

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

Financial Statements  
December 31, 2018 and 2017  
and for the years ended December 31, 2018,  
2017 and 2016

and

Independent Auditor's Report



## **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, 2018 and 2017, 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, 2018, 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, 2018 and 2017, and its financial performance and its cash flows for each of the three years in the period ended December 31, 2018 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, 2018, 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, 2018 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.



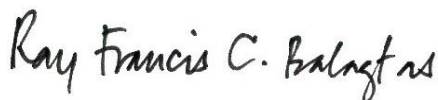
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude 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

Partner

CPA Certificate No. 108795

SEC Accreditation No. 1510-AR-1 (Group A),

September 18, 2018, valid until September 17, 2021

Tax Identification No. 216-950-288

BIR Accreditation No. 08-001998-107-2018,

February 14, 2018, valid until February 13, 2021

PTR No. 7332523, January 3, 2019, Makati City

March 21, 2019



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

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
<b>ASSETS</b>		
Cash and Cash Equivalents (Notes 6 and 24)	<b>₱13,551,253,323</b>	₱11,534,522,627
Financial Assets at Fair Value Through Profit or Loss (Note 7)	–	135,397,767
Financial Assets at Fair Value through Other Comprehensive Income (Note 7)	<b>1,081,864,447</b>	–
Available-for-Sale Financial Assets (Note 7)	–	2,220,626,084
Investment Securities at Amortized Cost (Note 7)	<b>8,712,822,931</b>	–
Held-to-Maturity Financial Assets (Notes 7 and 23)	–	3,502,817,726
Loans and Receivables (Notes 8 and 24)	<b>65,131,357,475</b>	63,144,324,080
Non-current Assets Held for Sale (Note 9)	<b>379,192,579</b>	212,031,191
Property and Equipment (Note 10)	<b>1,228,301,104</b>	1,248,751,066
Investment Properties (Note 11)	<b>3,197,091,385</b>	3,157,145,538
Branch Licenses (Note 12)	<b>74,480,000</b>	74,480,000
Software Costs (Note 12)	<b>63,333,167</b>	73,437,992
Deferred Tax Asset (Note 22)	<b>613,401,172</b>	338,324,894
Other Assets (Notes 13 and 24)	<b>1,746,611,709</b>	1,536,077,212
	<b>₱95,779,709,292</b>	₱87,177,936,177
<b>LIABILITIES AND EQUITY</b>		
<b>Liabilities</b>		
<b>Deposit Liabilities (Notes 15 and 24)</b>		
Demand	<b>₱16,036,991,323</b>	₱15,589,330,155
Savings	<b>12,796,615,183</b>	9,351,070,190
Time	<b>55,767,866,280</b>	51,496,682,275
	<b>84,601,472,786</b>	76,437,082,620
Manager's Checks	<b>484,179,921</b>	731,802,306
Accrued Interest and Other Expenses (Note 16)	<b>418,850,987</b>	266,842,282
Income Tax Payable	<b>345,478</b>	292,940
Other Liabilities (Notes 16 and 24)	<b>1,185,637,858</b>	1,375,852,104
	<b>86,690,487,030</b>	78,811,872,252
<b>Equity</b>		
Capital stock (Note 18)	<b>10,543,579,100</b>	10,043,579,100
Additional paid-in capital (Note 18)	<b>485,049,814</b>	490,049,814
Other equity reserves (Note 29)	<b>(2,248,520,637)</b>	(2,248,520,637)
Surplus reserves (Notes 18 and 23)	–	22,764,290
Surplus (Notes 18 and 23)	<b>347,992,619</b>	242,276,780
Remeasurement gains (losses) on retirement asset (Note 20)	<b>747,845</b>	(66,964,439)
Net unrealized losses on:		
Financial assets at fair value through other comprehensive income (Note 7)	<b>(85,306,273)</b>	–
Available-for-sale financial assets (Note 7)	–	(132,516,533)
Cumulative translation adjustment	<b>45,679,794</b>	15,395,550
	<b>9,089,222,262</b>	8,366,063,925
	<b>₱95,779,709,292</b>	₱87,177,936,177

See accompanying Notes to Financial Statements.



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

	<b>Years Ended December 31</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
<b>INTEREST INCOME</b>			
Loans and receivables (Notes 8 and 24)	<b>₱4,723,862,839</b>	₱4,269,523,330	₱3,825,506,373
Investment securities (Note 7)	<b>282,094,661</b>	262,808,362	212,401,581
Interbank loans receivable and securities purchased under resale agreements (Note 6)	<b>119,349,402</b>	91,952,398	37,994,899
Due from Bangko Sentral ng Pilipinas and other banks (Notes 6 and 24)	<b>25,347,885</b>	14,087,651	64,555,954
	<b>5,150,654,787</b>	4,638,371,741	4,140,458,807
<b>INTEREST EXPENSE</b>			
Deposit liabilities (Notes 15 and 24)	<b>1,886,664,631</b>	1,311,815,042	1,205,860,728
Bills payable	-	-	10,917,524
	<b>1,886,664,631</b>	1,311,815,042	1,216,778,252
<b>NET INTEREST INCOME</b>			
	<b>3,263,990,156</b>	3,326,556,699	2,923,680,555
Gain on asset exchange (Note 9)	<b>270,140,580</b>	120,530,783	121,408,146
Service charges, fees and commissions	<b>268,037,238</b>	239,452,223	268,968,398
Income from property rentals (Notes 11, 21 and 24)	<b>31,184,292</b>	27,847,995	24,599,679
Trading and securities gains (losses) - net (Notes 7 and 24)	<b>(866,221)</b>	68,871,922	89,296,487
Miscellaneous (Note 19)	<b>100,746,511</b>	90,554,583	84,823,799
<b>TOTAL OPERATING INCOME</b>			
	<b>3,933,232,556</b>	3,873,814,205	3,512,777,064
Compensation and fringe benefits (Notes 20 and 24)	<b>1,264,557,216</b>	1,167,316,193	1,060,508,535
Depreciation and amortization (Note 10)	<b>325,484,568</b>	345,824,017	326,229,128
Documentary stamp taxes	<b>325,246,773</b>	198,543,153	173,288,962
Occupancy costs (Note 21)	<b>303,179,796</b>	259,647,476	246,382,130
Taxes and licenses	<b>256,232,538</b>	223,349,751	222,971,604
Security, clerical, messengerial and janitorial	<b>244,763,404</b>	254,444,223	253,268,183
Insurance	<b>219,076,739</b>	195,971,231	170,572,121
Acquired asset and other litigation expense	<b>134,088,277</b>	171,657,363	93,038,714
Transportation and travel	<b>117,739,730</b>	91,703,285	82,338,949
Provision for impairment and credit losses (Note 14)	<b>104,649,096</b>	295,680,313	305,000,666
Entertainment, amusement and recreation (Note 22)	<b>99,022,205</b>	86,039,178	87,792,311
Utilities	<b>96,004,237</b>	88,691,492	89,079,470
Data processing and information technology	<b>60,223,207</b>	30,242,093	52,177,381
Stationery, supplies and postage	<b>31,635,981</b>	36,402,353	27,855,528
Management and other professional fees	<b>12,781,365</b>	11,844,995	21,207,906
Miscellaneous (Notes 11 and 19)	<b>162,907,228</b>	165,148,841	149,341,960
<b>TOTAL OPERATING EXPENSES</b>			
	<b>3,757,592,360</b>	3,622,505,957	3,361,053,548
<b>INCOME BEFORE INCOME TAX</b>			
	<b>175,640,196</b>	251,308,248	151,723,516
<b>BENEFIT FROM INCOME TAX</b> (Note 22)			
	<b>(194,223,416)</b>	(250,233,969)	(81,810,726)
<b>NET INCOME</b>			
	<b>₱369,863,612</b>	₱501,542,217	₱233,534,242

*See accompanying Notes to Financial Statements.*



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

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**STATEMENTS OF COMPREHENSIVE INCOME**

	<b>Years Ended December 31</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
<b>NET INCOME</b>	<b>₱369,863,612</b>	<b>₱501,542,217</b>	<b>₱233,534,242</b>
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>			
<i>Items that recycle to profit or loss in subsequent periods:</i>			
Changes in net unrealized losses on:			
Financial assets at fair value through other comprehensive income (Note 7)	<b>(8,132,886)</b>	–	–
Available-for-sale financial assets (Note 7)	–	25,196,599	(133,786,521)
Cumulative translation adjustment	<b>30,284,244</b>	(2,314,166)	27,350,859
<i>Items that do not recycle to profit or loss in subsequent periods:</i>			
Remeasurement gains (losses) on retirement asset (Note 20)	<b>67,712,284</b>	19,294,655	(68,467,785)
	<b>89,863,642</b>	42,177,088	(174,903,447)
<b>TOTAL COMPREHENSIVE INCOME</b>	<b>₱459,727,254</b>	<b>₱543,719,305</b>	<b>₱58,630,795</b>

*See accompanying Notes to Financial Statements.*



**CHINA BANK SAVINGS, INC.**  
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**STATEMENTS OF CHANGES IN EQUITY**

	Capital Stock (Note 18)	Additional Paid-in Capital (Note 18)	Deposit for Future Stock Subscription (Notes 18 and 24)	Other Equity Reserves (Note 29)	Surplus Reserves (Notes 18 and 23)	Surplus (Notes 18 and 23)	Remeasurement Gains (Losses) on Retirement Asset (Note 20)	Net Unrealized Losses on Financial Assets at Fair Value through Other Comprehensive Income (Note 7)	Net Unrealized Losses on Available-for- Sale Financial Assets (Note 7)	Cumulative Translation Adjustment	Total Equity
<b>Balance at January 1, 2018</b>	<b>₱10,043,579,100</b>	<b>₱490,049,814</b>	<b>₱-</b>	<b>(₱2,248,520,637)</b>	<b>₱22,764,290</b>	<b>₱242,276,780</b>	<b>(₱66,964,439)</b>	<b>₱-</b>	<b>(₱132,516,533)</b>	<b>₱15,395,550</b>	<b>₱8,366,063,925</b>
Effect of initial application of PFRS 9 (Note 2)	-	-	-	-	-	(286,912,063)	-	(77,173,387)	132,516,533	-	(231,568,917)
<b>Balance at January 1, 2018, as restated</b>	<b>10,043,579,100</b>	<b>490,049,814</b>	<b>-</b>	<b>(2,248,520,637)</b>	<b>22,764,290</b>	<b>(44,635,283)</b>	<b>(66,964,439)</b>	<b>(77,173,387)</b>	<b>-</b>	<b>15,395,550</b>	<b>8,134,495,008</b>
Issuance of capital stock	500,000,000	(5,000,000)	-	-	-	-	-	-	-	-	495,000,000
Total comprehensive income (loss) for the year	-	-	-	-	-	369,863,612	67,712,284	(8,132,886)	-	30,284,244	459,727,254
Transfer from surplus reserves	-	-	-	-	(22,764,290)	22,764,290	-	-	-	-	-
<b>Balance at December 31, 2018</b>	<b>₱10,543,579,100</b>	<b>₱485,049,814</b>	<b>₱-</b>	<b>(₱2,248,520,637)</b>	<b>₱-</b>	<b>₱347,992,619</b>	<b>₱747,845</b>	<b>(₱85,306,273)</b>	<b>₱-</b>	<b>₱45,679,794</b>	<b>₱9,089,222,262</b>
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 reserves	-	-	-	-	178,868	(178,868)	-	-	-	-	-
<b>Balance at December 31, 2017</b>	<b>₱10,043,579,100</b>	<b>₱490,049,814</b>	<b>₱-</b>	<b>(₱2,248,520,637)</b>	<b>₱22,764,290</b>	<b>₱242,276,780</b>	<b>(₱66,964,439)</b>	<b>-</b>	<b>(₱132,516,533)</b>	<b>₱15,395,550</b>	<b>₱8,366,063,925</b>
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 reserves	-	-	-	-	583,295	(583,295)	-	-	-	-	-
<b>Balance at December 31, 2016</b>	<b>₱7,402,164,200</b>	<b>₱495,643,582</b>	<b>₱2,647,942,142</b>	<b>(₱2,248,520,637)</b>	<b>₱22,585,422</b>	<b>(₱259,086,569)</b>	<b>(₱86,259,094)</b>	<b>-</b>	<b>(₱157,713,132)</b>	<b>₱17,709,716</b>	<b>₱7,834,465,630</b>

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		
	2018	2017	2016
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Income before income tax	¥175,640,196	¥251,308,248	¥151,723,515
Adjustments for:			
Depreciation and amortization (Note 10)	325,484,568	345,824,017	326,229,128
Gain on asset exchange (Note 9)	(270,140,580)	(120,530,783)	(121,408,146)
Provision for impairment and credit losses (Note 14)	104,649,096	295,680,313	305,000,666
Amortization of premium on investment securities	64,529,787	47,877,645	72,261,607
Realized trading gain on financial assets at fair value through other comprehensive income (Note 7)	(866,221)	–	–
Realized trading gain on available-for-sale financial assets (Note 7)	–	(63,355,179)	(61,119,743)
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)
Write-off of non-financial asset (Note 10)	–	–	10,743,845
Changes in operating assets and liabilities:			
Decrease (increase) in the amounts of:			
Loans and receivables	(3,201,090,037)	(6,053,432,776)	(8,373,484,271)
Financial assets at fair value through profit or loss	–	333,950,906	283,866,837
Other assets (Notes 13 and 27)	(323,896,787)	(254,786,332)	(288,390,865)
Increase (decrease) in the amounts of:			
Deposit liabilities	8,164,390,166	4,847,465,600	5,183,739,638
Manager's checks	(247,622,385)	147,600,685	(87,696,522)
Accrued interest and other expenses	152,008,705	(13,010,145)	43,310,446
Other liabilities (Notes 16 and 27)	(286,946,080)	415,581,452	29,109,297
Net cash generated from (used in) operations	4,656,140,428	185,087,597	(2,526,950,917)
Income tax paid (Notes 22 and 27)	(113,361,063)	(58,641,721)	(56,176,004)
Net cash provided by (used in) operating activities	4,542,779,365	126,445,876	(2,583,126,921)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Acquisitions of:			
Investment securities at amortized cost	(3,452,219,037)	–	–
Financial assets at fair value through other comprehensive income	(384,875,194)	–	–
Property and equipment (Note 10)	(221,501,212)	(343,660,006)	(270,049,299)
Software costs (Note 12)	(5,857,179)	(16,544,421)	(22,786,398)
Available-for-sale financial assets	–	(1,034,304,528)	(2,923,590,088)
Held-to-maturity financial assets	–	(188,875,689)	(480,256,847)
Proceeds from sale/maturity of:			
Investment properties (Notes 9 and 11)	506,060,571	556,300,236	452,390,207
Non-current assets held for sale (Note 9)	414,687,056	484,618,905	110,631,995
Financial assets at fair value through other comprehensive income	46,190,714	–	–
Investment securities at amortized cost	44,100,000	–	–
Property and equipment (Note 10)	–	57,701,286	–
Available-for-sale financial assets	–	1,018,832,682	1,785,042,827
Net cash provided by (used in) investing activities	(3,053,414,281)	534,068,465	(1,348,617,603)

