	–	11,246,562	175,707,477	83,095,260	270,049,299
Disposal	(1,779,000)	–	–	–	(1,779,000)
Write-offs	–	–	(23,104,799)	–	(23,104,799)
Balance at end of year	390,937,334	857,231,899	1,080,062,273	267,476,886	2,595,708,392
Accumulated Depreciation					
Balance at beginning of year	–	439,797,630	700,806,859	39,407,860	1,180,012,349
Depreciation and amortization	–	50,633,349	122,927,059	56,105,156	229,665,564
Write-offs	–	–	(14,139,955)	–	(14,139,955)
Balance at end of year	–	490,430,979	809,593,963	95,513,016	1,395,537,958
Accumulated Impairment Losses (Note 14)					
Balance at beginning of year	–	4,656,760	–	–	4,656,760
Reclassification	–	(4,656,760)	–	–	(4,656,760)
Balance at end of year	–	–	–	–	–
Net Book Value at End of Year	₱390,937,334	₱366,800,920	₱270,468,310	₱171,963,870	₱1,200,170,434

The details of depreciation and amortization under the statements of income follow:

	2017	2016	2015
Property and equipment	**₱237,378,088**	₱229,665,564	₱145,811,353
Investment properties (Note 11)	**88,305,477**	67,471,265	33,671,614
Software costs (Note 12)	**20,140,452**	29,092,299	6,883,274
	₱345,824,017	₱326,229,128	₱186,366,241

As of December 31, 2017 and 2016, the gross carrying amount of fully depreciated building and furniture, fixtures and equipment still in use amounted to ₱579.98 million and ₱529.43 million, respectively.

There are no restrictions on titles on property and equipment and the Bank does not have any contractual commitments for acquisition of property and equipment as of December 31, 2017 and 2016.

11. Investment Properties

The composition of and movements in this account follow:

	December 31, 2017		
	Land	**Condominium Properties, Buildings and Improvements**	**Total**
Cost			
Balance at beginning of year	**₱2,461,399,498**	**₱1,590,186,100**	**₱4,051,585,598**
Additions	**259,233,480**	**193,203,804**	**452,437,284**
Disposals	**(237,068,848)**	**(197,092,543)**	**(434,161,391)**
Balance at end of year	**2,483,564,130**	**1,586,297,361**	**4,069,861,491**

(Forward)

	December 31, 2017		
	Land	**Condominium Properties, Buildings and Improvements**	**Total**
Accumulated Depreciation			
Balance at beginning of year	**₱–**	**₱360,936,156**	**₱360,936,156**
Depreciation (Note 10)	**–**	**88,305,477**	**88,305,477**
Disposals	**–**	**(25,548,763)**	**(25,548,763)**
Balance at end of year	**–**	**423,692,870**	**423,692,870**
Accumulated Impairment Losses (Note 14)			
Balance at beginning of year	**40,546,836**	**440,909,699**	**481,456,535**
Reclassification	**105,228,231**	**(97,661,683)**	**7,566,548**
Balance at end of year	**145,775,067**	**343,248,016**	**489,023,083**
Net Book Value at End of Year	**₱2,337,789,063**	**₱819,356,475**	**₱3,157,145,538**

	December 31, 2016		
	Land	Condominium Properties, Buildings and Improvements	Total
Cost			
Balance at beginning of year	₱2,430,924,962	₱1,429,456,027	₱3,860,380,989
Additions	193,428,336	282,230,834	475,659,170
Disposals	(162,953,800)	(121,500,761)	(284,454,561)
Balance at end of year	2,461,399,498	1,590,186,100	4,051,585,598
Accumulated Depreciation			
Balance at beginning of year	–	331,532,751	331,532,751
Depreciation (Note 10)	–	67,471,265	67,471,265
Disposals	–	(38,067,860)	(38,067,860)
Balance at end of year	–	360,936,156	360,936,156
Accumulated Impairment Losses (Note 14)			
Balance at beginning of year	57,405,066	476,632,365	534,037,431
Provision for impairment losses (Note 14)	3,622,869	–	3,622,869
Reclassification	(20,481,099)	(35,722,666)	(56,203,765)
Balance at end of year	40,546,836	440,909,699	481,456,535
Net Book Value at End of Year	₱2,420,852,662	₱788,340,245	₱3,209,192,907

The table below summarizes the valuation techniques used and the significant unobservable inputs to the valuation for each type of investment properties held by the Bank:

	Valuation Techniques	**Significant Unobservable Inputs**
Land	Market Data Approach	Price per square meter, size, location, shape, time, element and corner influence
Land and Building	Market Data Approach and Cost Approach	Reproduction cost new - the cost to create a virtual replica of the existing structure, employing the same design and similar building materials

Details of rent income earned and direct operating expense incurred on investment properties of the Bank follow:

	2017	2016	2015
Rent income on investment properties (included under income from property rentals)	**₱25,657,843**	₱22,255,495	₱19,176,051
Direct operating expenses on investment properties not generating rent income (included under miscellaneous expenses)	**18,624,718**	5,274,892	3,816,188

Expenses on investment properties generating rent income are shouldered by the lessee.

12. Intangible Assets

Branch Licenses

This pertains to branch licenses recognized by the Bank in connection with its merger with PDB (Note 29). The recoverable amounts of these branch licenses have been determined using fair market value less cost to sell approach. The fair market value is based on special licensing fee of BSP for branches operating in restricted areas. As of December 31, 2017 and 2016, the branch licenses are not impaired.

Software Costs

Movements in software costs are as follows:

	2017	2016
Cost		
Balance at beginning of year	**₱138,720,197**	₱121,267,859
Additions	**16,544,421**	22,786,398
Write-off	–	(5,334,060)
Balance at end of year	**155,264,618**	138,720,197
Accumulated amortization		
Balance at beginning of year	**61,686,174**	37,927,935
Amortization (Note 10)	**20,140,452**	29,092,299
Write-off	–	(5,334,060)
Balance at end of year	**81,826,626**	61,686,174
Net Book Value at End of Year	**₱73,437,992**	₱77,034,023

13. Other Assets

This account consists of:

	2017	2016
Financial		
Accounts receivable (Note 24)	**₱713,387,674**	₱748,318,527
Accrued interest receivable	**685,256,474**	519,301,975
Returned checks and other cash items	**96,299,176**	14,542,197
	1,494,943,324	1,282,162,699

(Forward)

	2017	2016
Nonfinancial		
Non-performing Asset Pool (NPAP)	**₱1,242,740,568**	₱1,269,881,490
Creditable withholding taxes (CWT)	**310,133,158**	242,261,422
Documentary stamp tax	**89,326,535**	80,489,880
Stationary and supplies	**34,683,648**	27,238,581
Other equity investments	**21,792,208**	21,792,208
Prepaid expenses	**12,170,255**	13,985,488
Miscellaneous	**117,039,863**	143,506,107
	1,827,886,235	1,799,155,176
	3,322,829,559	3,081,317,875
Allowance for impairment and credit losses (Note 14)	**(1,786,752,347)**	(1,709,390,723)
	₱1,536,077,212	₱1,371,927,152

Accounts Receivable
As of December 31, 2017 and 2016, accounts receivable includes receivable from Philippine Deposit Insurance Corporation (PDIC) amounting to ₱58.20 million which was acquired as a result of the merger with PDB. This receivable represents the proceeds of the sale of certain assets of Region Bank to PDIC under the Asset Purchase and Assumption of Liability Agreement of PDB with Region Bank. The proceeds were temporarily placed in escrow until PDIC accepts the transfer of the assets.

As of December 31, 2016, this account also includes a receivable from a third party (acquired from the merger with PDB) amounting to ₱113.51 million which pertains to the final withholding tax (FWT) imposed by the BIR on Poverty Eradication and Alleviation Certificates (PEACe) bonds that matured on October 18, 2011.

On October 17, 2011, PDB together with seven other banks filed a joint petition against the BIR's decision to impose 20.00% FWT on PEACe bonds. The Supreme Court (SC) issued a temporary restraining order in favor of these banks on the same day and ordered these banks to place in escrow an amount equivalent to the disputed withholding tax until final decision is rendered. However, the Bureau of Treasury (BTr) withheld the 20.00% FWT from the proceeds of the PEACe bonds and held it in an escrow account with the Land Bank of the Philippines.