(Forward)



	<b>Years Ended December 31</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from capital infusion (Notes 18 and 24)	<b>₱500,000,000</b>	₱-	₱2,500,000,000
Settlement of bills payable	-	-	(662,530,655)
Net cash provided by financing activities	<b>500,000,000</b>	-	1,837,469,345
<b>EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>			
	<b>27,365,612</b>	(2,933,718)	27,350,859
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>2,016,730,696</b>	657,580,623	(2,066,924,320)
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b>11,534,522,627</b>	10,876,942,004	12,943,866,324
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b>₱13,551,253,323</b>	₱11,534,522,627	₱10,876,942,004
<b>OPERATIONAL CASH FLOWS FROM INTEREST</b>			
Interest received	<b>₱5,015,119,977</b>	₱4,421,272,502	₱4,012,626,173
Interest paid	<b>1,767,878,474</b>	1,294,064,555	1,219,328,394

*See accompanying Notes to Financial Statements.*



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

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**NOTES TO FINANCIAL STATEMENTS**

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**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, 2018 and 2017, the Bank has 162 and 160 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, 2018 and 2017, CBC, the ultimate parent bank, has ownership interest in the Bank of 99.60% and 99.22%, respectively.

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

Merger between the Bank and Unity Bank, A Rural Bank Inc.

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).



### Merger between the Bank and Planters Development Bank (PDB)

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).

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## 2. Accounting Policies

### **Basis of Preparation**

The accompanying financial statements have been prepared on a historical cost basis except for financial assets at fair value through profit or loss (FVPL), available-for-sale (AFS) financial assets and financial assets at fair value through other comprehensive income (OCI) 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 PFRS, Philippine Accounting Standards (PAS) and Philippine Interpretation which became effective as of January 1, 2018. Except as otherwise indicated, these changes in the accounting policies did not have any significant impact on the financial position or performance of the Bank:

- *New and Amended Standards*
  - Amendments to PFRS 2, *Share-based Payment, Classification and Measurement of Share-based Payment Transactions*
  - Amendments to PFRS 4, *Insurance Contracts, Applying PFRS 9, Financial Instruments, with PFRS 4*
  - Philippine Interpretation IFRIC-22, *Foreign Currency Transactions and Advance Consideration*
- *Annual Improvements to PFRSs (2014 - 2017 Cycle)*
  - Amendments to PAS 28, *Investments in Associates and Joint Ventures, Measuring an Associate or Joint Venture at Fair Value*
  - Amendments to PAS 40, *Investment Property, Transfers of Investment Property*

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

#### *PFRS 9, Financial Instruments*

The Bank adopted PFRS 9 on January 1, 2018 following the modified retrospective approach. PFRS 9 replaced PAS 39, *Financial Instruments: Recognition and Measurement*.

Under the modified retrospective approach, the Bank did not restate the prior-period comparative financial statements and remains to report the comparative information for 2017 under PAS 39. Accordingly, the 2017 comparative financial statements are not comparable to the information presented for 2018. Differences in the carrying amounts of financial instruments resulting from the adoption of PFRS 9 are recognized in the opening January 1, 2018 surplus and other comprehensive income (OCI) as if the Bank had always followed the new requirements.

As a result of applying PFRS 9's split between surplus and OCI requirements on classification and measurement of financial assets, the opening January 1, 2018 surplus and OCI in the Bank's statement of financial position increased by ₱68.84 million and ₱55.34 million, respectively. This



change resulted 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. However, applying PFRS 9's requirements on the recognition of expected credit losses decreased the opening January 1, 2018 surplus in the Bank's statement of financial position by ₱355.75 million. Impairment under expected credit losses (ECL) model is now dependent upon 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.

The accounting policies adopted by the Bank as a result of adopting PFRS 9 are discussed in page 8.

The adoption of PFRS 9 did not have an impact on the classification and measurement of the Bank's financial liabilities and on the application of hedge accounting.

The impact of adopting PFRS 9 as of January 1, 2018 follows:

	PAS 39		Re-classifications	Remeasurement		PFRS 9	
	Category	Amount		ECL	Others	Category	Amount
<b>Assets</b>							
Cash and other cash items	Loans and receivables	₱1,501,172,842	₱-	₱-	₱-	Amortized cost	₱1,501,172,842
Due from BSP	Loans and receivables	6,772,976,958	-	-	-	Amortized cost	6,772,976,958
Due from other banks	Loans and receivables	1,856,049,625	-	-	-	Amortized cost	1,856,049,625
SPURA	Loans and receivables	1,404,323,202	-	-	-	Amortized cost	1,404,323,202
Loans and receivables	Loans and receivables	63,144,324,080	-	(300,846,241)	-	Amortized cost	62,843,477,839
Other financial assets	Loans and receivables	1,005,217,324	-	(48,520,344)	-	Amortized cost	956,696,980
Investment securities	Financial assets at FVPL	135,397,767	(135,397,767)	-	-	FVPL	-
	AFS financial assets	2,220,626,084	(1,439,430,500)	(661,013)	-	FVOCI	780,534,571
	HTM financial assets	3,502,817,726	1,574,828,267	(5,725,840)	124,184,521	Amortized cost	5,196,104,674
		<b>₱81,542,905,608</b>	<b>₱-</b>	<b>(₱355,753,438)</b>	<b>₱124,184,521</b>		<b>₱81,311,336,691</b>

Equity	Balance at January 1, 2018	Transition adjustments	Balance at January 1, 2018 (as restated)
Surplus	₱242,276,780	(₱286,912,063)	(₱44,635,283)
Net unrealized losses taken to OCI	(132,516,533)	55,343,146	(77,173,387)

On January 1, 2018, the Bank reclassified the following:

- its previous financial assets at FVPL with carrying value of ₱135.40 million as financial assets at fair value through other comprehensive income (FVOCI). Market valuation previously credited to surplus on these financial assets amounting to ₱4.02 million were adjusted to net unrealized loss on FVOCI on January 1, 2018. These instruments had contractual cash flows that were solely payments for principal and interests and were held for liquidity management; and
- a portion of its previous AFS financial assets with carrying value of ₱1.64 billion as investment securities at amortized cost. Reclassification of these financial assets resulted in reversal of previously recognized market valuation loss of ₱68.62 million. These instruments had contractual cash flows that were solely payments for principal and interests, were not intended for active trading and were held for accrual business, with the intention to collect cash flows and without the intention to sell.

FVOCI assets as of January 1, 2018 included unquoted equity securities that were previously classified as AFS. The allowance for impairment losses on these securities which were previously charged to surplus amounted to ₱73.04 million was reversed and charged to net unrealized loss upon adoption of PFRS 9.

Had the financial assets at FVPL securities not been transferred to FVOCI, additional fair value loss of ₱12.82 million would have been charged to profit or loss in 2018. The effective interest rates on these reclassified securities range from 3.15% to 3.99%. Interest income earned in 2018 on these securities amounted to ₱3.94 million.



Had the AFS financial assets not been transferred to investment securities at amortized cost, additional fair value loss of ₱78.92 million would have been charged to OCI in 2018. The effective interest rates on these reclassified securities range from 2.89% to 6.72%. Interest income carried in 2018 amounted to ₱64.69 million.

#### *PFRS 15, Revenue from Contracts with Customers*

PFRS 15 supersedes PAS 11, *Construction Contracts*, PAS 18, *Revenue* and related Interpretations and it applies, with limited exceptions, to all revenue arising from contracts with customers. PFRS 15 establishes a five-step model to account for revenue arising from contracts with customers and requires that revenue be 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.

PFRS 15 requires entities to exercise judgment, taking into consideration all of the relevant facts and circumstances when applying each step of the model to contracts with their customers. The standard also specifies the accounting for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract. In addition, the standard requires extensive disclosures.

The Bank adopted PFRS 15 using the modified retrospective method of adoption with the date of initial application of January 1, 2018. Under this method, the standard can be applied either to all contracts at the date of initial application or only to contracts that are not completed at this date. The Bank elected to apply the standard to all contracts as at January 1, 2018.

There were no adjustments recognized to the opening balance of surplus at the date of initial application as an effect of initially applying PFRS 15. Also, the comparative information was not restated and continues to be reported under PAS 11, PAS 18 and related Interpretations.

### **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 or financial assets at FVOCI, retirement liability and cumulative translation adjustment, based on amounts reflected in the financial statements of the absorbed entity on merger date.

#### 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 financial assets at FVPL, AFS financial assets and financial assets at FVOCI, 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.

#### Cash and Cash Equivalents

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.

#### SPURA

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. Any change in fair value of unrecognized financial asset is recognized in the statement of income for assets classified as financial assets at FVPL, and in equity for assets classified as financial assets at FVOCI and AFS financial assets. 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.

### *'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.

## Classification, Reclassification and Impairment of Financial Assets (PFRS 9)

### *Classification and measurement*

Under PFRS 9, the classification and measurement of financial assets is driven by the entity's contractual cash flow characteristics of the financial assets and business model for managing the financial assets.

As part of its classification process, the Bank assesses the contractual terms of financial assets to identify whether they meet the 'solely payments of principal and interest' (SPPI) test. 'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (e.g., if there are repayments of principal or amortization of the premium or discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgment and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set. In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.



The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- how the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- how managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected); and
- the expected frequency, value and timing of sales are also important aspects of the Bank's assessment

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realized in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

The Bank's measurement categories are described below:

*Investment securities at amortized cost*

Financial assets are measured at amortized cost if both of the following conditions are met:

- the asset is held within the Bank's business model whose objective is to hold financial assets in order to collect contractual cash flows; and,
- the contractual terms of the instrument give rise, on specified dates, to cash flows that are SPPI on the principal amount outstanding.

Financial assets meeting these criteria are measured initially at fair value plus transaction costs. They are subsequently measured at amortized cost using the effective interest method, less any impairment in value.

The Bank's investment securities at amortized cost are presented in the statement of financial position as cash and cash equivalents, investment securities at amortized cost, loans and receivables and certain accounts under other assets.

The Bank may irrevocably elect at initial recognition to classify a financial asset that meets the amortized cost criteria above as at FVPL if that designation eliminates or significantly reduces an accounting mismatch had the financial asset been measured at amortized cost.

*Financial assets at FVPL*

Debt instruments that neither meet the amortized cost nor the FVOCI criteria, or that meet the criteria but the Bank has chosen to designate as at FVPL at initial recognition, are classified as financial assets at FVPL. Equity investments are classified as financial assets at FVPL, unless the Bank designates an equity investment that is not held for trading as at FVOCI at initial recognition. As of December 31, 2018, the Bank does not have financial assets at FVPL.

Financial assets at FVPL are measured at fair value. Related transaction costs are recognized directly as expense in profit or loss. Gains and losses arising from changes (mark-to-market) in the fair value of the financial assets at FVPL and gains or losses arising from disposals of these instruments are included in 'Trading and securities gains (losses) - net' account in the statement of income.



Interest recognized based on the modified effective interest rate of these investments is reported in statement of income under 'Interest income' account while dividend income is reported in statement of income under 'Miscellaneous income' account when the right of payment has been established.

*Financial assets at FVOCI - equity investments*

At initial recognition, the Bank can make an irrevocable election (on an instrument-by-instrument basis) to designate equity investments as at FVOCI; however, such designation is not permitted if the equity investment is held by the Bank for trading. The Bank has designated its unquoted equity instruments as at FVOCI on initial application of PFRS 9 as these are not held for trading purposes.

Financial assets at FVOCI are initially measured at fair value plus transaction costs. Subsequently, they are measured at fair value, with no deduction for any disposal costs. Gains and losses arising from changes in fair value are recognized in other comprehensive income and accumulated in net unrealized losses on investment securities in the statements of financial position. When the asset is disposed of, the cumulative gain or loss previously recognized in the net losses on investment securities account is not reclassified to profit or loss, but is reclassified directly to 'Surplus-free' account. Any dividends earned on holding these equity instruments are recognized in profit or loss under 'Miscellaneous income' account.

*Financial assets at FVOCI - debt investments*

The Bank applies the new category under PFRS 9 of debt instruments measured at FVOCI when both of the following conditions are met:

- the instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset meet the SPPI test.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value being recognized in OCI. Interest income and foreign exchange gains and losses are recognized in profit or loss in the same manner as for financial assets measured at amortized cost. The ECL calculation for financial assets at FVOCI is explained in the 'Impairment of Financial Assets' section.

On derecognition, cumulative gains or losses previously recognized in OCI are reclassified from OCI to profit or loss.