On January 13, 2015, the SC ordered the BTr to release to the bondholders the amount corresponding to the 20.00% FWT. On March 13, 2015, the BIR filed a motion for reconsideration and clarification. Pursuant to a resolution dated April 21, 2015 by the SC, the public filed a consolidated comment on the motions filed by the respondents.

In an en banc ruling received on October 5, 2016, the SC upheld its October 2011 decision ordering the BTr to return the ₱4.97 billion to the petitioners and for the BTr to pay legal interest for failure to comply with the SC's earlier ruling in favor of the holders of the said bonds. In late October 2016, the Government filed a motion for partial reconsideration with regard to the October 2016 ruling.

In an en banc ruling received on January 17, 2017, the SC denied the motion for partial consideration. No further pleadings or motions were entertained by the SC.

On April 11, 2017, the BTr paid the Bank together with the seven banks the withheld amount and 4.00% interest per annum from October 19, 2011 to April 10, 2017. Total settlement amount were paid in the form of 3-year Retail Treasury Bonds with interest of 4.25% per annum. The settlement resulted in gain amounting to ₱24.88 million which is presented under 'Miscellaneous income' (Note 19).

Non-performing Asset Pool (NPAP)
As of December 31, 2017 and 2016, miscellaneous assets include NPAP which was acquired as a result of the merger with PDB. The NPAP represents the non-performing assets of PDB which were purchased by PDIC under a buy-back arrangement following the terms and conditions of the Financial Assistance Agreement dated June 28, 2002 between PDIC and PDB. This consists of the following (in thousands):

	2017	2016
Loans and receivables	**₱992,965**	₱995,474
Investment properties	**175,762**	200,331
Other assets*	**74,014**	74,076
	₱1,242,741	₱1,269,881

* *Other assets include various property and equipment, various rental deposits of PDB's branches and other miscellaneous assets.*

As of December 31, 2017 and 2016, the above NPAP are fully provided with allowance for impairment losses.

Other equity investments
This account comprises of investments acquired by the Bank from its merger with PDB. The investments include the 100% owned subsidiary, Filrice Inc. (Filrice), with investment cost of ₱2.19 million, and 49% owned investee, PDB SME Solutions, Inc. (PDB SME), with investment cost of ₱19.60 million. Filrice was established for the business of rice milling and warehousing but ceased operations in 2011 and has not begun formal winding up process. Its principal place of business is in Bulacan, Philippines. Investment in Filrice is classified under prudential regulations as a nonfinancial allied undertaking. Accordingly, for prudential reporting purposes, such investments are accounted for under the equity method of accounting instead of consolidated on a line-by-line basis.

PDB SME (SME.com.ph) provides web-based solutions to help SME-entrepreneurs to manage businesses better and to expand to new markets. Its principal place of business is in Makati City, Philippines. In 2013, PDB SME. was dissolved and is currently under liquidation.

Filrice and PDB SME are non-operating private companies and as such, have no available quoted market prices. As of December 31, 2017 and 2016, investment in PDB SME is fully provided with ₱19.60 million allowance for impairment losses while investment in Filrice is carried at original acquisition cost of ₱2.19 million where majority of its assets represent cash that is deposited with the Bank.

Receivable from BIR
Receivable from BIR represents the Bank's claim for refund of its MCIT in 1999. Under tax regulations, domestic and resident foreign corporation are given a four (4)-year period from their time of registration with the BIR before they are subjected to MCIT. However, for thrift banks in particular, the reckoning period is the date of registration with the SEC or the date when the Certificate of Authority to Operate as thrift bank was signed by the MB of the BSP, whichever comes later. As discussed in Note 1, the MB granted the Bank its thrift bank license on April 21, 1999. In December 2016, the Bank received its tax credit certificate for the ₱33.82 million claim and reclassified the receivable balance to CWT account.

Miscellaneous assets
As of December 31, 2017 and 2016, miscellaneous assets include prepayments to contractors for construction of leasehold improvements, security deposits and postage stamps.

Allowance for impairment and credit losses
Allowance for impairment and credit losses includes provision against impaired AIR and long-outstanding advances amounting to ₱489.73 million and ₱398.56 million as of December 31, 2017 and 2016, respectively (Note 14).

14. Allowance for Impairment and Credit Losses

Changes in the allowance for impairment and credit losses are as follows:

	2017	2016
Balance at beginning of year		
Loans and receivables	**₱2,460,325,896**	₱2,329,190,497
Investment properties	**481,456,535**	534,037,431
AFS financial assets	**63,153,755**	63,153,755
Property and equipment	**–**	4,656,760
Other assets	**1,709,390,723**	1,702,438,223
	4,714,326,909	4,633,476,666
Provisions charged to operations	**295,680,313**	305,000,666
Accounts charged off and others	**(322,888,063)**	(224,150,423)
	(27,207,750)	80,850,243
Balance at end of year		
Loans and receivables (Note 8)	**2,338,300,602**	2,460,325,896
Investment properties (Note 11)	**489,023,083**	481,456,535
AFS financial assets (Note 7)	**73,043,127**	63,153,755
Other assets (Note 13)	**1,786,752,347**	1,709,390,723
	₱4,687,119,159	₱4,714,326,909

Below is the breakdown of provision for (reversal of) impairment and credit losses:

	2017	2016	2015
Loans and receivables	**₱287,706,251**	₱235,175,829	₱257,331,746
Investment properties (Note 11)	**–**	3,622,869	(11,928,212)
AFS financial assets	**–**	–	59,200
Property and equipment	**–**	–	2,070,488
Other assets	**7,974,062**	66,201,968	45,024,932
	₱295,680,313	₱305,000,666	₱292,558,154

Movement in allowance for impairment and credit losses on financial assets follow (amounts in thousands):

	December 31, 2017						
	Loans and Receivables						
	Corporate Lending	**Consumer Lending and others**	**Unquoted Debt Securities**	**Sales Contracts Receivable**	**Total**	**AFS Financial Assets**	**Other Assets***
Balance at beginning of year	**₱1,448,675**	**₱804,848**	**₱151,837**	**₱54,966**	**₱2,460,326**	**₱63,154**	**₱398,569**
Provision	**287,706**	**–**	**–**	**–**	**287,706**	**–**	**7,974**
Accounts charged off	**(106,755)**	**(216,133)**	**–**	**–**	**(322,888)**	**–**	**–**
Reclassification	**(216,133)**	**118,810**	**–**	**10,480**	**(86,843)**	**9,889**	**83,183**
Balance at end of year	**₱1,413,493**	**₱707,525**	**₱151,837**	**₱65,446**	**₱2,338,301**	**₱73,043**	**₱489,726**
Individual impairment	**₱1,082,149**	**₱21,561**	**₱151,837**	**₱59,078**	**₱1,314,625**	**₱73,043**	**₱434,758**
Collective impairment	**331,344**	**685,964**	**–**	**6,368**	**1,023,676**	**–**	**54,968**
	₱1,413,493	**₱707,525**	**₱151,837**	**₱65,446**	**₱2,338,301**	**₱73,043**	**₱489,726**
Gross amount of loans and receivables individually determined to be impaired	**₱1,997,786**	**₱22,450**	**₱151,837**	**₱149,734**	**₱2,321,807**	**₱73,043**	**₱434,758**

**Excludes allowance for impairment losses on nonfinancial assets amounting to ₱1.30 billion.*

	December 31, 2016						
	Loans and Receivables						
	Corporate Lending	Consumer Lending and others	Unquoted Debt Securities	Sales Contracts Receivable	Total	AFS Financial Assets	Other Assets*
Balance at beginning of year	₱1,126,085	₱998,088	₱151,837	₱53,183	₱2,329,193	₱63,154	₱385,706
Provision	235,101	–	–	75	235,176	–	66,202
Accounts charged off	–	(193,240)	–	–	(193,240)	–	–
Reclassification	87,489	–	–	1,708	89,197	–	(53,339)
Balance at end of year	₱1,448,675	₱804,848	₱151,837	₱54,966	₱2,460,326	₱63,154	₱398,569
Individual impairment	₱1,000,404	₱14,490	₱151,837	₱46,979	₱1,213,710	₱63,154	₱329,928
Collective impairment	448,271	790,358	–	7,987	1,246,616	–	68,641
	₱1,448,675	₱804,848	₱151,837	₱54,966	₱2,460,326	₱63,154	₱398,569
Gross amount of loans and receivables individually determined to be impaired	₱2,203,516	₱24,868	₱151,837	₱55,349	₱2,435,570	₱63,154	₱391,152

**Excludes allowance for impairment losses on nonfinancial assets amounting to ₱1.31 billion.*

15. Deposit Liabilities

BSP Circular No. 832 provides for an 8.00% reserve requirement for deposit liabilities of thrift banks. As of December 31, 2017 and 2016, Due from BSP amounting to ₱6.77 billion and ₱5.71 billion, respectively, was set aside as reserves for deposit liabilities to comply with the reserve requirement (Note 6).

Foreign currency-denominated deposit liabilities bear annual fixed interest rates ranging from 0.25% to 1.50% in 2017, from 0.25% to 1.75% in 2016 and from 0.25% to 1.50% in 2015, while peso-denominated deposit liabilities bear interest rates ranging from 0.50% to 4.75% in 2017, from 0.25% to 5.50% in 2016 and from 0.25% to 4.44% in 2015.

16. Accruals and Other Liabilities

Accrued Interest and Other Expenses
This account consists of:

	2017	2016
Accrued interest payable	**₱105,725,782**	₱87,975,295
Accrued other expenses	**161,116,500**	191,877,132
	₱266,842,282	₱279,852,427

Accrued other expenses include accrual for employee benefits, utilities, janitorial and security services.

Other Liabilities
This account consists of:

	2017	2016
Financial		
Accounts payable (Note 24)	**₱889,378,524**	₱691,493,796
Other credits - dormant	**83,919,568**	81,790,086
Due to the Treasurer of the Philippines	**9,224,406**	3,470,735
Bills purchased	**7,842,548**	13,364,731
Security deposit	**3,885,646**	3,368,425
Other payable	**5,437,792**	4,676,234
	999,688,484	798,164,007
Nonfinancial		
Retirement liability (Note 20)	**106,046,713**	130,185,501
Taxes payable	**41,586,661**	31,826,786
Accrued gross receipts tax	**16,754,796**	21,838,485
Miscellaneous	**211,775,450**	2,612,799
	376,163,620	186,463,571
	₱1,375,852,104	₱984,627,578

Accounts payable consists mainly of mortgage and vehicle registration fees held for the account of loan borrowers which will be remitted to various government agencies, liability to automated tellering machine interbank network service provider, registration fees, insurance premium, documentary stamps and notarial fee.

Bills purchased pertains to credit accommodation where check payments in the form of manager's check, demand draft and cashier's check are purchased by the Bank and will be paid after the credit period. Other payable consists of SSS, medicare and employee compensation premium.

Miscellaneous includes sundry credits, inter-office float items, dormant deposit accounts and deposit for keys on safety deposit boxes.

17. Maturity Analysis of Assets and Liabilities

The table below presents the Bank's assets and liabilities as of December 31, 2017 and 2016, analyzed according to when they are expected to be recovered or settled within one year and beyond one year from the respective reporting dates (in thousands):

	December 31, 2017			December 31, 2016		
	Within twelve months	Over twelve months	Total	Within twelve months	Over twelve months	Total
Financial assets						
Cash and cash equivalents	**₱11,534,523**	**₱–**	**₱11,534,523**	₱10,876,942	₱–	₱10,876,942
FVPL investments	**135,398**	**–**	**135,398**	471,017	–	471,017
AFS financial assets	**31,966**	**2,261,703**	**2,293,669**	68,527	2,141,364	2,209,891
HTM financial assets	**–**	**3,502,818**	**3,502,818**	–	3,335,823	3,335,823
Loans and receivables	**22,040,434**	**43,474,735**	**65,515,169**	29,015,529	31,727,170	60,742,699
Other assets						
Accounts receivable	**713,388**	**–**	**713,388**	748,319	–	748,319
AIR	**685,256**	**–**	**685,256**	519,302	–	519,302
RCOCI	**96,299**	**–**	**96,299**	14,542	–	14,542
	35,237,264	**49,239,256**	**84,476,520**	41,714,178	37,204,357	78,918,535
Nonfinancial assets						
NCAHS	**212,031**	**–**	**212,031**	225,140	–	225,140
Property and equipment	**–**	**2,805,037**	**2,805,037**	–	2,595,708	2,595,708
Investment properties	**–**	**4,069,861**	**4,069,861**	–	4,051,586	4,051,586
Branch licenses	**–**	**74,480**	**74,480**	–	74,480	74,480
Software costs	**–**	**155,265**	**155,265**	–	138,720	138,720
Deferred tax asset	**–**	**338,325**	**338,325**	–	29,156	29,156
Other assets						
NPAP	**–**	**1,242,740**	**1,242,740**	–	1,269,882	1,269,882
CWT	**310,133**	**–**	**310,133**	242,261	–	242,261
Documentary stamp	**89,326**	**–**	**89,326**	80,490	–	80,490
Stationery and supplies	**34,684**	**–**	**34,684**	27,239	–	27,239
Other equity investments	**–**	**21,792**	**21,792**	–	21,792	21,792
Prepaid expenses	**12,170**	**–**	**12,170**	13,985	–	13,985
Miscellaneous	**117,040**	**–**	**117,040**	143,506	–	143,506
	775,384	**8,707,500**	**9,482,884**	732,621	8,181,324	8,913,945
	36,012,648	**57,946,756**	**93,959,404**	42,446,799	45,385,681	87,832,480
Allowances for impairment and credit losses (Note 14)			**(4,687,119)**			(4,714,327)
Unearned interest and discounts (Note 8)			**(32,544)**			(49,557)
Accumulated depreciation and amortization (Notes 10, 11 and 12)			**(2,061,805)**			(1,818,160)
			(6,781,468)			(6,582,044)
			₱87,177,936			₱81,250,436
Financial liabilities						
Deposit liabilities	**₱63,532,626**	**₱12,904,457**	**₱76,437,083**	₱58,647,416	₱12,919,872	₱71,567,288
Manager's checks	**731,802**	**–**	**731,802**	584,202	–	584,202
Accrued interest and other expenses	**266,842**	**–**	**266,842**	279,852	–	279,852
Other liabilities						
Accounts payable	**889,379**	**–**	**889,379**	691,494	–	691,494
Other credits - dormant	**–**	**83,920**	**83,920**	–	81,790	81,790
Due to the Treasurer of the Philippines	**9,224**	**–**	**9,224**	3,471	–	3,471
Bills purchased	**7,842**	**–**	**7,842**	13,365	–	13,365
Security deposit	**–**	**3,886**	**3,886**	–	3,368	3,368
Other payable	**5,438**	**–**	**5,438**	4,676	–	4,676
	65,443,153	**12,992,263**	**78,435,416**	60,224,476	13,005,030	73,229,506
Nonfinancial liabilities						
Retirement liability	**–**	**106,047**	**106,047**	–	130,186	130,186
Income tax payable	**293**	**–**	**293**	–	–	–
Other liabilities	**270,116**	**–**	**270,116**	56,278	–	56,278
	270,409	**106,047**	**376,456**	56,278	130,186	186,464
	₱65,713,562	**₱13,098,310**	**₱78,811,872**	₱60,280,754	₱13,135,216	₱73,415,970

18. **Equity**

The Bank's authorized common shares amounted to 134.00 million in 2017 and 74.00 million in 2016 and 2015 and authorized preferred shares amounted to 6.00 million in 2017, 2016 and 2015.

As of December 31, 2017, 2016 and 2015, the Bank's capital stock consists of:

	2017		2016		2015	
	Shares	**Amount**	Shares	Amount	Shares	Amount
Preferred stock - ₱100 par value						
Balance at beginning and end of year	**21,642**	**₱2,164,200**	21,642	₱2,164,200	21,642	₱2,164,200
Common stock - ₱100 par value						
Balance at beginning of year	**74,000,000**	**7,400,000,000**	37,056,482	3,705,648,200	20,555,389	2,055,538,900
Issuance of shares from DFFS	**26,414,149**	**2,641,414,900**	36,943,518	3,694,351,800	–	–
Effect of merger (Note 29)	–	–	–	–	16,501,093	1,650,109,300
Balance at end of year	**100,414,149**	**10,041,414,900**	74,000,000	7,400,000,000	37,056,482	3,705,648,200
	100,435,791	**₱10,043,579,100**	74,021,642	₱7,402,164,200	37,078,124	₱3,707,812,400

The Bank's Amended Articles of Incorporation disclosed the following features of its preferred stock:

a. Non-voting and non-participating;
b. Preference at liquidation, including declared dividends which have not been distributed;
c. Non-cumulative dividend rate as determined by the BOD, provided not to exceed twice the current ninety-day Treasury bill rate at date of approval by the BOD;
d. Convertible to common shares, at the option of the stockholder, if no dividends are declared for three consecutive years, at book value of common shares at the time of the conversion; and
e. Re-issuable.