*Reclassification*

The Bank can only reclassify financial assets if the objective of its business model for managing those financial assets changes. Accordingly, the Bank is required to reclassify financial assets:

(i) from amortized cost to FVPL, if the objective of the business model changes so that the amortized cost criteria are no longer met; and, (ii) from FVPL to amortized cost, if the objective of the business model changes so that the amortized cost criteria start to be met and the characteristic of the instrument's contractual cash flows meet the amortized cost criteria.

A change in the objective of the Bank's business model will be effected only at the beginning of the next reporting period following the change in the business model.

*Impairment of financial assets*

Starting January 1, 2018, the Bank has been recording the allowance for expected credit losses for all loans and other debt financial assets carried at amortized cost, financial assets carried at FVOCI, together with loan commitments and financial guarantee contracts. Equity instruments are not subject to impairment under PFRS 9.



ECL 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 are 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 (General Approach). The 12-month ECL is the portion of lifetime ECL that results from default events on a financial instrument that are possible within the 12 months after the reporting date. Lifetime ECL are credit losses that results from all possible default events over the expected life of a financial instrument.

For non-credit-impaired financial instruments:

- Stage 1 is comprised of all non-impaired financial instruments which have not experienced an SICR since initial recognition. The Bank recognizes a 12-month ECL for Stage 1 financial instruments.
- Stage 2 is comprised of all non-impaired financial instruments which have experienced an SICR since initial recognition. The Bank recognizes a lifetime ECL for Stage 2 financial instruments.

For credit-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 loan or a portfolio of loans. The ECL model requires that lifetime ECL be recognized for impaired financial instruments.

The Bank uses internal credit assessment and approvals at various levels to determine the credit risk of exposures at initial recognition. Assessment can be quantitative or qualitative and depends on the materiality of the facility or the complexity of the portfolio to be assessed.

The Bank defines a financial instrument as in default, which is fully aligned with the definition of credit impaired, in all cases when the borrower becomes at least 90 days past due on its contractual payments. As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted. An instrument is considered to be no longer in default (i.e., to have cured) when it no longer meets any of the default criteria for a consecutive period of 180 days (i.e., consecutive payments from the borrowers for 180 days).

The criteria for determining whether credit risk has increased significantly vary by portfolio and include quantitative changes in probabilities of default and qualitative factors such as downgrade in the credit rating of the borrowers and a backstop based on delinquency. The credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, based on the Bank's internal credit assessment, the borrower or counterparty is determined to require close monitoring or with well-defined credit weaknesses. For exposures without internal credit grades, if contractual payments are more than a specified days past due threshold (i.e., 30 days), the credit risk is deemed to have increased significantly since initial recognition. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. In subsequent reporting periods, if the credit risk of the financial instrument improves such that there is no longer a SICR since initial recognition, the Bank shall revert to recognizing a 12-month ECL.



ECL is a function of the probabilities of default (PD), exposure at default (EAD) and loss given default (LGD), with the timing of the loss also considered, and is estimated by incorporating forward-looking economic information and through the use of experienced credit judgment.

The PD represents the likelihood that a credit exposure will not be repaid and will go into default in either a 12-month horizon for Stage 1 or lifetime horizon for Stage 2. EAD represents an estimate of the outstanding amount of credit exposure at the time a default may occur. For off-balance sheet and undrawn amounts, EAD includes an estimate of any further amounts to be drawn at the time of default. LGD is the amount that may not be recovered in the event of default. LGD takes into consideration the amount and quality of any collateral held. Please refer to Note 6 for other information related to the Bank's models for PD, EAD, and LGD.

The calculation of ECLs, including the estimation of PD, EAD, LGD and discount rate is made, on an individual basis for most of the Bank's financial assets, and on a collective basis for retail products such as personal and teachers' loans. The collective assessments are made separately for portfolios of facilities with similar credit risk characteristics.

In certain circumstances, the Bank modifies the original terms and conditions of a credit exposure to form a new loan agreement or payment schedule. The modifications can be given depending on the borrower's or counterparty's current or expected financial difficulty. The modifications may include, but are not limited to, change in interest rate and terms, principal amount, maturity date, date and amount of periodic payments and accrual of interest and charges. Distressed restructuring with indications of unlikelihood to pay are categorized as impaired accounts and are moved to Stage 3.

#### Classification, Reclassification and Impairment of Financial Assets (Prior to Adoption of PFRS 9)

The Bank classifies its financial assets in the following categories: financial assets at FVPL, 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 investments were acquired and whether they are quoted in an active market. Management determines the classification of its investments at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

#### *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, all financial assets at FVPL 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 profit or loss. As of December 31, 2017, 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 financial assets at FVPL, 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.

#### Impairment of Financial Assets (prior to adoption of PFRS 9)

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 derecognition of financial assets.

### 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.

### Write-offs

Financial assets are written off either partially or in their entirety when the Bank no longer expects collections or recoveries within a foreseeable future. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense.

### 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, 2018 and 2017, 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

Surplus 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

Prior to PFRS 15, 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. Starting January 1, 2018, revenue from contracts with customers is recognized when control of the goods or services are transferred to the customer at an amount that reflects the consideration to which the Bank expects to be entitled in exchange for those goods or services. The Bank has assessed that it is acting as principal in all 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 FVOCI and AFS financial assets, interest income is recorded at either 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, or at rate stated in the contract. 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'.

Under PFRS 9, when a financial asset becomes credit-impaired and is, therefore, regarded as Stage 3 (as discussed in "Impairment of Financial Assets" above), the Bank calculates interest income by applying the EIR to the net amortized cost of the financial asset. If the financial asset cures and is no longer credit-impaired, the Bank reverts to calculating interest income on a gross basis. Under PAS 39, 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 commission income*

Fees earned for the provision of services over a period of time are accrued over that period, as the customer simultaneously receives and consumes the benefits provided by the bank. Using an output method, revenue is recognized if the Bank has a right to invoice the customer for services directly corresponding to performance completed to date. These include charges from usage of ATM, charges for returned checks, charges for below minimum maintaining balance and commission income.

The Bank assessed that there is no difference in accounting for service fees and commission income under PFRS 15 and PAS 18.

#### *Gain 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 (losses) - net*

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 and FVOCI debt investments.

#### *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.

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 asset or liability 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 asset or 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

There are new PFRSs, amendments, interpretation and annual improvements, to existing standards effective for annual periods subsequent to 2018, which are adopted by the Financial Reporting Standards Council. Management will adopt the following relevant pronouncements in accordance with their transitional provisions; and, unless otherwise stated, none of these are expected to have significant impact on the Bank's financial statements:

##### *Effective beginning on or after January 1, 2019:*

- PFRS 9 (Amendment), *Prepayment Features with Negative Compensation*. Under PFRS 9, a debt instrument can be measured at amortized cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to PFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract. The amendments should be applied retrospectively and are effective from January 1, 2019, with earlier application permitted. Management has assessed that the amendment has no impact on the financial statements.



- PFRS 16, *Leases*. This new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under PAS 17, *Leases*. The standard includes two recognition exemptions for lessees - leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less).

At the commencement date of a lease, a lessee will recognize a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognize the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognize the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under PFRS 16 is substantially unchanged from today's accounting under PAS 17. Lessors will continue to classify all leases using the same classification principle as in PAS 17 and distinguish between two types of leases: operating and finance leases.

PFRS 16 also requires lessees and lessors to make more extensive disclosures than under PAS 17.

A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs.

Upon adoption of this standard, the Bank expect to recognize a right of use asset and lease liability for covered lease contracts. Management is currently assessing the impact of this new standard in the financial statements.

- PAS 19 (Amendments), *Employee Benefits, Plan Amendment, Curtailment or Settlement*. The amendments to PAS 19 address the accounting when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments specify that when a plan amendment, curtailment or settlement occurs during the annual reporting period, an entity is required to:
  - Determine current service cost for the remainder of the period after the plan amendment, curtailment or settlement, using the actuarial assumptions used to remeasure the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event
  - Determine net interest for the remainder of the period after the plan amendment, curtailment or settlement using: the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event; and the discount rate used to remeasure that net defined benefit liability (asset).

The amendments also clarify that an entity first determines any past service cost, or a gain or loss on settlement, without considering the effect of the asset ceiling. This amount is recognized in profit or loss. An entity then determines the effect of the asset ceiling after the plan amendment, curtailment or settlement. Any change in that effect, excluding amounts included in the net interest, is recognized in other comprehensive income.



Early application is permitted. These amendments will apply only to any future plan amendments, curtailments, or settlements of the Bank.

- PAS 28 (Amendments), *Long-term Interests in Associates and Joint Ventures*. The amendments clarify that an entity applies PFRS 9 to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in the associate or joint venture (long-term interests). This clarification is relevant because it implies that the expected credit loss model in PFRS 9 applies to such long-term interests.

The amendments also clarified that, in applying PFRS 9, an entity does not take account of any losses of the associate or joint venture, or any impairment losses on the net investment, recognized as adjustments to the net investment in the associate or joint venture that arise from applying PAS 28, *Investments in Associates and Joint Ventures*.

The amendments should be applied retrospectively, with early application permitted.

- IFRIC 23, *Uncertainty over Income Tax Treatments*. The interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of PAS 12, *Income Taxes*, and does not apply to taxes or levies outside the scope of PAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments.

The interpretation specifically addresses the following:

- Whether an entity considers uncertain tax treatments separately
- The assumptions an entity makes about the examination of tax treatments by taxation authorities
- How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates
- How an entity considers changes in facts and circumstances

An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed.

This interpretation is not relevant to the Bank because there is no uncertainty involved in the tax treatments made by management in connection with the calculation of current and deferred taxes as of December 31, 2018 and 2017.

#### *Annual Improvements to PFRS 2015-2017 Cycle*

- Amendments to PFRS 3, *Business Combinations*, and PFRS 11, *Joint Arrangements, Previously Held Interest in a Joint Operation*. The amendments clarify that, when an entity obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. In doing so, the acquirer remeasures its entire previously held interest in the joint operation.

A party that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes a business as defined in PFRS 3. The amendments clarify that the previously held interests in that joint operation are not remeasured.



An entity applies those amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2019 and to transactions in which it obtains joint control on or after the beginning of the first annual reporting period beginning on or after January 1, 2019, with early application permitted. These amendments are currently not applicable to the Bank but may apply to future transactions.

- Amendments to PAS 12, *Income Tax Consequences of Payments on Financial Instruments Classified as Equity*. The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognizes the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognized those past transactions or events.
- Amendments to PAS 23, *Borrowing Costs, Borrowing Costs Eligible for Capitalization*. The amendments clarify that an entity treats as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete.

An entity applies those amendments to borrowing costs incurred on or after the beginning of the annual reporting period in which the entity first applies those amendments. Early application is permitted.

*Effective beginning on or after January 1, 2020*

- Amendments to PFRS 3, *Definition of a Business*. The amendments to PFRS 3 clarify the minimum requirements to be a business, remove the assessment of a market participant's ability to replace missing elements, and narrow the definition of outputs. The amendments also add guidance to assess whether an acquired process is substantive and add illustrative examples. An optional fair value concentration test is introduced which permits a simplified assessment of whether an acquired set of activities and assets is not a business.

Earlier application is permitted.

- Amendments to PAS 1, *Presentation of Financial Statements*, and PAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors, Definition of Material*. The amendments refine the definition of material in PAS 1 and align the definitions used across PFRSs and other pronouncements. They are intended to improve the understanding of the existing requirements rather than to significantly impact an entity's materiality judgments.

Earlier application is permitted.

*Effective beginning on or after January 1, 2021*

- PFRS 17, *Insurance Contracts*. The standard is a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, PFRS 17 will replace PFRS 4, *Insurance Contracts*. This new standard on insurance contracts applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features. A few scope exceptions will apply.





The overall objective of PFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers. In contrast to the requirements in PFRS 4, which are largely based on grandfathering previous local accounting policies, PFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects. The core of PFRS 17 is the general model, supplemented by:

- A specific adaptation for contracts with direct participation features (the variable fee approach)
- A simplified approach (the premium allocation approach) mainly for short-duration contracts

Early application is permitted. This standard has no impact on the Bank as it has no insurance operations.

#### *Deferred effectivity*

- Amendments to PFRS 10, *Consolidated Financial Statements*, and PAS 28, *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*. The amendments address the conflict between PFRS 10 and PAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that a full gain or loss is recognized when a transfer to an associate or joint venture involves a business as defined in PFRS 3. Any gain or loss resulting from the sale or contribution of assets that does not constitute a business, however, is recognized only to the extent of unrelated investors' interests in the associate or joint venture.

On January 13, 2016, the Financial Reporting Standards Council deferred the original effective date of January 1, 2016 of the said amendments until the International Accounting Standards Board (IASB) completes its broader review of the research project on equity accounting that may result in the simplification of accounting for such transactions and of other aspects of accounting for associates and joint ventures.

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### 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 (prior to adoption of PFRS 9)*  
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 (prior to PFRS 9 adoption)*

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).

*e. Evaluation of business model in managing financial instruments (PFRS 9)*

The Bank manages its financial assets based on business models that maintain an adequate level of financial assets to match its expected cash outflows, largely arising from customers' withdrawals and continuing loan disbursements to borrowers, while maintaining a strategic portfolio of financial assets for investment and trading activities consistent with its risk appetite.

The Bank developed business models which reflect how it manages its portfolio of financial instruments. The Bank's business models need not be assessed at entity level or as a whole but applied at the level of a portfolio of financial instruments (i.e., group of financial instruments that are managed together by the Bank) and not on an instrument-by-instrument basis (i.e., not based on intention or specific characteristics of individual financial instrument).

In determining the classification of a financial instrument under PFRS 9, the Bank evaluates in which business model a financial instrument or a portfolio of financial instruments belong to taking into consideration the objectives of each business model established by the Bank, various



risks and key performance indicators being reviewed and monitored by responsible officers, as well as the manner of compensation for them.