The summarized information on the Bank's registration of securities under the Securities Regulation Code follows:

Date of SEC Approval	Type/Class	Authorized Shares	Par Value
December 7, 2017	Common	134,000,000	₱100
	Preferred	6,000,000	100
December 17, 2015	Common	74,000,000	100
	Preferred	6,000,000	100
March 1, 1973	Common	24,000,000	100
	Preferred	6,000,000	100

As of December 31, 2017 and 2016, the total number of stockholders is 1,605.

Capital Infusion
CBC made additional capital infusions to the Bank amounting to ₱1.50 billion, ₱1.00 billion and ₱2.00 billion on December 31, 2016, September 29, 2016 and December 16, 2015, respectively, to support the Bank's planned business growth and expansion.

As of December 31, 2016, the DFFS includes both the ₱2.50 billion capital infusions in 2016 and ₱0.15 million of the ₱2.00 billion infusion in 2015.

Amendment to the Articles of Incorporation
On June 26, 2014, the BOD of the Bank approved the increase in its authorized capital stock from ₱3.00 billion to ₱8.00 billion. The increase in capitalization aims to enable the Bank in meeting the

minimum capital requirement under Basel III and the planned merger with PDB then. The SEC approved the increase in authorized capital stock on December 17, 2015.

On July 21, 2016, the BOD and two-thirds (2/3) of the stockholders of the Bank approved a further increase in the Bank's authorized capital stock from ₱8.00 billion to ₱14.00 billion. The increase was approved by the BSP and the SEC on August 10, 2017 and December 7, 2017, respectively.

Surplus (Deficit) and Surplus Reserves

Surplus (deficit)

As of December 31, 2017 and 2016, surplus (deficit) included the amount of ₱15.62 million and ₱26.04 million, respectively, representing the transfer of revaluation increment on condominium properties, net of deferred tax liability, which was carried at deemed cost when the Bank transitioned to PFRS in 2005. This amount will be available to be declared as dividends upon sale of the underlying condominium properties.

Surplus reserves

This account consists of general reserves for the Bank's self-insurance and trust business, representing accumulated amounts set up by the Bank in compliance with BSP regulations.

Capital Management

The primary objectives of the Bank's capital management are to ensure that it complies with externally imposed capital requirements and that it maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value.

The Bank manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made to the Bank's capital management objectives, policies and processes as of December 31, 2017 and 2016.

Capital Allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by optimization of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but in some cases the regulatory requirements do not reflect fully the varying degree of risks associated with different activities. In such cases, the capital requirements may be flexed to reflect differing risk profiles, subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes. The process of allocating capital to specific operations and activities is undertaken by the ExeCom.

Although maximization of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Bank to particular operations or activities, it is not the sole basis used for decision-making. Also taken into account are synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Bank's longer term strategic objectives. The Bank's policies in respect of capital management and allocation are reviewed regularly by the BOD.

The issuance of BSP Circular No. 639 covering the ICAAP in 2009 supplements the BSP's risk-based capital adequacy framework under Circular No. 538. In compliance with this circular, the Parent Company has adopted and developed its ICAAP framework to ensure that appropriate level and quality of capital are maintained by the Group. Under this framework, the assessment of risks extends beyond the Pillar 1 set of credit, market and operational risks and onto other risks deemed material by the Parent Company. The level and structure of capital are assessed and determined in light of the Parent Company's business environment, plans, performance, risks and budget, as well as regulatory edicts. The BSP requires submission of an ICAAP document every March 31. The Group has complied with this requirement.

Regulatory Qualifying Capital

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

In addition, the risk-based capital ratio of a bank, expressed as a percentage of qualifying capital to risk-weighted assets, should not be less than 10.00%. Qualifying capital and risk-weighted assets are computed based on BSP regulations. Risk-weighted assets consist of total assets less cash on hand, due from BSP, loans covered by deposit hold-out on or assignment of deposits, loans or acceptances under letters of credit to the extent covered by margin deposits and other non-risk items determined by the MB of the BSP.

On August 4, 2006, the BSP, under Circular No. 538, issued the prescribed guidelines implementing the revised risk-based capital adequacy framework for the Philippine banking system to conform to Basel II capital adequacy framework. The new BSP guidelines took effect on July 1, 2007. Thereafter, banks were required to compute their capital adequacy ratio (CAR) using these guidelines.

On January 15, 2013, the BSP issued Circular No. 781, *Basel III Implementing Guidelines on Minimum Capital Requirements*, which provides the implementing guidelines on the revised risk-based capital adequacy framework particularly on the minimum capital and disclosure requirements for universal banks and commercial banks, as well as their subsidiary banks and quasi-banks, in accordance with the Basel III standards. The circular took effect on January 1, 2014.

The Circular sets out a minimum Common Equity Tier 1 (CET1) ratio of 6.00% and Tier 1 capital ratio of 7.50%. It also introduces a capital conservation buffer of 2.50% comprised of CET1 capital. The BSP's existing requirement for Total CAR remains unchanged at 10.00% and this ratio shall be maintained at all times.

Further, existing capital instruments as of December 31, 2010 which do not meet the eligibility criteria for capital instruments under the revised capital framework shall no longer be recognized as capital upon the effectivity of Basel III. Capital instruments issued under BSP Circular Nos. 709 and 716 (the circulars amending the definition of qualifying capital particularly on Hybrid Tier 1 and Lower Tier 2 capitals), starting January 1, 2011 and before the effectivity of BSP Circular No. 781, shall be recognized as qualifying capital until December 31, 2015. In addition to changes in minimum capital requirements, this Circular also requires various regulatory adjustments in the calculation of qualifying capital.

The Bank has taken into consideration the impact of the foregoing requirements to ensure that the appropriate level and quality of capital are maintained on an ongoing basis.

The CAR of the Bank as reported to the BSP as of December 31, 2017 and 2016 are shown in the tables below (amounts in thousands).

	2017	2016
Tier 1 capital	**₱7,514,474**	₱7,868,958
Tier 2 capital	**700,804**	718,930
Total qualifying capital	**₱8,215,278**	₱8,587,888
Risk weighted assets	**₱71,852,728**	₱68,941,514
Capital adequacy ratio	**11.43%**	12.46%

The regulatory qualifying capital of the Bank consists of Tier 1 (core) capital, which comprises of paid-up common stock, DFFS, hybrid capital securities, deficit including results of current year operations, surplus reserves and non-controlling interest less required deductions such as unsecured credit accommodations to DOSRI, deferred income tax, and goodwill. Certain adjustments are made to PFRS-based results and reserves, as prescribed by the BSP. The other component of regulatory capital is Tier 2 (supplementary) capital, which includes general loan loss provision and appraisal increment authorized by the MB.

Standardized credit risk weights were used in the credit assessment of asset exposures. Third party credit assessments were based on ratings by Standard & Poor's, Moody's and Fitch, while PhilRatings were used on peso-denominated exposures to Sovereigns, MDBs, Banks, Local Government Units, Government Corporations and Corporates.

On October 9, 2014, the BSP issued BSP Circular No. 854 which amends the provisions of the Manual of Regulations for Banks on the minimum capitalization of banks and on the prerequisites for the grant of authority to establish a branch. Based on this circular, the Bank is required to maintain a minimum capitalization of ₱2.00 billion.

Deposit for Future Stock Subscription

As of December 31, 2016, Tier 1 capital includes DFFS from the Parent Bank to the Bank amounting to ₱2.50 billion. On August 24, 2017, the BSP, pursuant to the MB Resolution No. 1462, approved the request of the Bank to account for the capital infusion of CBC as part of the Bank's equity and qualifying capital in computing for the CAR for the periods ended September 30, 2016, December 31, 2016 and March 31, 2017.

On October 19, 2017, the SEC, following Securities Regulation Code Rule 68, granted an exemptive relief for the Bank to classify the DFFS of ₱2.50 billion as part of Equity as of December 31, 2016 considering the approval of the same by the BSP, as the Bank's primary regulator.

On December 7, 2017, the Bank applied ₱2.65 billion of the above deposits against issued shares of 26,414,149 common shares. Documentary stamp taxes amounting to ₱12.12 million incurred from the issuance of the common shares were charged against APIC.

19. **Miscellaneous Income and Expenses**

Miscellaneous income comprise the following:

	2017	2016	2015
Bancassurance activities	**₱26,605,451**	₱14,735,877	₱–
Recovery on charged off assets	**14,741,456**	7,979,599	103,034
Dividends	**3,786,000**	4,452,356	1,256,354
Net foreign exchange gain	**728,740**	25,547,803	–
Others (Note 13)	**40,327,931**	27,819,684	7,957,932
	₱86,189,578	₱80,535,319	₱9,317,320

Others include donations, income from issuance of letters of credits and various non-recurring income transactions.

Miscellaneous income in 2015 represents the stand-alone income of the Bank prior to merger with PDB.

Miscellaneous expenses consist of:

	2017	2016	2015
Supervision and administrative expenses	**₱52,380,309**	₱55,974,037	₱6,061,359
Repairs and maintenance fees	**33,935,818**	20,137,202	5,031,728
Advertising	**20,922,480**	23,598,573	8,514,901
Clearing and processing fees	**4,932,604**	2,853,729	2,746,545
Others	**52,977,630**	46,778,419	10,744,276
	₱165,148,841	₱149,341,960	₱33,098,809

Supervision and administrative fees include BSP supervision and PDIC fees, and support operation service expenses.

Others pertain mainly to membership fees and dues, internal meeting expenses, printing expenses and expenditures for Christmas party, anniversary, team-building activities and various non-recurring expenses.

Miscellaneous expenses in 2015 represent the stand-alone expenses of the Bank prior to merger with PDB.

20. **Retirement Liability**

The Bank has two separate funded noncontributory defined benefit retirement plans, which is being managed by the trust department of CBC (Note 24). These retirement plans cover all the Bank's officers and regular employees who are entitled to cash benefits after satisfying certain age and service requirements.

The Bank’s annual contribution to the retirement plan consists of a payment covering the current service cost, unfunded actuarial accrued liability and interest on such unfunded actuarial liability.

The latest actuarial valuation study of the retirement plans was made as of December 31, 2017. The principal actuarial assumptions as of December 31, 2017 and 2016 used in determining the retirement obligation for the Bank’s retirement plans are shown below:

	2017	2016
Discount rate	**5.63%**	5.08%
Salary increase rate	**6.00%**	6.00%

As of December 31, 2017 and 2016, accrued retirement obligation comprised the following:

	2017	2016
Fair value of plan assets	**₱210,827,701**	₱126,093,579
Present value of defined benefit obligation	**316,874,414**	256,279,080
Net defined benefit liability (Note 16)	**(₱106,046,713)**	(₱130,185,501)

The movements in the defined retirement liability, present value of defined benefit obligation and fair value of plan assets follow:

	2017											
		Net benefit cost					**Remeasurements in other comprehensive income**					
	January 1, 2017	**Current service cost**	**Net interest**	**Gain/Loss due to settlement**	**Net pension expense***	**Benefits paid**	**Return on plan assets (excluding amount included in net interest)**	**Actuarial changes arising from experience adjustments**	**Actuarial changes arising from changes in financial assumptions**	**Changes in remeasurement gains**	**Contribution by employer**	**December 31, 2017**
	(a)	**(b)**	**(c)**	**(d)**	**(e) = b + c + d**	**(f)**	**(g)**	**(h)**	**(i)**	**(j) = g + h + i**	**(k)**	**(l) = a + e + f + j + k**
Fair value of plan assets	**₱126,093,579**	**₱–**	**₱6,405,554**	**₱–**	**₱6,405,554**	**(₱9,617,856)**	**(₱10,053,576)**	**₱–**	**₱–**	**(₱10,053,576)**	**₱98,000,000**	**₱210,827,701**
Present value of defined benefit obligation	**256,279,080**	**86,542,444**	**13,018,977**	**–**	**99,561,421**	**(9,617,856)**	**–**	**(2,984,308)**	**(26,363,923)**	**(29,348,231)**	**–**	**316,874,414**
Net defined benefit liability	**(₱130,185,501)**	**(₱86,542,444)**	**(₱6,613,423)**	**₱–**	**(₱93,155,867)**	**₱–**	**(₱10,053,576)**	**₱2,984,308**	**₱26,363,923**	**₱19,294,655**	**₱98,000,000**	**(₱106,046,713)**

**Presented under Compensation and fringe benefits in the statements of income.*

	2016											
		Net benefit cost					Remeasurements in other comprehensive income					
	January 1, 2016	Current service cost	Net interest	Gain/Loss due to settlement	Net pension expense*	Benefits paid	Return on plan assets (excluding amount included in net interest)	Actuarial changes arising from experience adjustments	Actuarial changes arising from changes in financial assumptions	Changes in remeasurement gains	Contribution by employer	December 31, 2016
	(a)	(b)	(c)	(d)	(e) = b + c + d	(f)	(g)	(h)	(i)	(j) = g + h + i	(k)	(l) = a + e + f + j + k
Fair value of plan assets	₱518,953,985	₱–	₱3,166,725	₱–	₱3,166,725	(₱458,635,500)	(₱4,746,344)	₱–	₱–	(₱4,746,344)	₱67,354,713	₱126,093,579
Present value of defined benefit obligation	575,327,572	69,885,800	5,979,767	–	75,865,567	(458,635,500)	–	63,721,441	–	63,721,441	–	256,279,080
Net defined benefit liability	(₱56,373,587)	(₱69,885,800)	(₱2,813,042)	₱–	(₱72,698,842)	₱–	(₱4,746,344)	(₱63,721,441)	₱–	(₱68,467,785)	₱67,354,713	(₱130,185,501)

** Presented under Compensation and fringe benefits in the statements of income*

The maximum economic benefit available is a combination of expected refunds from the plan and reductions in future contributions.

The Bank expects to contribute ₱163.43 million to its defined retirement plan in 2018.

The carrying values of total plan assets which approximate their fair values as of the end of the reporting periods are as follows (in thousands):

	2017	2016
Cash and cash equivalents (Note 24)	**₱137,105**	₱101,214
Debt instruments	**73,485**	25,181
Accrued interest receivable	**1,208**	458
Other accountabilities	**(970)**	(760)
	₱210,828	₱126,093

The sensitivity analysis below has been determined based on the impact of reasonably possible changes of each significant assumption on the defined benefit obligation as of December 31, 2017 and 2016, assuming if all other assumptions were held constant (in thousands):

	2017	2016
Discount rate		
1.00%	**(₱39,471)**	(₱56,548)
(1.00%)	**50,838**	71,913
Salary increase rate		
1.00%	**48,520**	68,335
(1.00%)	**(38,611)**	(55,097)

Shown below is the maturity analysis of the undiscounted benefit payments (in thousands):

	2017	2016
Less than five years	**₱82,734**	₱73,514
More than five years to ten years	**178,995**	140,944
More than ten years to fifteen years	**635,724**	541,074
More than fifteen years to twenty years	**1,034,331**	1,023,406
More than twenty years	**10,283,386**	8,360,827

The average duration of the defined benefit obligation as at December 31, 2017 and 2016 is 18 years.

21. Lease Contracts

The Bank leases the premises occupied by its branches. The lease contracts are for periods ranging from one to ten years from the dates of contracts and are renewable under certain terms and conditions. Various lease contracts include escalation clauses, which generally bear an annual rent increase ranging from 5.00% to 10.00%.

For the years ended December 31, 2017, 2016 and 2015, annual rentals of the Bank on these lease contracts included in 'Occupancy costs' in the statements of income amounted to ₱167.11 million, ₱185.13 million and ₱93.64 million, respectively.