At the start of 2018, the Bank's BOD approved its documentation of business models which contains broad categories of banking and trading business models. The banking business model includes the Bank's lending activities as well as treasury business activities broken down into liquidity and investment portfolios. The approval of the business models triggered the realignment and reassessment of the Bank's strategy for managing its hold to collect (HTC) portfolio and the introduction of new portfolios with the objective of maximizing risk-adjusted returns. As such, the Bank's classification of financial assets now consists of amortized cost and FVOCI, where certain securities were reclassified from a classification measured at amortized cost to a classification measured at fair value, and vice versa, at the beginning of first quarter of 2018.

The business model assessment is based on reasonably expected scenarios without taking worst case or stress case scenarios into account. If cash flows, after initial recognition are realized in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

*f. Testing the cash flow characteristics of financial assets (PFRS 9)*

In determining the classification of financial assets under PFRS 9, the Bank assesses whether the contractual terms of the financial assets give rise on specified dates to cash flows that are SPPI on the principal outstanding, with interest representing time value of money and credit risk associated with the principal amount outstanding. The assessment as to whether the cash flows meet the test is made in the currency in which the financial asset is denominated. Any other contractual term that changes the timing or amount of cash flows (unless it is a variable interest rate that represents time value of money and credit risk), i.e., cash flows that are non-SPPI, does not meet the amortized cost criteria. In cases where the relationship between the passage of time and the interest rate of the financial instrument may be imperfect, known as modified time value of money, the Bank assesses the modified time value of money feature to determine whether the financial instrument still meets the SPPI criterion. The objective of the assessment is to determine how different the undiscounted contractual cash flows could be from the undiscounted cash flows that would arise if the time value of money element was not modified (the benchmark cash flows). If the resulting difference is significant, the SPPI criterion is not met. In view of this, the Bank considers the effect of the modified time value of money element in each reporting period and cumulatively over the life of the financial instrument.

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' (prior to adoption of PFRS 9)*

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 are disclosed in Notes 7 and 8, respectively.

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

*b. Expected credit losses on financial assets (PFRS 9)*

The Bank reviews its financial assets and commitments at each reporting date to determine the amount of expected credit losses to be recognized in the balance sheet and any changes thereto in the statement of income. In particular, judgments and estimates by management are required in determining the following:

- whether a financial asset has had a significant increase in credit risk since initial recognition;
- whether default has taken place and what comprises a default;
- macro-economic factors that are relevant in measuring a financial asset's probability of default as well as the Bank's forecast of these macro-economic factors;
- probability weights applied over a range of possible outcomes;
- sufficiency and appropriateness of data used and relationships assumed in building the components of the Bank's expected credit loss models;
- measuring the exposure at default for unused commitments on which an expected credit loss should be recognized and the applicable loss rate

The related allowance for credit losses of financial assets are disclosed in Note 14.

*c. 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).

d. *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.

e. *Net retirement asset (liability) and retirement expense*

The determination of the Bank's net retirement asset (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 asset (liability).

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

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#### 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.

*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.

*Equity securities (prior to adoption of PFRS 9)* - Unquoted equity securities 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.

*Equity securities (upon adoption of PFRS 9)* - Remeasurement of the unquoted equity securities to their fair values is not material to the financial statements.



*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 6.43% to 28.43% and from 5.65% to 28.43% in 2018 and 2017, 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% in 2017.

*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, 2018 and 2017 range from 0.50% to 7.50% and from 0.25% to 4.75%, 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, 2018 and 2017, 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, 2018				
	Carrying Value	Level 1	Level 2	Level 3	Total
<b>Recurring fair value measurements</b>					
Financial assets at FVOCI					
Government debt securities	₱1,053,071,928	₱1,053,004,955	₱-	₱-	₱1,053,004,955
<b>Fair values of assets carried at amortized cost</b>					
Investment securities at amortized cost					
Government debt securities	₱7,193,439,895	₱6,975,887,319	₱-	₱-	₱6,975,887,319
Private debt securities	1,519,383,036	1,374,870,799	-	-	1,374,870,799
Loans and receivables					
Loans and discounts					
Consumer lending	34,432,783,942	-	-	38,472,520,026	38,472,520,026
Corporate and commercial lending	29,835,089,657	-	-	32,455,390,920	32,455,390,920
Others	11,716,709	-	-	12,850,022	12,850,022
Sales contract receivable	851,767,167	-	-	923,455,254	923,455,254
	₱74,897,252,334	₱9,403,763,073	₱-	₱71,864,216,222	₱81,267,979,295
<b>Nonrecurring fair value measurement</b>					
NCAHS	₱379,192,579	₱-	₱-	₱379,192,579	₱379,192,579
<b>Fair values of assets carried at cost</b>					
Investment properties					
Land	₱2,241,278,234	₱-	₱-	₱2,865,573,398	₱2,865,573,398
Condominium properties, buildings and improvements	955,813,151	-	-	1,329,810,375	1,329,810,375
	₱3,197,091,385	₱-	₱-	₱4,195,383,773	₱4,195,383,773
<b>Fair values of liabilities carried at amortized cost</b>					
Deposit liabilities - Time	₱55,767,866,280	₱-	₱-	₱55,786,226,503	₱55,786,226,503



	December 31, 2017				
	Carrying Value	Level 1	Level 2	Level 3	Total
<b>Recurring fair value measurements</b>					
Financial assets at FVPL					
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
<b>Fair values of assets carried at amortized cost</b>					
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					
Consumer lending	29,119,090,672	-	-	32,343,165,606	32,343,165,606
Corporate and commercial lending	33,154,769,037	-	-	35,238,912,995	35,238,912,995
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
<b>Nonrecurring fair value measurement</b>					
NCAHS	₱212,031,191	₱-	₱-	₱212,031,191	₱212,031,191
<b>Fair values of assets carried at cost</b>					
Investment properties					
Land	₱2,337,789,063	₱-	₱-	₱3,049,029,030	₱3,049,029,030
Condominium properties, 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
<b>Fair values of liabilities carried at amortized cost</b>					
Deposit liabilities - Time	₱51,496,682,274	₱-	₱-	₱51,501,993,831	₱51,501,993,831

As of December 31, 2018 and 2017, there were no transfers into and out of Level 3 fair value measurement. Level 2 securities in 2017 that met the Level 1 criteria were transferred to Level 1 in 2018.

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:

Valuation Techniques

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.

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**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):

	2018						Total
	Loans and receivables	%	Other financial assets*	%	Off-balance sheet exposures	%	
Real estate, renting and business services	₱24,446,653	36.13	₱1,699,869	7.38	₱-	-	₱26,146,522
Consumer	20,145,151	29.77	244,341	1.06	-	-	20,389,492
Government	-	-	18,053,581	78.33	-	-	18,053,581
Wholesale and retail trade	6,048,506	8.94	73,362	0.32	628,102	93.29	6,749,970
Financial intermediaries	1,610,678	2.38	1,953,985	8.48	34,462	5.11	3,599,125
Manufacturing	3,201,156	4.73	38,823	0.17	9,237	1.37	3,249,216
Transportation, storage and communication	2,793,739	4.13	33,882	0.15	171	0.03	2,827,792
Construction	2,090,991	3.09	25,362	0.11	-	-	2,116,353
Electricity, gas, steam and air-conditioning supply	1,675,457	2.48	20,323	0.09	-	-	1,695,780
Agriculture	1,836,052	2.71	22,268	0.10	1,179	0.18	1,859,499
Hotels and restaurant	1,338,171	1.98	16,227	0.07	-	-	1,354,398
Education	855,637	1.26	128,375	0.56	-	-	984,012
Other community, social and personal services	599,795	0.89	7,272	0.03	-	-	607,067
Health and social work	496,811	0.73	6,025	0.03	-	-	502,836
Others	531,794	0.78	724,460	3.14	151	0.02	1,256,405
<b>Total</b>	<b>67,670,591</b>	<b>100.00</b>	<b>23,048,155</b>	<b>100.00</b>	<b>673,302</b>	<b>100.00</b>	<b>91,392,048</b>
Allowance for impairment and credit losses	(2,492,075)		(567,825)		-	-	(3,059,900)
Unearned interest and discount	(47,159)		-		-	-	(47,159)
<b>Net</b>	<b>₱65,131,357</b>		<b>₱22,480,330</b>		<b>₱673,302</b>		<b>₱88,284,989</b>

\* Other financial assets include the following: due from BSP, due from other banks, SPURA, financial assets at FVOCI, investments securities at amortized cost and other financial assets.

	2017						Total
	Loans and receivables	%	Other financial assets*	%	Off-balance sheet exposures	%	
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
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
<b>Total</b>	<b>65,515,169</b>	<b>100.00</b>	<b>17,460,178</b>	<b>100.00</b>	<b>2,548,424</b>	<b>100.00</b>	<b>85,523,771</b>
Allowance for impairment and credit losses	(2,338,301)		(562,769)		-	-	(2,901,070)
Unearned interest and discount	(32,544)		-		-	-	(32,544)
<b>Net</b>	<b>₱63,144,324</b>		<b>₱16,897,409</b>		<b>₱2,548,424</b>		<b>₱82,590,157</b>

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



Real estate, renting and business services include exposure to consumer housing loans amounting to ₱5.44 billion and ₱3.93 billion as of December 31, 2018 and 2017, 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, 2018		
	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	₱3,000,000,000	₱-	₱3,000,000,000
Loans and receivables			
Loans and discounts			
Consumer lending	34,432,783,942	16,332,914,803	18,099,869,139
Corporate and commercial lending	29,835,089,657	9,715,385,878	20,119,703,779
Others	11,716,709	11,716,709	-
Sales contract receivable	851,767,167	-	851,767,167
	<b>₱68,131,357,475</b>	<b>₱26,060,017,390</b>	<b>₱42,071,340,085</b>

	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			
Consumer lending	29,119,090,672	19,062,625,005	10,056,465,667
Corporate and commercial lending	33,154,769,037	8,526,096,961	24,628,672,076
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
	<b>₱64,548,647,282</b>	<b>₱27,627,455,175</b>	<b>₱36,921,192,107</b>

An analysis of the maximum credit risk exposure relating to financial assets under Stage 3 as of December 31, 2018 is shown below:

	December 31, 2018		
	Gross maximum exposure	Net exposure	Financial effect of collateral or credit enhancement
Credit risk exposure relating to on-balance sheet items are as follows:			
Loans and receivables			
Loans and discounts			
Consumer lending	₱545,083,433	₱-	₱545,083,433
Corporate and commercial lending	1,177,047,021	-	1,177,047,021
Others	1,213,453	1,213,453	-
Sales contract receivable	50,757,845	-	50,757,845
	<b>₱1,774,101,752</b>	<b>₱1,213,453</b>	<b>₱1,772,888,299</b>



The maximum exposure to credit risks for the other financial assets is limited to the carrying value as of December 31, 2018 and 2017. The fair values of financial assets at FVOCI, FVPL 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 2018 and 2017 that are still held by the Bank as of December 31, 2018 and 2017 amounted to ₱703.46 million and ₱691.24 million, respectively. These collaterals consist of real properties and vehicles.

#### ***Credit quality per class of financial assets***

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.

The financial assets are also grouped according to stage whose description is explained as follows:

*Stage 1* - those that are considered current and up to 30 days past due, and based on change in rating, delinquencies and payment history, do not demonstrate significant increase in credit risk.

*Stage 2* - those that, based on change in rating, delinquencies and payment history, demonstrate significant increase in credit risk, and/or are considered more than 30 days past due but does not demonstrate objective evidence of impairment as of reporting date.

*Stage 3* - those that are considered in default or demonstrate objective evidence of impairment as of reporting date.

The following tables illustrate the Bank's credit exposures.