Future minimum rentals payable of the Bank under non-cancelable operating leases follow:

	2017	2016
Within one year	**₱44,978,174**	₱83,341,303
After one year but not more than five years	**238,887,143**	338,335,331
After more than five years	**419,975,843**	313,968,139
	₱703,841,160	₱735,644,773

The Bank has also entered into commercial property leases on its investment properties, most of which are with related parties (Note 24). These non-cancelable leases have remaining lease terms of between one to ten years.

Future minimum rentals receivable under non-cancelable operating leases follow:

	2017	2016
Within one year	**₱8,285,993**	₱8,234,306
After one year but not more than five years	**16,802,167**	11,014,722
After more than five years	**5,998,491**	27,652,843
	₱31,086,651	₱46,901,871

22. Income and Other Taxes

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 GRT.

Income taxes include the corporate income tax, as discussed below, and final tax paid at the rate of 20.00% of gross interest income from government securities and other deposit substitutes and 7.50% on interest income on deposit placements with other FCDU and offshore banking units (OBUs). These income taxes, as well as the deferred tax benefits and provisions, are presented as 'Provision for income tax' in the statements of income.

Current tax regulations provide that RCIT rate shall be 30.00% while interest expense allowed as a deductible expense is reduced to 33.00% of interest income subject to final tax.

An MCIT of 2.00% on modified gross income is computed and compared with the RCIT. Any excess MCIT over 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 taxable income in the next three years from the year of inception.

Current tax regulations also prescribe the attribution and allocation of expenses between FCDUs/Expanded FCDUs or OBU and RBU and within RBU. Pursuant to the regulations, the Bank made an allocation of its expenses in calculating income taxes due from its RBU and FCDU.

Further, current tax regulations also provide for the ceiling on the amount of entertainment, amusement and recreation (EAR) expense that can be claimed as a deduction against taxable income. Under the regulations, EAR expense allowed as a deductible expense is limited to the actual EAR paid or incurred but not to exceed 1.00% of the Bank's net revenue.

Under current tax regulations, the income derived by the FCDU from foreign currency transactions with nonresidents, OBUs, local commercial banks including branches of foreign banks is tax-exempt while interest income on foreign currency loans from residents other than OBUs or other depository banks under the expanded system is subject to 10.00% gross income tax. In addition, interest income on deposit placements with other FCDUs and RBUs is fixed at 7.50%. All other income of the FCDU is subject to the 30.00% RCIT rate.

Provision for (benefit from) income tax consists of:

	2017	2016	2015
Current			
RCIT	**₱48,389,561**	₱61,725,020	₱8,791,261
Final tax	**58,912,148**	54,814,973	16,267,700
Excess of MCIT over RCIT	**–**	–	11,908,638
	107,301,709	116,539,993	36,967,599
Deferred*	**(357,535,678)**	(198,350,719)	375,257
	(₱250,233,969)	(₱81,810,726)	₱37,342,856

* *Includes effect of tax benefit from used of prior years' MCIT of ₱48.37 million and ₱61.72 million against 2017 and 2016 tax liability, respectively.*

The provision for income tax in 2015 includes the stand-alone provision of the Bank prior to merger with PDB.

Components of net deferred tax asset are as follows:

	2017	2016
Deferred tax asset on		
Difference between book base and tax base of investment property	**₱256,055,219**	₱150,358,556
Allowance for impairment and credit losses	**210,656,114**	29,252,194
Retirement liability	**15,907,007**	–
	482,618,340	179,610,750
Deferred tax liability on		
Fair value adjustment on investment property	**(136,137,628)**	(131,019,894)
Revaluation increment on condominium properties credited to surplus free	**(6,695,755)**	(11,159,591)
Accrued lease receivable	**(1,460,063)**	(944,244)
Unrealized foreign exchange gain	**–**	(7,330,757)
	(144,293,446)	(150,454,486)
	₱338,324,894	₱29,156,264

The Bank did not set up deferred tax assets on the following temporary differences as it believes that it is highly probable that these temporary differences will not be realized in the near foreseeable future:

	2017	2016
Tax effects of		
Allowance for impairment and credit losses	**₱3,337,499,761**	₱4,051,206,356
Retirement liability	**53,023,357**	130,185,501
Accruals	**51,957,668**	25,026,737
Unamortized past service cost	**5,948,983**	7,018,226
Excess MCIT over RCIT	**101,094**	48,468,142
Depreciation on asset foreclosures	**–**	71,594,169
	₱3,448,530,863	₱4,333,499,131

Details of the Bank's excess MCIT over RCIT are as follows:

Year incurred	CBS pre-merger	PDB pre-merger*	Total	Used*	Balance	Expiry date
2013	₱8,221,302	₱29,558,361	₱37,779,663	₱37,779,663	₱–	2016
2014	16,153,157	20,846,141	36,999,298	36,999,298	–	2017
2015	11,908,638	23,505,563	35,414,201	35,313,107	101,094	2018
	₱36,283,097	₱73,910,065	₱110,193,162	₱110,092,068	₱101,094	

* *Utilization and balances include unexpired MCIT of PDB pursuant to the merger.*

The reconciliation between the statutory income tax and effective income tax follows:

	2017	2016	2015
Statutory income tax	**₱75,392,474**	₱45,517,055	(₱67,760,093)
Tax effects of			
Movement in unrecognized deferred tax assets	**(250,980,366)**	(92,999,457)	6,961,302
Nontaxable and tax-paid income	**(154,798,354)**	(87,905,039)	(68,393,069)
Nondeductible expenses	**97,532,741**	90,574,684	166,872,721
FCDU income	**(17,380,464)**	(36,997,969)	(338,005)
Effective income tax	**(₱250,233,969)**	(₱81,810,726)	₱37,342,856

23. Trust Operations

Securities and other properties (other than deposits) held by the Bank, including those assumed from PDB, in fiduciary or agency capacities for clients and beneficiaries are not included in the accompanying statements of financial position since these are not assets of the Bank (Note 25).

In compliance with the requirements of current banking regulations relative to the Bank's trust functions: (a) government bonds included under HTM financial assets in the statements of financial position with total face value of ₱12.00 million and AFS financial assets in the statements of financial position with total face value of ₱32.00 million as of December 31, 2017 and 2016, respectively, are deposited with the BSP as security for the Bank's faithful compliance with its fiduciary obligations; and (b) 10.00% of the Bank's annual trust fee income is transferred to surplus reserve.

On December 11, 2014, the BOD of the Bank approved the winding down of the Bank's Trust business.

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. The Bank's related parties include:

- key management personnel, close family members of key management personnel and entities which are controlled, significantly influenced by or for which significant voting power is held by key management personnel or their close family members;
- significant investors;
- associates; and
- post-employment benefit plans for the benefit of the Bank's employees

Generally, the related party transactions are settled in cash. There are no provisions for credit losses in 2017 and 2016 in relation to amounts due from related parties.

<u>Transactions with Retirement Plans</u>
The Bank has a business relationship with its retirement plan pursuant to which it provides trust and management services. As of December 31, 2016, plan assets of the CBS and PDB retirement plans are managed by CBC's Trust Department and the Bank's Trust Department, respectively (Note 20). In 2017, PDB retirement plan assets amounting to ₱81.00 million which was previously managed by the Bank's Trust Department have been transferred for management of CBC's Trust Department. Accordingly, all of the plan assets of the retirement funds of the Bank is now managed by CBC's Trust Department. The total fair value of the retirement fund as of December 31, 2017 and 2016 amounted to ₱210.83 million and ₱126.09 million, respectively. The details of the assets of the fund as of December 31, 2017 and 2016 are disclosed in Note 20.

Significant transactions of the retirement fund, particularly with related parties, are approved by the Retirement Committee (RC) of the Bank. The members of the RC are directors and key management personnel of the Bank.

As of December 31, 2017 and 2016, cash and cash equivalents of the retirement plan amounting to ₱134.38 million and ₱100.00 million, respectively, are held by the Bank and earn interest ranging from 3.00% to 4.25% and from 2.25% in 2017 and 2016, respectively.

As of December 31, 2017 and 2016, cash and cash equivalents of the retirement plan amounting to ₱2.72 million and ₱1.21 million, respectively, are held by the Parent Bank and earn interest ranging from 2.38% to 2.63% and from 2.13% and 2.50% in 2017 and 2016, respectively.