#### *Loans and receivables*

	2018			2017	
	ECL Staging			Total	Total
	Stage 1	Stage 2	Stage 3		
Consumer lending	12-month ECL	Lifetime ECL	Lifetime ECL		
Neither past due nor impaired					
High grade	₱33,577,866,070	₱-	₱-	₱33,577,866,070	₱26,822,649,300
Standard grade	142,321,826	-	-	142,321,826	112,075,916
Sub-Standard	3,058,947	-	-	3,058,947	4,966,864
Past due but not impaired	-	315,392,099	-	315,392,099	1,421,176,638
Past due and impaired	-	-	1,104,932,295	1,104,932,295	1,480,812,632
<b>Gross carrying amount</b>	<b>₱33,723,246,843</b>	<b>₱315,392,099</b>	<b>₱1,104,932,295</b>	<b>₱35,143,571,237</b>	<b>₱29,841,681,350</b>

	2018			2017	
	ECL Staging			Total	Total
	Stage 1	Stage 2	Stage 3		
Corporate and commercial lending	12-month ECL	Lifetime ECL	Lifetime ECL		
Neither past due nor impaired					
High grade	₱27,756,341,121	₱-	₱-	₱27,756,341,121	₱30,631,380,317
Standard grade	-	-	-	-	66,801,139
Sub-Standard	59,538,157	-	-	59,538,157	176,435,213
Past due but not impaired	-	962,623,337	-	962,623,337	1,562,602,556
Past due and impaired	-	-	2,659,001,473	2,659,001,473	2,148,500,654
<b>Gross carrying amount</b>	<b>₱27,815,879,278</b>	<b>₱962,623,337</b>	<b>₱2,659,001,473</b>	<b>₱31,437,504,088</b>	<b>₱34,585,719,879</b>

	2018			2017	
	ECL Staging			Total	Total
	Stage 1	Stage 2	Stage 3		
Others	12-month ECL	Lifetime ECL	Lifetime ECL		
Neither past due nor impaired					
High grade	₱12,221,107	₱-	₱-	₱12,221,107	₱25,475,321
Past due but not impaired	-	82,048	-	82,048	4,638,772
Past due and impaired	-	-	4,659,984	4,659,984	8,638,680
<b>Gross carrying amount</b>	<b>₱12,221,107</b>	<b>₱82,048</b>	<b>₱4,659,984</b>	<b>₱16,963,139</b>	<b>₱38,752,773</b>



	2018			2017	
	ECL Staging			Total	Total
	Stage 1	Stage 2	Stage 3		
Unquoted debt securities	12-month ECL	Lifetime ECL	Lifetime ECL		
Neither past due nor impaired					
High grade	₱-	₱-	₱-	₱-	₱102,911,415
Past due and impaired	-	-	151,836,309	151,836,309	151,836,309
<b>Gross carrying amount</b>	<b>₱-</b>	<b>₱-</b>	<b>₱151,836,309</b>	<b>₱151,836,309</b>	<b>₱254,747,724</b>

	2018			2017	
	ECL Staging			Total	Total
	Stage 1	Stage 2	Stage 3		
Sales contract receivable	12-month ECL	Lifetime ECL	Lifetime ECL		
Neither past due nor impaired					
High grade	₱643,741,133	₱-	₱-	₱643,741,133	₱606,136,479
Past due but not impaired	-	165,321,214	-	165,321,214	38,396,511
Past due and impaired	-	-	111,654,373	111,654,373	149,734,353
<b>Gross carrying amount</b>	<b>₱643,741,133</b>	<b>₱165,321,214</b>	<b>₱111,654,373</b>	<b>₱920,716,720</b>	<b>₱794,267,343</b>

*Other financial assets*

	2018			2017	
	ECL Staging			Total	Total
	Stage 1	Stage 2	Stage 3		
Accounts receivable and accrued interest receivable	12-month ECL	Lifetime ECL	Lifetime ECL		
Neither past due nor impaired					
High grade	₱770,815,442	₱-	₱-	₱770,815,442	₱886,789,244
Standard grade	1,788,624	-	-	1,788,624	2,057,734
Sub-Standard	786,687	-	-	786,687	905,048
Past due but not impaired	-	39,897,268	-	39,897,268	74,133,639
Past due and impaired	-	-	744,717,882	744,717,882	434,758,483
<b>Gross carrying amount</b>	<b>₱773,390,753</b>	<b>₱39,897,268</b>	<b>₱744,717,882</b>	<b>₱1,558,005,903</b>	<b>₱1,398,644,148</b>

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, 2018 and 2017:

	December 31, 2018				Total
	Less than 30 days	31 to 60 days	61 to 90 days	More than 90 days	
Loans and receivables					
Loans and discounts					
Corporate and commercial lending	₱658,656,862	₱29,130,063	₱8,921,827	₱265,914,585	₱962,623,337
Consumer lending	-	230,638,204	84,753,895	-	315,392,099
Others	-	69,108	12,940	-	82,048
Sales contract receivable	100,193,425	64,797,741	-	330,048	165,321,214
	<b>₱758,850,287</b>	<b>₱324,635,116</b>	<b>₱93,688,662</b>	<b>₱266,244,633</b>	<b>₱1,443,418,698</b>

	December 31, 2017				Total
	Less than 30 days	31 to 60 days	61 to 90 days	More than 90 days	
Loans and receivables					
Loans and discounts					
Corporate and commercial lending	₱176,439,628	₱64,340,942	₱84,878,919	₱1,236,943,067	₱1,562,602,556
Consumer lending	14,805,169	20,658,742	169,782,241	1,215,930,486	1,421,176,638
Others	204,681	172,281	291,869	3,969,941	4,638,772
Sales contract receivable	44,552	146,624	8,705,348	29,499,987	38,396,511
	<b>₱191,494,030</b>	<b>₱85,318,589</b>	<b>₱263,658,377</b>	<b>₱2,486,343,481</b>	<b>₱3,026,814,477</b>

Depository accounts with the BSP and counterparty banks and investment securities

For these financial assets, outstanding exposure is rated primarily based on external risk rating (i.e., Standard and Poor's (S&P), otherwise, rating is based on risk grades by a local rating agency or included under "Unrated", when the counterparty has no available risk grade.



The external risk rating of the Bank's depository accounts with the BSP and counterparty banks and investment securities, is grouped as follows:

<u>Credit Quality Rating</u>	<u>External Credit Risk Rating</u>	<u>Credit Rating Agency</u>
High grade	AAA, AA+, AA, AA-	S&P
	Aaa, Aa1, Aa2, Aa3	Moody's
	AAA, AA+, AA, AA-	Fitch
Standard grade	A+, A, A-, BBB+, BBB, BBB-	S&P
	A1, A2, A3, Baa1, Baa2, Baa3	Moody's
	A+, A, A-, BBB+, BBB, BBB-	Fitch
Substandard grade	BB+, BB, BB-, B/B+, CCC, R, SD & D	S&P
	Ba1, Ba2, Ba3, B1, B2, R, SD & D	Moody's
	BB+, BB, BB-, B/B+, CCC, R, SD & D	Fitch

Following is the credit rating scale applicable for foreign banks, and government securities (aligned with S&P ratings):

AAA - An obligor has extremely strong capacity to meet its financial commitments.

AA - An obligor has very strong capacity to meet its financial commitments. It differs from the highest-rated obligors at a minimal degree.

A - An obligor has strong capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.

BBB and below:

BBB - An obligor has adequate capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments.

BB - An obligor is less vulnerable in the near term than other lower-rated obligors. However, it faces major ongoing uncertainties and exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitments.

B - An obligor is more vulnerable than the obligors rated 'BB', but the obligor currently has the capacity to meet its financial commitments. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitments.

CCC - An obligor is currently vulnerable and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitments.

CC - An obligor is currently vulnerable. The rating is used when a default has not yet occurred, but expects default to be a virtual certainty, regardless of the anticipated time to default.

R - An obligor is under regulatory supervision owing to its financial condition. During the pendency of the regulatory supervision, the regulators may have the power to favor one class of obligations over others or pay some obligations and not others.





SD and D - An obligor is in default on one or more of its financial obligations including rated and unrated financial obligations but excluding hybrid instruments classified as regulatory capital or in non-payment according to terms.

Due from other banks and government securities

The external risk rating of the Bank's depository accounts with counterparty banks, trading and investment securities, is grouped as follows (aligned with the Philippine Ratings System):

<u>Credit Quality Rating</u>	<u>External Credit Risk Rating</u>
High grade	PRSAaa, PRSAa+, PRSAa, PRSAa-
Standard grade	PRSA+, PRSA, PRSA-, PRSBaa+, PRSBaa, PRSBaa-
Substandard grade	PRSBa+, PRSBa, PRSBa-, PRSB+, PRSB, PRSB-, PRSCaa+, PRSCaa, PRSCaa-, PRSCa+, PRSCa, PRSCa-, PRSC+, PRSC, PRSC-

PRSAaa - The obligor's capacity to meet its financial commitment on the obligation is extremely strong.

PRSAa - The obligor's capacity to meet its financial commitment on the obligation is very strong.

PRSA - With favorable investment attributes and are considered as upper-medium grade obligations. Although obligations rated 'PRSA' are somewhat more susceptible to the adverse effects of changes in economic conditions, the obligor's capacity to meet its financial commitments on the obligation is still strong.

PRSBaa - An obligation rated 'PRSBaa' exhibits adequate protection parameters. However, adverse economic conditions and changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation. PRSBaa-rated issues may possess certain speculative characteristics.

PRSBa - An obligation rated 'PRSBa' is less vulnerable to nonpayment than other speculative issues. However, it faces major ongoing uncertainties relating to business, financial or economic conditions, which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

PRSB - An obligation rated 'PRSB' is more vulnerable to nonpayment than obligations rated 'PRSBa', but the obligor currently has the capacity to meet its financial commitment on the obligation. Adverse economic conditions will likely impair the obligor's capacity to meet its financial commitment on the obligation. The issue is characterized by high credit risk.

PRSCaa - An obligation rated 'PRSCaa' is presently vulnerable to nonpayment and is dependent upon favorable business, financial and economic conditions for the obligor to meet its financial commitments on the obligation. In the event of adverse economic conditions, the obligor is not likely to have the capacity to meet its financial commitment on the obligation. The issue is considered to be of poor standing and is subject to very high credit risk.

PRSCa - An obligation rated "PRSCa" is presently highly vulnerable to nonpayment. Likely already in or very near default with some prospect for partial recovery of principal or interest.

PRSC - An obligation is already in default with very little prospect for any recovery of principal or interest.



The succeeding tables show the credit exposure of the Bank related to these financial assets.

Financial assets at FVOCI - debt	2018			Total	2017*
	ECL Staging				
	Stage 1	Stage 2	Stage 3		
Neither past due nor impaired	12-month ECL	Lifetime ECL	Lifetime ECL		
High grade	<b>₱1,053,071,928</b>	<b>₱-</b>	<b>₱-</b>	<b>₱1,053,071,928</b>	₱2,174,720,852

\* 2017 refers to AFS financial assets under PAS 39

Investment securities at amortized cost	2018			Total	2017
	ECL Staging				
	Stage 1	Stage 2	Stage 3		
Neither past due nor impaired	12-month ECL	Lifetime ECL	Lifetime ECL		
High grade	<b>₱8,721,031,740</b>	<b>₱-</b>	<b>₱-</b>	<b>₱8,721,031,740</b>	₱3,502,817,725

\* 2017 refers to HTM financial assets under PAS 39

	2018				Total
	High Grade	Standard Grade	Substandard Grade	Unrated	
Due from BSP	<b>₱6,800,827,709</b>	<b>₱-</b>	<b>₱-</b>	<b>₱-</b>	<b>₱6,800,827,709</b>
Due from other banks	<b>1,934,450,369</b>	-	-	-	<b>1,934,450,369</b>
SPURA	<b>3,000,000,000</b>	-	-	-	<b>3,000,000,000</b>
	<b>₱11,735,278,078</b>	<b>₱-</b>	<b>₱-</b>	<b>₱-</b>	<b>₱11,735,278,078</b>

	2017				Total
	High Grade	Standard Grade	Substandard Grade	Unrated	
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
Financial assets at FVPL	135,397,767	-	-	-	135,397,767
	<b>₱10,168,747,552</b>	<b>₱-</b>	<b>₱-</b>	<b>₱-</b>	<b>₱10,168,747,552</b>

### ***Impairment assessment (prior to adoption of PFRS 9)***

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.

### ***Impairment assessment (PFRS 9)***

The Bank recognizes a credit loss allowance on a financial asset based on whether it has had a significant increase in credit risk since initial recognition. Accordingly, the Bank categorizes its financial assets into three categories:

- stage 1 - financial asset that has not had a significant increase in credit risk;
- stage 2 - financial asset that has had a significant increase in credit risk; and
- stage 3 - financial asset in default.

Generally, the Bank applies a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due.

Further, the Bank considers a financial asset as in default when (a) as a result of one or more loss events, there is objective evidence that its recoverable value is less than its carrying amount; (b) it is classified as doubtful or loss under prudential reporting; (c) it is in litigation; and/or (d) full repayment of principal and interest is unlikely without foreclosure of collateral, if any. When applicable, the Bank also applies a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due unless the Bank has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate.

The Bank then measures the credit loss allowance on a financial instrument at an amount equal to 12-month expected credit losses for items categorized as stage 1 and lifetime credit losses to items categorized as stage 2 and stage 3.

Two modeling approaches were employed to build a consistent framework for the development of all ECL models of the Bank. Both modeling approaches consider past events, current conditions and forecast of economic conditions in assessing impairment.

The complex model approach is used for portfolios with a significant number of historical defaults. This approach was applied to the consumer loan portfolios. These quantitative models are built by applying statistical, economic, financial or mathematical theories, techniques and assumptions to calculate provisions. Where historical data are insufficient to develop statistical models, the simplified ECL approach was employed.

### ***Default and Cure***

As a part of a qualitative assessment of whether a customer is in default, the Bank considers a variety of instances that may indicate unlikeliness to pay. The Bank's definition of default is aligned with the non-performing loan criteria as prescribed in BSP Circular No. 941. Defaults refer to loans, investments, receivables, or any financial asset, even without missed contractual payments, that satisfy any of the following conditions (1) impaired under existing accounting standards, (2) classified as doubtful or loss, (3) in litigation, (4) and/or there is evidence that full repayment of



principal and interest is unlikely without foreclosure of collateral, if any. All other loans, even if not considered impaired, shall be considered non-performing if any principal and/or interest are (5) unpaid for more than ninety (90) days from contractual due date, or accrued interests for more than ninety (90) days have been capitalized, refinanced, or delayed by agreement. (6) Microfinance and other small loans with similar credit characteristics shall be considered non-performing after contractual due date or after it has become past due. (7) Restructured loans shall be considered nonperforming. However, if prior to restructuring, the loans were categorized as performing, such classification shall be retained. Defaults are characterized by financial assets that have objective evidence of impairment at the reporting date and as such classified under Stage 3 ECL treatment.

An instrument is considered to be no longer in default, i.e., to have cured, when it no longer meets any of the default criteria above and there is sufficient evidence to support full collection through payments received for at least 6 months. Cured accounts are classified under Stage 1 ECL treatment.

#### *Restructuring*

In certain circumstances, the Bank modifies the original terms and conditions of a credit exposure to form a new loan agreement or payment schedule. The modifications can be given depending on the borrower's or counterparty's current or expected financial difficulty. The modifications may include, but are not limited to, changes in maturity date, principal amount from capitalization of accrued interest, terms and conditions from conversion/consolidation or interest rates/repricing cycle that results in an extension in the loan maturity. Distressed restructuring with indications of unlikeliness to pay are categorized as impaired accounts and are initially moved to Stage 3.