Interest income on the retirement plan's cash and cash equivalents amounted to ₱0.43 million and ₱0.47 million in 2017 and 2016, respectively.

<u>Remunerations of Directors and other Key Management Personnel</u>
Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly. The Bank considers the members of the Management Committee as key management personnel for purposes of PAS 24.

The compensation of key management personnel included under 'Compensation and benefits' in the statement of income are as follows (in thousand):

	2017	2016	2015
Short-term employee benefits	**₱40,392**	₱35,955	₱28,411
Post-employment benefits	**3,223**	2,465	2,273
	₱43,615	₱38,420	₱30,684

In 2017, 2016 and 2015, no remunerations were given to the directors of the Bank who are also occupying key management positions with the ultimate parent company.

The Bank also provides banking services to key management personnel and persons connected to them. These transactions are presented in the tables below.

	December 31, 2017		
Category	Amount/ Volume	Outstanding Balance	Nature, Terms and Conditions
Key Management Personnel			
Loans		**₱38,360**	Loans with interest rates ranging from 5.50% to 8.00% and maturities of 5 to 15 years and secured by real estate mortgage and unimpaired.
Issuances	**₱–**		
Repayments	**(2,951,961)**		
Deposit liabilities		**43,001,483**	These are checking and savings account with annual interest rates ranging from 0.25% to 0.75%.
Deposits	**40,756,025**		
Withdrawals	**(6,490,543)**		
Other Related Party			
Deposit liabilities		**19,763,286**	These deposit accounts earns annual interest ranging from 0.25% to 4.25%.
Deposits	**2,103,663**		
Withdrawals	**(9,577,634)**		

	December 31, 2016		
Category	Amount/ Volume	Outstanding Balance	Nature, Terms and Conditions
Key Management Personnel			
Loans		₱2,990,321	Loans with interest rates ranging from 5.50% to 8.00% and maturities of 5 to 15 years and secured by real estate mortgage and unimpaired.
Issuances	₱–		
Repayments	(808,004)		
Deposit liabilities		8,736,001	These are checking and savings account with annual interest rates ranging from 0.25% to 0.75%.
Deposits	5,230,914		
Withdrawals	(19,888,522)		
Other Related Party			
Deposit liabilities		27,237,257	These deposit accounts earns annual interest ranging from 0.25% to 4.25%.
Deposits	10,367,132		
Withdrawals	(25,651,178)		

As of December 31, 2017 and 2016, all loans to related parties are secured and no provision for credit losses was recorded.

Interest income earned and interest expense incurred from the above loans and deposit liabilities, respectively, for the years ended December 31, 2017, 2016 and 2015 are as follows:

	2017	2016	2015
Interest income	**₱9,701**	₱201,132	₱236,302
Interest expense	**1,230,828**	507,635	467,310

Related party transactions of the Bank with the Parent Bank and affiliates are as follows:

	Parent Bank		
	2017	2016	**Nature, Terms and Conditions**
Statements of Financial Position			
Due from other banks	**₱281,193,219**	₱716,131,764	This pertains to cash in bank deposited with CBC that bears annual interest rates ranging from 0.13% to 0.25% in 2017 and 2016.
Net movements	**(434,938,545)**	613,769,847	
Accounts receivable	**9,835,384**	8,548,787	This pertains to receivable from CBC for unpaid rental.
Security deposit	**2,444,337**	2,758,937	This pertains to the rental deposits for office space leased out to CBC presented under 'Other liabilities' (Note 16).
Accounts payable	**1,111,153**	2,296,384	This pertains to the various expenses advanced by CBC on behalf of the Bank.
Deposit for future stock subscription	–	2,500,000,000	DFFS for additional shares to be purchased by the Parent Bank (Note 18).

	Parent Company			
	2017	2016	2015	**Nature, Terms and Conditions**
Statements of Income				
Interest income	**₱473,729**	₱339,552	₱75,070	This pertains to interest income earned from cash in bank deposited with CBC.
Trading and securities gain	**3,548,612**	14,479,079	13,978,371	The Bank earned investment securities gain from its outright sale of securities to CBC.
Income from property rentals	**24,209,412**	19,940,719	16,266,169	Certain units of the condominium owned by the Bank are being leased to CBC for a term of 5 years, with no escalation clause.

	Other Related Party		
	2017	2016	**Nature, Terms and Conditions**
Statements of Financial Position			
Accounts receivable	**₱2,180,467**	₱1,714,649	This pertains to receivable from China Bank Insurance Brokers (CIBI), a subsidiary of CBC, for unpaid rental.
Accounts payable	**44,740,361**	80,948,623	These are non-interest bearing insurance premiums held on behalf of loan borrowers to be subsequently remitted to CIBI.
Security deposit	**291,347**	291,347	These pertain to rental deposits for office space leased out to CIBI presented under 'Other liabilities' (Note 16).

	Other Related Party			
	2017	2016	2015	**Nature, Terms and Conditions**
Statements of Income				
Income from property rentals	**₱3,806,582**	₱3,806,582	₱3,455,277	Certain units of the condominium owned by the Bank are being leased to CIBI for a term of 5 years, with 10.00% escalation clause.

Outright purchases and outright sale of debt securities of the Bank with CBC are as follows:

	2017	2016	2015
Outright purchase	**₱347,588,893**	₱1,835,501,100	₱278,102,038
Outright sale	**430,145,157**	756,441,947	198,358,965

Trading transactions are conducted based on the following terms and conditions: (a) trade prices were determined based on Philippine Dealing System Treasury Reference Rates PM (PDST-R2) on trade date, and (b) payment and settlement through the Bank's demand deposit account with BSP on the day of transaction.

As of December 31, 2017, 2016 and 2015, the number of common shares held by the Parent Bank are 99.63 million, 73.21 million and 36.27 million shares, respectively. The Parent Bank does not hold preferred shares of the Bank in 2017, 2016 and 2015.

Regulatory Reporting
As required by the BSP, the Bank discloses loan transactions with investees and with certain directors, officers, stockholders and related interests (DOSRI). Existing banking regulations limit the amount of individual loans to DOSRI, 70.00% of which must be secured, to the total of their respective deposits and book value of their respective investments in the lending company within the Bank. In the aggregate, loans to DOSRI generally should not exceed total equity or 15.00% of total loan portfolio, whichever is lower. BSP Circular No. 423 dated March 15, 2004 amended the definition of DOSRI accounts. The following table shows information relating to the loans, other credit accommodations and guarantees classified as DOSRI accounts under regulations existing prior to said Circular, and new DOSRI loans, other credit accommodations granted under said circular:

	2017	2016
Total outstanding DOSRI accounts*	**₱303,066,462**	₱794,709,758
Total outstanding DOSRI accounts prior to effectivity of BSP Circular No. 423	**–**	–
Percent of DOSRI accounts to total loans	**0.47%**	1.35%
Percent of unsecured DOSRI accounts to total DOSRI accounts	**5.44%**	2.65%
Percent of nonperforming DOSRI accounts to total DOSRI accounts	**0.01%**	0.01%

** Includes deposits with CBC*

The amounts of loans disclosed for related parties under PFRS differ with the amounts for DOSRI since the latter is more expansive than that of key management personnel identified for related party transaction reporting under PFRS.

BSP Circular No. 560 provides that the total outstanding loans, other credit accommodation and guarantees to each of the bank's/quasi-bank's subsidiaries and affiliates shall not exceed 10.00% of the net worth of the lending bank/quasi-bank, provided that the unsecured portion of which shall not exceed 5.00% of such net worth. Further, the total outstanding loans, credit accommodations and guarantees to all subsidiaries and affiliates shall not exceed 20.00% of the net worth of the lending bank/quasi-bank; and the subsidiaries and affiliates of the lending bank/quasi-bank are not related interest of any director, officer and/or stockholder of the lending institution, except where such director, officer or stockholder sits in the BOD or is appointed officer of such corporation as representative of the bank/quasi-bank. As of December 31, 2017 and 2016, the Bank is in compliance with these requirements.

25. Commitments and Contingencies

In the normal course of the Bank's operations, there are various outstanding commitments and contingent liabilities which are not reflected in the accompanying financial statements. Management does not anticipate any material losses as a result of these transactions.