The Bank implements a curing policy for restructured accounts compliant with the BSP Circular No. 1011. Restructured accounts that have exhibited improvements in creditworthiness may be moved from Stage 3 after a total of one-year probation period. These accounts are transferred to Stage 2 after six months of full payments and consequently transferred to Stage 1 after making the next six months full payments.

The Bank modeled the following inputs to the expected credit loss formula separately. The formula is applied to each financial asset, with certain exceptions wherein a collective or other general approach is applied:

#### *Exposure at Default (EAD)*

The Bank defines EAD as the principal and interests that would not be collected assuming the borrower's defaults during a future point in time. The Bank computes for a financial asset's EAD using the expected contractual cash flows during the contractual life of the financial instrument. A financial asset's EAD is defined as the sum of EAD from principal and EAD from interest.

#### *Probability of default (PD)*

The Bank uses forward-looking PD estimates that are unbiased and probability-weighted using a range of possible outcomes. The PD for each individual instrument is modelled based on historical data and is estimated based on current market conditions and reasonable and supportable information about future economic conditions. The Bank segmented its credit exposures based on homogenous risk characteristics and developed a corresponding PD methodology for each portfolio. The PD methodology for each relevant portfolio is determined based on the underlying nature or characteristic of the portfolio, behavior of the accounts and materiality of the segment as compared to the total portfolio. The Bank's PDs are mainly categorized into the following: (a) corporate and commercial loans; (b) small and medium-size enterprise financing; (c) auto and housing loans; and (d) personal and consumption loans.



*Loss given default (LGD)*

The Bank's LGD model considers certain factors such as the historical cash flow recovery and reasonable and supportable information about future economic conditions, where appropriate. Generally, the model utilizes the Bank's existing loan exposure rating system which is designed to capture these factors as well as the characteristics of collaterals related to an exposure. In cases wherein this does not apply, the Bank looks into the standard characteristics of collaterals (e.g., auto and housing loans) in order to estimate an LGD factor.

*Economic Overlays*

The Bank's incorporates economic overlays into the measurement of ECL to add a forward-looking risk measure parallel to the expected future macroeconomic atmosphere. A broad range of economic indicators were considered for the economic inputs. The inputs and models used for calculating ECL may not always capture all characteristics of the market at the date of the financial statements. To address this, quantitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material. The Bank's loans and receivables consist of different portfolios, such as corporate and commercial loans and consumer loans, as well as other receivables (e.g., sales contract receivables). In compliance with PFRS 9, the Bank developed ECL parameters and methodologies for each portfolio, using historical data as well as forward-looking inputs and assumptions.

*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, equity prices and other market changes. The Bank's market risk originates from its holdings of foreign exchange instruments, debt securities, and loans and receivables.

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, 2018 and 2017:

	<b>2018</b>	2017
Long-term retail loans with monthly amortization	<b>52.68%</b>	45.24%
Commercial loans with monthly or quarterly amortization	<b>32.71%</b>	43.24%
Commercial loans payable at maturity (mostly maturing for less than 6 months)	<b>14.61%</b>	11.52%
	<b>100.00%</b>	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, 2018 and 2017:

	2018	2017
Demand	18.96%	20.01%
Savings	15.13%	12.23%
Time	65.92%	67.37%
	<b>100.00%</b>	<b>99.61%</b>

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 financial assets at FVOCI, 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, 2018 and 2017 (in millions):

	December 31, 2018					Total
	Up to 1 Month	>1 to 3 Months	>3 to 6 Months	>6 to 12 Months	>12 Months	
<b>Financial Assets</b>						
Loans and receivables	₱8,881	₱6,758	₱6,899	₱9,098	₱33,428	₱65,065
Investment securities	105	1	930	2,160	6,607	9,803
<b>Total financial assets</b>	<b>8,986</b>	<b>6,759</b>	<b>7,829</b>	<b>11,258</b>	<b>40,035</b>	<b>74,868</b>
<b>Financial Liabilities</b>						
Deposit liabilities	29,370	16,499	1,648	741	36,358	84,616
<b>Repricing gap</b>	<b>(₱20,384)</b>	<b>(₱9,740)</b>	<b>₱6,181</b>	<b>₱10,517</b>	<b>₱3,677</b>	<b>(₱9,748)</b>



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

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, 2018 and 2017 (amounts in thousands):

	December 31, 2019			
	Change in interest rates (in basis points)			
	100bp rise	50bp rise	50bp fall	100bp fall
Change in annualized net interest income	(₱220,550)	(₱110,275)	₱110,275	₱220,550
As a percentage of the Bank's net interest income	(6.75%)	(3.33%)	3.33%	6.66%
	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	(6.76%)	(3.38%)	3.81%	7.62%

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 financial assets at FVPL and the Bank's equity through the impact on unrealized gain/loss on financial assets at FVOCI and AFS financial assets in fixed rate debt securities (amounts in thousands).

	December 31, 2018			
	Change in interest rates (in basis points)			
	25bp rise	10bp rise	10bp fall	25bp fall
Change in equity	(₱11,081)	(₱4,458)	₱4,493	₱11,299
	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



*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 FCDO 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, 2018			
	On demand	Within 1 year	Over 1 year	Total
<b>Financial Assets</b>				
Cash and cash equivalents				
Cash and other cash items	P1,815,975,245	P-	P-	P1,815,975,245
Due from BSP	6,800,827,709	-	-	6,800,827,709
Due from other banks	1,713,256,002	236,108,791	-	1,949,364,793
SPURA	-	3,001,979,167	-	3,001,979,167
Financial assets at FVOCI	-	195,341,090	1,080,161,835	1,275,502,925
Investment securities at amortized cost	-	3,515,965,067	6,761,274,377	10,277,239,444
Loans and receivables	-	36,601,023,742	56,183,457,675	92,784,481,417
Other assets				
Accrued interest receivable	-	820,791,284	-	820,791,284
Accounts receivable	-	737,214,619	-	737,214,619
Returned checks and other cash items	11,914,478	-	-	11,914,478
<b>Total financial assets</b>	<b>P10,341,973,434</b>	<b>P45,108,423,760</b>	<b>P64,024,893,887</b>	<b>P119,475,291,081</b>

(Forward)





	December 31, 2018			
	On demand	Within 1 year	Over 1 year	Total
<b>Financial Liabilities</b>				
Deposit liabilities				
Demand	P16,036,991,323	P-	P-	P16,036,991,323
Savings	12,796,615,183	-	-	12,796,615,183
Time	-	46,416,691,104	8,467,143,193	54,883,834,297
Manager's checks	484,179,921	-	-	484,179,921
Accrued interest and other expenses	-	418,850,987	-	418,850,987
Other liabilities				
Accounts payable	-	836,030,557	-	836,030,557
Other credits - dormant	-	-	95,167,204	95,167,204
Security deposit	-	-	79,325,328	79,325,328
Due to the Treasurer of the Philippines	-	8,059,717	-	8,059,717
Bills purchased	-	1,297,783	-	1,297,783
Other payable	-	6,224,905	-	6,224,905
<b>Total financial liabilities</b>	<b>P29,317,786,427</b>	<b>P47,687,155,053</b>	<b>P8,641,635,725</b>	<b>P85,646,577,205</b>

	December 31, 2017			
	On demand	Within 1 year	Over 1 year	Total
<b>Financial Assets</b>				
Cash and cash equivalents				
Cash and other cash items	P1,501,172,842	P-	P-	P1,501,172,842
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
Financial assets at FVPL	-	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
<b>Total financial assets</b>	<b>P9,570,087,178</b>	<b>P28,904,723,644</b>	<b>P60,824,114,238</b>	<b>P99,298,925,060</b>

<b>Financial Liabilities</b>				
Deposit liabilities				
Demand	P15,589,330,155	P-	P-	P15,589,330,155
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	-	266,842,282	-	266,842,282
Other liabilities				
Accounts payable	-	889,378,524	-	889,378,524
Other credits - dormant	-	-	83,919,568	83,919,568
Security deposit	-	-	3,885,646	3,885,646
Due to the Treasurer of the Philippines	-	9,224,406	-	9,224,406
Bills purchased	-	7,842,548	-	7,842,548
Other payable	-	5,437,792	-	5,437,792
<b>Total financial liabilities</b>	<b>P25,672,202,651</b>	<b>P44,916,696,170</b>	<b>P10,104,621,552</b>	<b>P80,693,520,373</b>

## 6. Cash and Cash Equivalents

	2018	2017
Cash and other cash items	P1,815,975,245	P1,501,172,842
Due from BSP (Note 15)	6,800,827,709	6,772,976,958
Due from other banks (Notes 24 and 28)	1,934,450,369	1,856,049,625
SPURA (Note 28)	3,000,000,000	1,404,323,202
	<b>P13,551,253,323</b>	<b>P11,534,522,627</b>



*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, 2018 and 2017, the Bank's demand deposits with the BSP amounted to ₱6.80 billion and ₱6.77 billion, respectively. TDF deposit accounts earn annual interest rates ranging from 2.50% to 4.25% in 2018 and 2.50% in 2017 and 2016.

*Due from other banks*

Due from other banks represent savings and demand deposits. USD-denominated deposits amounted to USD3.95 million (₱207.68 million) and USD8.86 million (₱442.26 million) as of December 31, 2018 and 2017, respectively.

Peso denominated deposits earn interest at annual rates ranging from 0.10% to 1.25% in 2018 and 2017 and from 0.10% to 1.50% in 2016. USD-denominated deposits earn interest at an annual rate of 0.25% in 2018 and from 0.25% to 1.63% in 2017.

*SPURA*

Deposits in reverse repurchase facility, classified as SPURA, earn interest at annual rates ranging from 3.00% to 4.75% in 2018 and 3.00% in 2017 with tenor of five (5) days.

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**7. Investment Securities**

Financial assets at FVPL

As of December 31, 2017, financial assets at FVPL pertain to the peso-denominated and USD-denominated government securities of the Bank. Peso-denominated government securities amounted to ₱100.57 million, while USD-denominated government securities amounted to USD0.70 million (₱34.83 million) as of December 31, 2017.

The carrying amount of financial assets at FVPL includes unrealized gain of ₱4.20 million as of December 31, 2017.

Financial Assets at FVOCI

As of December 31, 2018, this account consists of:

Quoted government debt securities	<b>₱1,053,071,928</b>
Unquoted securities	<b>28,792,519</b>
	<b>₱1,081,864,447</b>

*Unquoted equity securities*

This account comprises of shares of stocks of various unlisted private corporations. The Bank has designated these equity securities as at FVOCI because they will not be sold in the foreseeable future. The carrying amount of these investments is presented net of unrealized market valuation loss of ₱47.25 million as of December 31, 2018.

*Net unrealized losses*

Financial assets at FVOCI include fair value losses of ₱85.31 million as of December 31, 2018. The fair value losses are recognized under OCI. Impairment loss on debt financial assets at FVOCI amounted to ₱0.90 million in 2018.



Effective interest rates for peso-denominated financial assets at FVOCI range from 2.73% to 4.25% in 2018. Effective interest rates for foreign currency-denominated financial assets at FVOCI range from 2.20% to 7.02% in 2018.

AFS Financial Assets

As of December 31, 2017, this account consists of:

Quoted	
Government debt securities	₱1,734,267,611
Private debt securities	440,453,241
	<hr/> 2,174,720,852
Unquoted securities	118,948,359
	<hr/> 2,293,669,211
Allowance for impairment losses (Note 14)	(73,043,127)
	<hr/> <hr/> <b>₱2,220,626,084</b>

*Unquoted equity securities*

This account comprises of shares of stocks of various unlisted private corporations. As of December 31, 2017, these securities are carried at cost, net of allowance for impairment losses of ₱73.04 million.

*Net unrealized losses*

AFS financial assets include fair value losses of ₱132.52 million and ₱157.71 million as of December 31, 2017 and 2016, respectively. The fair value losses are recognized under OCI.

Government debt securities have effective interest rates ranging from 2.73% to 4.50% in 2017 and from 1.45% to 3.84% in 2016. These investments have maturity dates ranging from 2 to 24 years in 2017 and from 1 to 18 years in 2016.

Private debt securities earn effective interest rate ranging from 3.89% to 6.72% and from 3.89% to 6.73% in 2017 and 2016, respectively. These securities have maturity dates ranging from 2 to 8 years in 2017 and from 6 to 10 years in 2016.

Investment Securities at Amortized Cost

As of December 31, 2018, this account consists of

Quoted	
Government debt securities (Note 23)	<b>₱7,199,681,740</b>
Private debt securities	<b>1,521,350,000</b>
	<hr/> <b>8,721,031,740</b>
Allowance for impairment losses (Note 14)	<b>(8,208,809)</b>
	<hr/> <hr/> <b>₱8,712,822,931</b>

Peso-denominated government securities and private bonds carry a yield-to-maturity ranging from 3.19% to 6.88%, with maturities ranging from 1 to 20 years in 2018.

USD-denominated government securities and private bonds carry a yield-to-maturity ranging from 2.80% to 3.88%, with maturities ranging from 11 to 25 years in 2018.

As of December 31, 2018, government securities with face and carrying value of ₱250.00 million and ₱251.19 million, respectively, are pledged to CBC in compliance with DOSRI rules.



HTM Financial Assets

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

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

As of December 31, 2017, government securities with face and carrying value of ₱250.00 million and ₱252.50 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, the transferred assets had the following balances:

	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

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 on peso-denominated government bonds and increased from fair value gain by USD0.23 million (₱11.48 million) on USD-denominated government bonds in 2017.

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.



Interest Income on Investment Securities

Interest income on investment securities follows:

	2018	2017	2016
Investment securities at amortized cost	P248,255,449	P-	P-
Financial assets at FVOCI	33,839,212	-	-
HTM financial assets	-	147,744,287	98,071,192
AFS financial assets	-	102,951,714	88,855,071
Financial assets at FVPL	-	12,112,361	25,475,318
	<b>P282,094,661</b>	<b>P262,808,362</b>	<b>P212,401,581</b>

Trading and Securities Gains (Losses) - Net

Details of trading and securities gains (losses) - net are as follows:

	2018	2017	2016
Net unrealized gain (loss) on changes in fair value of financial assets at FVPL	P-	(P1,646,852)	P1,307,647
Net realized gain (loss) on sale of:			
Financial assets at FVPL	-	7,163,595	26,869,097
Financial assets at FVOCI	(866,221)	-	-
AFS financial assets	-	63,355,179	61,119,743
	<b>(P866,221)</b>	<b>P68,871,922</b>	<b>P89,296,487</b>

**8. Loans and Receivables**

This account consists of:

	2018	2017
Loans and discounts		
Consumer lending	P35,143,571,237	P29,841,681,350
Corporate and commercial lending	31,437,504,088	34,585,719,879
Others	16,963,138	38,752,773
	<b>66,598,038,463</b>	64,466,154,002
Unearned interest and discounts	(47,159,148)	(32,544,387)
	<b>66,550,879,315</b>	64,433,609,615
Unquoted debt securities	151,836,309	254,747,724
Sales contract receivable	920,716,720	794,267,343
	<b>67,623,432,344</b>	65,482,624,682
Allowance for credit losses (Note 14)	(2,492,074,869)	(2,338,300,602)
	<b>P65,131,357,475</b>	<b>P63,144,324,080</b>

As of December 31, 2018 and 2017, 38.13% and 47.91% of the total loans and receivables, respectively, are subject to periodic interest repricing. In 2018, 2017 and 2016, the remaining loans and receivables bear annual fixed interest rates ranging from 2.50% to 39.43%, from 2.00% to 39.43% and from 3.25% 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 its selected investment properties, non-performing loans, AFS financial assets and other assets as identified in the Omnibus Agreement. As of December 31, 2018 and 2017, these securities amounting to ₱151.84 million are fully provided with allowance for credit losses.

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:

	2018		2017	
	Amounts	%	Amounts	%
Loans secured by				
Real estate	<b>₱27,945,631,337</b>	<b>41.30</b>	₱28,980,785,226	44.24
Chattel mortgage	<b>14,956,028,340</b>	<b>22.10</b>	13,374,018,339	20.41
Deposit hold out and others	<b>1,768,850,516</b>	<b>2.61</b>	2,225,876,981	3.40
	<b>44,670,510,193</b>	<b>66.01</b>	44,580,680,546	68.05
Unsecured loans	<b>23,000,081,299</b>	<b>33.99</b>	20,934,488,523	31.95
	<b>₱67,670,591,492</b>	<b>100.00</b>	₱65,515,169,069	100.00

Prior to January 1, 2018, non-performing loans (NPLs) generally 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.

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

In the case of loans that are payable in daily, weekly, or semi-monthly installments, 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.

Loans which do not meet the requirements to be treated as performing loans shall also be considered as NPLs.



With the issuance of BSP Circular 941 *Amendments to the Regulations on Past Due and Non-Performing Loans* effective January 1, 2018, loans shall be considered non-performing, even without any missed contractual payments, when it is considered impaired under existing accounting standards, classified as doubtful or loss, in litigation, and/or there is evidence that full repayment of principal and interest is unlikely without foreclosure of collateral, if any. All other loans, even if not considered impaired, shall be considered non-performing if any principal and/or interest are unpaid for more than ninety (90) days from contractual due date, or accrued interests for more than ninety (90) days have been capitalized, refinanced, or delayed by agreement.

As of December 31, 2018 and 2017, secured and unsecured NPLs of the Bank follow:

	2018	2017
Secured	<b>₱2,380,831,069</b>	₱2,745,788,782
Unsecured	<b>1,106,447,484</b>	1,180,751,002
	<b>₱3,487,278,553</b>	₱3,926,539,784

Restructured loans as of December 31, 2018 and 2017 amounted to ₱713.68 million and ₱828.87 million, respectively. The Bank's loan portfolio includes non-risk loans as defined under BSP regulations totaling ₱6.85 billion and ₱5.50 billion as of December 31, 2018 and 2017, respectively.

#### Interest Income on Loans and Receivables

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

	2018	2017	2016
Loans and discounts			
Consumer lending	<b>₱2,561,785,861</b>	₱2,237,979,198	₱2,303,853,620
Corporate and commercial lending	<b>2,103,068,999</b>	1,945,444,015	1,411,825,952
Others	<b>803,012</b>	2,011,277	882,422
Unquoted debt securities	<b>724,297</b>	6,076,951	9,294,803
Sales contract receivable	<b>57,480,670</b>	78,011,889	99,649,576
	<b>₱4,723,862,839</b>	₱4,269,523,330	₱3,825,506,373

## 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.

	2018	2017
Balance at beginning of year	<b>₱212,031,191</b>	₱225,139,735
Additions	<b>565,676,547</b>	556,689,819
Disposals	<b>(398,515,159)</b>	(569,798,363)
Balance at end of year	<b>₱379,192,579</b>	₱212,031,191



Gain on asset exchange

Gain on asset exchange includes:

	2018	2017	2016
<b>NCAHS</b>			
Gain (loss) on foreclosure	<b>₱9,734,249</b>	(₱45,211,019)	(₱57,458,603)
Gain (loss) on sale	<b>16,171,897</b>	(85,179,458)	(14,442,252)
	<b>25,906,146</b>	(130,390,477)	(71,900,855)
<b>Investment properties (Note 11)</b>			
Gain on foreclosure	<b>97,981,741</b>	112,233,652	68,214,992
Gain on sale	<b>146,252,693</b>	138,687,608	125,094,009
	<b>244,234,434</b>	250,921,260	193,309,001
	<b>₱270,140,580</b>	₱120,530,783	₱121,408,146

## 10. Property and Equipment

The composition of and movements in this account follow:

	December 31, 2018				
	Land	Condominium Properties, Buildings and Improvements	Furniture, Fixtures and Equipment	Leasehold Improvements	Total
<b>Cost</b>					
Balance at beginning of year	<b>₱390,937,334</b>	<b>₱871,847,116</b>	<b>₱1,163,373,363</b>	<b>₱378,879,099</b>	<b>₱2,805,036,912</b>
Additions	1,779,000	2,776,631	124,544,933	92,400,648	221,501,212
Disposal	–	–	(62,102,331)	–	(62,102,331)
<b>Balance at end of year</b>	<b>392,716,334</b>	<b>874,623,747</b>	<b>1,225,815,965</b>	<b>471,279,747</b>	<b>2,964,435,793</b>
<b>Accumulated Depreciation</b>					
Balance at beginning of year	–	529,760,229	863,137,433	163,388,184	1,556,285,846
Depreciation and amortization	–	42,826,065	128,638,750	62,809,252	234,274,067
Disposal	–	–	(54,425,224)	–	(54,425,224)
<b>Balance at end of year</b>	–	<b>572,586,294</b>	<b>937,350,959</b>	<b>226,197,436</b>	<b>1,736,134,689</b>
<b>Net Book Value at End of Year</b>	<b>₱392,716,334</b>	<b>₱302,037,453</b>	<b>₱288,465,006</b>	<b>₱245,082,311</b>	<b>₱1,228,301,104</b>
<b>December 31, 2017</b>					
	Land	Condominium Properties, Buildings and Improvements	Furniture, Fixtures and Equipment	Leasehold Improvements	Total
<b>Cost</b>					
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)
<b>Balance at end of year</b>	<b>390,937,334</b>	<b>871,847,116</b>	<b>1,163,373,363</b>	<b>378,879,099</b>	<b>2,805,036,912</b>
<b>Accumulated Depreciation</b>					
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)
<b>Balance at end of year</b>	–	<b>529,760,229</b>	<b>863,137,433</b>	<b>163,388,184</b>	<b>1,556,285,846</b>
<b>Net Book Value at End of Year</b>	<b>₱390,937,334</b>	<b>₱342,086,887</b>	<b>₱300,235,930</b>	<b>₱215,490,915</b>	<b>₱1,248,751,066</b>

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

	2018	2017	2016
Property and equipment	<b>₱234,274,067</b>	₱237,378,088	₱229,665,564
Investment properties (Note 11)	<b>75,248,497</b>	88,305,477	67,471,265
Software costs (Note 12)	<b>15,962,004</b>	20,140,452	29,092,299
	<b>₱325,484,568</b>	₱345,824,017	₱326,229,128





As of December 31, 2018 and 2017, the gross carrying amount of fully depreciated building and furniture, fixtures and equipment still in use amounted to ₱677.95 million and ₱579.98 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, 2018 and 2017.

## 11. Investment Properties

The composition of and movements in this account follow:

	December 31, 2018		
	Land	Condominium Properties, Buildings and Improvements	Total
<b>Cost</b>			
Balance at beginning of year	₱2,483,564,130	₱1,586,297,361	₱4,069,861,491
Additions	137,769,870	146,378,264	284,148,134
Disposals	(234,280,699)	(133,710,000)	(367,990,699)
<b>Balance at end of year</b>	<b>2,387,053,301</b>	<b>1,598,965,625</b>	<b>3,986,018,926</b>
<b>Accumulated Depreciation</b>			
Balance at beginning of year	-	423,692,870	423,692,870
Depreciation (Note 10)	-	75,248,497	75,248,497
Disposals	-	(8,182,821)	(8,182,821)
<b>Balance at end of year</b>	<b>-</b>	<b>490,758,546</b>	<b>490,758,546</b>
<b>Accumulated Impairment Losses (Note 14)</b>			
Balance at beginning of year	145,775,067	343,248,016	489,023,083
Reclassification	-	(190,854,088)	(190,854,088)
<b>Balance at end of year</b>	<b>145,775,067</b>	<b>152,393,928</b>	<b>298,168,995</b>
<b>Net Book Value at End of Year</b>	<b>₱2,241,278,234</b>	<b>₱955,813,151</b>	<b>₱3,197,091,385</b>
	December 31, 2017		
	Land	Condominium Properties, Buildings and Improvements	Total
<b>Cost</b>			
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)
<b>Balance at end of year</b>	<b>2,483,564,130</b>	<b>1,586,297,361</b>	<b>4,069,861,491</b>
<b>Accumulated Depreciation</b>			
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)
<b>Balance at end of year</b>	<b>-</b>	<b>423,692,870</b>	<b>423,692,870</b>
<b>Accumulated Impairment Losses (Note 14)</b>			
Balance at beginning of year	40,546,836	440,909,699	481,456,535
Reclassification	105,228,231	(97,661,683)	7,566,548
<b>Balance at end of year</b>	<b>145,775,067</b>	<b>343,248,016</b>	<b>489,023,083</b>
<b>Net Book Value at End of Year</b>	<b>₱2,337,789,063</b>	<b>₱819,356,475</b>	<b>₱3,157,145,538</b>



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:

	<b>Valuation Techniques</b>	<b>Significant Unobservable Inputs</b>
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:

	<b>2018</b>	2017	2016
Rent income on investment properties (included under income from property rentals)	<b>₱24,328,731</b>	₱25,657,843	₱22,255,495
Direct operating expenses on investment properties not generating rent income (included under miscellaneous expenses)	<b>36,426,409</b>	18,624,718	5,274,892

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, 2018 and 2017, the branch licenses are not impaired.

### Software Costs

Movements in software costs are as follows:

	<b>2018</b>	2017
<b>Cost</b>		
Balance at beginning of year	<b>₱155,264,618</b>	₱138,720,197
Additions	<b>5,857,179</b>	16,544,421
<b>Balance at end of year</b>	<b>161,121,797</b>	155,264,618
<b>Accumulated amortization</b>		
Balance at beginning of year	<b>81,826,626</b>	61,686,174
Amortization (Note 10)	<b>15,962,004</b>	20,140,452
<b>Balance at end of year</b>	<b>97,788,630</b>	81,826,626
<b>Net Book Value at End of Year</b>	<b>₱63,333,167</b>	₱73,437,992



### 13. Other Assets

This account consists of:

	2018	2017
<b>Financial</b>		
Accrued interest receivable	<b>₱820,791,284</b>	₱685,256,474
Accounts receivable (Note 24)	<b>737,214,619</b>	713,387,674
Returned checks and other cash items (RCOCI)	<b>11,914,478</b>	96,299,176
	<b>1,569,920,381</b>	1,494,943,324
<b>Nonfinancial</b>		
Non-performing Asset Pool (NPAP)	<b>1,241,290,224</b>	1,242,740,568
Creditable withholding taxes (CWT)	<b>316,892,344</b>	310,133,158
Documentary stamp tax	<b>66,617,968</b>	89,326,535
Advance rental deposits	<b>62,068,783</b>	42,471,238
Prepaid expenses	<b>42,473,897</b>	12,170,255
Stationery and supplies	<b>36,810,771</b>	34,683,648
Other equity investments	<b>21,792,208</b>	21,792,208
Retirement asset (Note 20)	<b>6,095,512</b>	-
Miscellaneous	<b>240,489,403</b>	74,568,625
	<b>2,034,531,110</b>	1,827,886,235
	<b>3,604,451,491</b>	3,322,829,559
Allowance for impairment and credit losses (Note 14)	<b>(1,857,839,782)</b>	(1,786,752,347)
	<b>₱1,746,611,709</b>	₱1,536,077,212

#### Accounts Receivable

As of December 31, 2017, 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. On August 10, 2018, the full proceeds were already received by the Bank from PDIC.

#### Non-performing Asset Pool (NPAP)

As of December 31, 2018 and 2017, 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):

	2018	2017
Loans and receivables	<b>₱991,514</b>	₱992,965
Investment properties	<b>175,763</b>	175,762
Other assets*	<b>74,014</b>	74,014
	<b>₱1,241,290</b>	₱1,242,741

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

As of December 31, 2018 and 2017, 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, 2018 and 2017, 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.