Summary of the Bank's contingencies and commitments follows:

	2017	2016
Committed credit lines	**₱2,335,446,073**	₱3,357,789,406
Trust department accounts (Note 23)	**235,267,741**	1,639,351,156
Standby domestic letters of credit	**212,977,965**	334,485,314
Late deposits/payments received	**11,518,582**	11,721,501
Outward bills for collection	**1,829,009**	16,475,000
Others	**260,018**	227,758
	₱2,797,299,388	₱5,360,050,135

The Bank has several suits and claims that remain unsettled. It is not practicable to estimate the potential financial statement impact of these contingencies. However, in the opinion of management, the suits and claims, if decided adversely, will not involve sums having a material effect on the financial statements.

26. Financial Performance

The following basic ratios measure the financial performance of the Bank (excluding the effect of merger with PDB in 2015 for comparative purposes):

	2017	2016	2015
Return on average equity (ROE)	**6.19%**	3.55%	(9.08%)
Return on average asset (ROA)	**0.60%**	0.30%	(1.13%)
Net interest margin over average earning assets (NIM)*	**4.74%**	4.87%	5.18%

* *Average monthly balances of the related statement of financial position accounts were used for the computation of ratios*

27. Notes to Statements of Cash Flows

The following is a summary of non-cash activities:

	2017	2016	2015
Non-cash operating activities			
Recognition of investment properties from foreclosure of real estate mortgage on loans and receivables (Notes 9 and 11)	**₱340,203,632**	₱407,444,178	₱35,385,024
Recognition of NCAHS arising from foreclosure of chattel mortgage on loans and receivables (Note 9)	**601,900,838**	330,621,295	151,465,226
Payment of current tax expense using excess MCIT over RCIT (Note 22)	**(48,367,048)**	(61,725,020)	–
Non-cash investing activities			
Fair value gains (losses) on AFS financial assets (Note 7)	**85,284,684**	(73,138,076)	(5,399,283)
Remeasurement losses (gains) on retirement liability (Note 20)	**(19,294,655)**	68,467,785	(39,852,078)

(Forward)

	2017	2016	2015
Non-cash operating activities			
Reclassification of AFS financial assets to HTM financial assets (Note 7)	**₱–**	₱708,417,631	₱–
Non-cash financing activities			
Application of DFFS to issued shares (Note 18)	**2,635,821,132**	3,826,675,040	–
Utilization of prepaid documentary stamps for additional DFFS	**(12,121,010)**	(37,882,818)	–

28. Offsetting of Financial Assets and Liabilities

The amendments to PFRS 7, which became effective beginning on January 1, 2013, require the Bank to disclose information about rights of offset and related arrangements (such as collateral posting requirements) for financial instruments under an enforceable master netting agreements or similar arrangements. The effects of these arrangements are disclosed in the succeeding table (amounts in thousands).

December 31, 2017						
				Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria		
Financial assets recognized at end of reporting period by type	**Gross carrying amounts (before offsetting) [a]**	**Gross amounts offset in accordance with the offsetting criteria [b]**	**Net amount presented in statements of financial position [a-b] [c]**	**Financial Instruments [d]**	**Fair value of financial collateral**	**Net exposure [c-d] [e]**
Financial assets						
SPURA (Note 6)	**₱1,404,323**	**₱–**	**₱–**	**₱–**	**₱1,404,323**	**₱–**
Due from other banks (Note 6)	**281,193**	**–**	**281,193**	**–**	**378,367**	**–**

December 31, 2016						
				Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria		
Financial instruments recognized at end of reporting period by type	Gross carrying amounts (before offsetting) [a]	Gross amounts offset in accordance with the offsetting criteria [b]	Net amount presented in statements of financial position [a-b] [c]	Financial Instruments [d]	Fair value of financial collateral	Net exposure [c-d] [e]
Financial assets						
SPURA (Note 6)	₱493,078	₱–	₱–	₱–	₱493,078	₱–
Due from other banks (Note 6)	221,355	–	221,355	–	404,370	–

The amounts disclosed in column (d) include those rights to set-off amounts that are only enforceable and exercisable in the event of default, insolvency or bankruptcy. This includes amounts related to financial collateral both received and pledged, whether cash or non-cash collateral, excluding the extent of over-collateralization.

29. **Business Combination**

In accordance with PIC Q&A 2012-01, the Bank elected to use the 'pooling of interest' method in accounting for its merger with PDB and Unity Bank in 2015 and 2014, respectively.

Merger with PDB
On June 26, 2014, the BOD approved the merger of the Bank with PDB. The terms of the Plan and Articles of Merger were approved by the Bank's stockholders in their meeting held on August 14, 2014 with the Bank as the surviving entity.

On June 25, 2015, the MB, in its Resolution Nos. 789 and 1559, approved the Plan and Articles of Merger of the Bank and PDB subject to certain conditions. On December 17, 2015, the Bank obtained approval from the SEC for the merger to be effective. The actual merger took place on December 31, 2015. As of the effective date of merger, all common and preferred shares of PDB have been converted into fully paid China Bank Savings common shares totaling to 16,501,093 shares. The Bank recognized 'Other equity reserves' amounting to ₱1.94 billion as a result of the merger with PDB.

As of December 31, 2015, the assets acquired and liabilities assumed by the Bank as a result of the mergers with PDB are as follows:

	2015
Assets	
Cash and cash equivalents	₱6,199,302,250
FVPL investments	677,240,456
AFS financial assets	42,212,841
HTM financial assets	2,084,521,866
Loans and receivables	34,929,613,263
NCAHS	20,465,738
Property and equipment	823,013,192
Investment properties	2,487,753,744
Branch licenses (Note12)	74,480,000
Software costs	63,048,780
Other assets	691,990,024
	₱48,093,642,154
Liabilities	
Deposit liabilities	₱44,844,656,252
Manager's checks	407,053,750
Bills payable	662,530,655
Deposit for stock subscription	1,700,000,000
Income tax payable	1,361,031
Accrued interest and other expenses	159,493,797
Deferred tax liabilities	106,607,499
Other liabilities	535,535,395
	₱48,417,238,379

Merger with Unity Bank
On June 6, 2013, the BOD approved the merger of the Bank with Unity Bank. The terms of the Plan of Merger were approved by the Bank's stockholders in their meeting held on July 18, 2013 with the Bank as the surviving entity.

On November 22, 2013, the MB, in its Resolution No. 1949, approved the Plan of Merger and Articles of Merger of the Bank and Unity Bank subject to certain conditions. On January 20, 2014, the Bank obtained approval from the SEC for the merger to be effective. Under the approved plan of merger, all the issued and outstanding common stocks of Unity Bank ("Unity shares"), as well as shares that have been subscribed but have not been issued or covered by Stock Purchase Agreement, shall be convertible into fully-paid and non-assessable common stock of CBS at the approximate ratio of 1.144 Unity Bank common shares for every CBS common share (the "Exchange Ratio"). The actual merger took place on January 31, 2014. The Bank issued 5,173,881 common shares and recognized 'Other equity reserves' amounting to ₱303.96 million as a result of the merger with Unity Bank.

As of January 31, 2014, the assets acquired and liabilities assumed by the Bank as a result of the merger are as follows:

	2014
Assets	₱1,633,010,353
Liabilities	1,119,754,168
	₱513,256,185

30. Approval of the Release of Financial Statements

The accompanying financial statements were authorized for issue by the Bank's BOD on March 15, 2018.

31. Supplementary Information Required Under Revenue Regulations 15-2010

In compliance with the requirements set forth by Revenue Regulations 15-2010, hereunder are the details of percentage and other taxes paid or accrued by the Bank in 2017.

Taxes and Licenses

Gross receipts tax	₱193,454,375
Local taxes	15,783,900
Others	14,111,476
	₱223,349,751

Withholding Taxes

Details of total remittances of withholding taxes in 2017 and amounts outstanding as of December 31, 2017 are as follows:

	Total Remittances	Amounts Outstanding
Final withholding taxes	₱165,401,214	₱13,925,763
Withholding taxes on compensation and benefits	161,590,894	12,393,451
Expanded withholding taxes	48,595,888	8,146,960
	₱375,587,996	₱34,466,174

Tax Cases and Assessments

As of December 31, 2017, there are no outstanding deficiency tax assessment and tax cases under investigation, litigation nor prosecution in courts or bodies outside the BIR.