Miscellaneous assets

As of December 31, 2018 and 2017, 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 accrued interest receivable (AIR) and long-outstanding advances amounting to ₱559.62 million and ₱489.73 million as of December 31, 2018 and 2017, respectively (Note 14).

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**14. Allowance for Impairment and Credit Losses**

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

	2018	2017
<b>Balance at beginning of year</b>		
Loans and receivables	<b>₱2,338,300,602</b>	₱2,460,325,896
Investment properties	<b>489,023,083</b>	481,456,535
AFS financial assets	<b>73,043,127</b>	63,153,755
Other assets	<b>1,786,752,347</b>	1,709,390,723
	<b>4,687,119,159</b>	4,714,326,909
Effect of PFRS 9 adoption (Note 2)	<b>282,049,298</b>	-
Balance at beginning of year, <i>as restated</i>	<b>4,969,168,457</b>	4,714,326,909
Provisions charged to operations	<b>104,649,096</b>	295,680,313
Accounts charged off and others	<b>(417,525,098)</b>	(322,888,063)
	<b>(312,876,002)</b>	(27,207,750)

(Forward)



	2018	2017
<b>Balance at end of year</b>		
Loans and receivables (Note 8)	₱2,492,074,869	₱2,338,300,602
Investment properties (Note 11)	298,168,995	489,023,083
Investment securities at amortized cost (Note 7)	8,208,809	-
AFS financial assets (Note 7)	-	73,043,127
Other assets (Note 13)	1,857,839,782	1,786,752,347
	<b>₱4,656,292,455</b>	<b>₱4,687,119,159</b>

At the current level of allowance for impairment and credit losses, management believes that the Bank has sufficient allowance to cover any losses that may be incurred from the non-collection or non-realization of its loans and receivables and other risk assets.

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

	2018	2017	2016
Loans and receivables	₱79,357,501	₱287,706,251	₱235,175,829
Investment securities at amortized cost	2,482,969	-	-
Financial assets at FVOCI	241,535	-	-
Investment properties (Note 11)	-	-	3,622,869
Other assets	22,567,091	7,974,062	66,201,968
	<b>₱104,649,096</b>	<b>₱295,680,313</b>	<b>₱305,000,666</b>

The tables below illustrate the movements of the allowance for impairment and credit losses of the financial assets for the year ended December 31, 2018 (effect of movements in ECL due to transfers between stages are shown in the total column):

*Loans and receivables*

	ECL Staging			Total
	Stage 1	Stage 2	Stage 3	
<b>Consumer lending</b>	12-month ECL	Lifetime ECL	Lifetime ECL	
<b>Loss allowance at January 1, 2018</b>	₱149,361,693	₱118,306,184	₱899,633,679	₱1,167,301,556
<b>Movements with P&amp;L impact</b>				
Transfers:				
Transfer from Stage 1 to Stage 2	(627,073)	5,310,801	-	4,683,728
Transfer from Stage 1 to Stage 3	(399,292)	-	48,782,074	48,382,782
Transfer from Stage 2 to Stage 1	4,373,405	(37,039,174)	-	(32,665,769)
Transfer from Stage 2 to Stage 3	-	(2,597,274)	37,466,711	34,869,437
Transfer from Stage 3 to Stage 1	526,168	-	(64,282,697)	(63,756,529)
Transfer from Stage 3 to Stage 2	-	446,480	(6,440,653)	(5,994,173)
New financial assets originated or purchased	51,241,601	13,832,260	216,515,061	281,588,922
Changes in PDs/LGDs/EADs	(52,534,747)	(44,108,337)	(28,303,363)	(124,946,447)
Financial assets derecognized during the period	(12,081,240)	(14,284,498)	(377,093,332)	(403,459,070)
<b>Total net P&amp;L charge during the period</b>	(9,501,178)	(78,439,742)	(173,356,199)	(261,297,119)
<b>Other movements without P&amp;L impact</b>				
Write-offs, foreclosures and other movements	-	(28,788,524)	(166,428,618)	(195,217,142)
<b>Loss allowance at December 31, 2018</b>	₱139,860,515	₱11,077,918	₱559,848,862	₱710,787,295



	ECL Staging			Total
	Stage 1	Stage 2	Stage 3	
	12-month ECL	Lifetime ECL	Lifetime ECL	
<b>Corporate and commercial lending</b>				
<b>Loss allowance at January 1, 2018</b>	<b>₱57,938,016</b>	<b>₱15,490,662</b>	<b>₱1,161,763,604</b>	<b>₱1,235,192,282</b>
<b>Movements with P&amp;L impact</b>				
Transfers:				
Transfer from Stage 1 to Stage 2	(1,559,543)	2,289,637	–	730,094
Transfer from Stage 1 to Stage 3	(625,209)	–	131,421,410	130,796,201
Transfer from Stage 2 to Stage 1	1,031,363	(1,514,191)	–	(482,828)
Transfer from Stage 2 to Stage 3	–	(2,275,714)	325,828,811	323,553,097
Transfer from Stage 3 to Stage 1	48,885	–	(10,275,856)	(10,226,971)
Transfer from Stage 3 to Stage 2	–	284,825	(40,780,318)	(40,495,493)
New financial assets originated or purchased	14,274,028	113,262	5,719,779	20,107,069
Changes in PDs/LGDs/EADs	16,411,587	(7,975,342)	(7,048,585)	1,387,660
Financial assets derecognized during the period	(13,966,612)	(1,924,253)	(63,753,918)	(79,644,783)
<b>Total net P&amp;L charge during the period</b>	<b>15,614,499</b>	<b>(11,001,776)</b>	<b>341,111,323</b>	<b>345,724,046</b>
<b>Other movements without P&amp;L impact</b>				
Write-offs, foreclosures and other movements	–	(751,823)	(24,909,222)	(25,661,045)
<b>Loss allowance at December 31, 2018</b>	<b>₱73,552,515</b>	<b>₱3,737,063</b>	<b>₱1,477,965,705</b>	<b>₱1,555,255,283</b>

	ECL Staging			Total
	Stage 1	Stage 2	Stage 3	
	12-month ECL	Lifetime ECL	Lifetime ECL	
<b>Others</b>				
<b>Loss allowance at January 1, 2018</b>	<b>₱3,865,729</b>	<b>₱4,638,772</b>	<b>₱8,638,680</b>	<b>₱17,143,181</b>
<b>Movements with P&amp;L impact</b>				
Transfers:				
Transfer from Stage 2 to Stage 1	188,870	(1,244,663)	–	(1,055,793)
Transfer from Stage 2 to Stage 3	–	(764,873)	764,873	–
New financial assets originated or purchased	178,373	231,065	318,259	727,697
Changes in PDs/LGDs/EADs	(11,527)	225,991	(680,544)	(466,080)
Financial assets derecognized during the period	(1,251,797)	(1,502,122)	(2,797,369)	(5,551,288)
<b>Total net P&amp;L charge during the period</b>	<b>(896,081)</b>	<b>(3,054,602)</b>	<b>(2,394,781)</b>	<b>(6,345,464)</b>
<b>Other movements without P&amp;L impact</b>				
Foreclosures and other movements	(1,251,797)	(1,502,122)	(2,797,369)	(5,551,288)
<b>Loss allowance at December 31, 2018</b>	<b>₱1,717,851</b>	<b>₱82,048</b>	<b>₱3,446,530</b>	<b>₱5,246,429</b>

	ECL Staging			Total
	Stage 1	Stage 2	Stage 3	
	12-month ECL	Lifetime ECL	Lifetime ECL	
<b>Unquoted debt securities</b>				
<b>Loss allowance at January 1, 2018</b>	<b>₱92,510</b>	<b>₱–</b>	<b>₱151,836,309</b>	<b>₱151,928,819</b>
<b>Movements with P&amp;L impact</b>				
Financial assets derecognized during the period	(92,510)	–	–	(92,510)
<b>Total net P&amp;L charge during the period</b>	<b>(92,510)</b>	<b>–</b>	<b>–</b>	<b>(92,510)</b>
<b>Loss allowance at December 31, 2018</b>	<b>₱–</b>	<b>₱–</b>	<b>₱151,836,309</b>	<b>₱151,836,309</b>

	ECL Staging			Total
	Stage 1	Stage 2	Stage 3	
	12-month ECL	Lifetime ECL	Lifetime ECL	
<b>Sales contract receivable</b>				
<b>Loss allowance at January 1, 2018</b>	<b>₱5,827,343</b>	<b>₱383,965</b>	<b>₱61,369,697</b>	<b>₱67,581,005</b>
<b>Movements with P&amp;L impact</b>				
Transfers:				
Transfer from Stage 1 to Stage 2	(566,200)	588,938	–	22,738
Transfer from Stage 3 to Stage 2	–	619,181	(25,377,564)	(24,758,383)
New financial assets originated or purchased	1,993,383	127,015	27,014,844	29,135,242
Changes in PDs/LGDs/EADs	(463,670)	(40,121)	2,007,751	1,503,960
Financial assets derecognized during the period	(391,043)	(25,766)	(4,118,200)	(4,535,009)
<b>Total net P&amp;L charge during the period</b>	<b>572,470</b>	<b>1,269,247</b>	<b>(473,169)</b>	<b>1,368,548</b>
<b>Loss allowance at December 31, 2018</b>	<b>₱6,399,813</b>	<b>₱1,653,212</b>	<b>₱60,896,528</b>	<b>₱68,949,553</b>



*Investment securities at amortized cost*

	ECL Staging			Total
	Stage 1	Stage 2	Stage 3	
Debt securities	12-month ECL	Lifetime ECL	Lifetime ECL	
<b>Loss allowance at January 1, 2018</b>	<b>₱5,725,840</b>	<b>₱-</b>	<b>₱-</b>	<b>₱5,725,840</b>
<b>Movements with P&amp;L impact</b>				
New financial assets originated or purchased	3,249,456	-	-	3,249,456
Changes in PDs/LGDs/EADs	(717,945)	-	-	(717,945)
Financial assets derecognized during the period	(48,542)	-	-	(48,542)
<b>Total net P&amp;L charge during the period</b>	<b>2,482,969</b>	<b>-</b>	<b>-</b>	<b>2,482,969</b>
<b>Loss allowance at December 31, 2018</b>	<b>₱8,208,809</b>	<b>₱-</b>	<b>₱-</b>	<b>₱8,208,809</b>

*Financial assets at FVOCI*

	ECL Staging			Total
	Stage 1	Stage 2	Stage 3	
Debt securities	12-month ECL	Lifetime ECL	Lifetime ECL	
<b>Loss allowance at January 1, 2018</b>	<b>₱661,013</b>	<b>₱-</b>	<b>₱-</b>	<b>₱661,013</b>
<b>Movements with P&amp;L impact</b>				
New financial assets originated or purchased	329,862	-	-	329,862
Changes in PDs/LGDs/EADs	(46,024)	-	-	(46,024)
Financial assets derecognized during the period	(42,303)	-	-	(42,303)
<b>Total net P&amp;L charge during the period</b>	<b>241,535</b>	<b>-</b>	<b>-</b>	<b>241,535</b>
<b>Loss allowance at December 31, 2018</b>	<b>₱902,548</b>	<b>₱-</b>	<b>₱-</b>	<b>₱902,548</b>

*Other financial assets*

	ECL Staging			Total
	Stage 1	Stage 2	Stage 3	
Accounts receivable and accrued interest receivable	12-month ECL	Lifetime ECL	Lifetime ECL	
<b>Loss allowance at January 1, 2018</b>	<b>₱60,289,523</b>	<b>₱51,893,547</b>	<b>₱426,063,314</b>	<b>₱538,246,384</b>
<b>Movements with P&amp;L impact</b>				
Transfers:				
Transfer from Stage 1 to Stage 2	(352,276)	3,639,224	-	3,286,948
Transfer from Stage 1 to Stage 3	(224,314)	-	3,244,213	3,019,899
Transfer from Stage 2 to Stage 1	1,474,131	(15,228,650)	-	(13,754,519)
Transfer from Stage 2 to Stage 3	-	(63,576,669)	89,007,337	25,430,668
Transfer from Stage 3 to Stage 1	295,590	-	(4,275,070)	(3,979,480)
Transfer from Stage 3 to Stage 2	-	21,192,223	(29,669,112)	(8,476,889)
New financial assets originated or purchased	(9,097,927)	51,503,849	267,892,885	310,298,807
Changes in PDs/LGDs/EADs	(41,875,928)	(21,053,890)	(178,678,714)	(241,608,532)
Financial assets derecognized during the period	(5,076,868)	(21,429,180)	(25,143,763)	(51,649,811)
<b>Total net P&amp;L charge during the period</b>	<b>(54,857,592)</b>	<b>(44,953,093)</b>	<b>122,377,776</b>	<b>22,567,091</b>
<b>Other movements without P&amp;L impact</b>				
Write-offs, foreclosures and other movements	-	477,556	(1,675,041)	(1,197,485)
<b>Total movements without P&amp;L impact</b>	<b>-</b>	<b>477,556</b>	<b>(1,675,041)</b>	<b>(1,197,485)</b>
<b>Loss allowance at December 31, 2018</b>	<b>₱5,431,931</b>	<b>₱7,418,010</b>	<b>₱546,766,049</b>	<b>₱559,615,990</b>



The corresponding movement of the gross carrying amount of the financial asset are shown below:

*Loans and receivables*

	ECL Staging			Total
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	
<b>Consumer lending</b>				
<b>Gross carrying amount as at January 1, 2018</b>	<b>₱26,939,692,080</b>	<b>₱1,421,176,638</b>	<b>₱1,480,812,632</b>	<b>₱29,841,681,350</b>
Transfers:				
Transfer from Stage 1 to Stage 2	(151,200,303)	151,200,303	–	–
Transfer from Stage 1 to Stage 3	(96,277,572)	–	96,277,572	–
Transfer from Stage 2 to Stage 1	1,054,517,901	(1,054,517,901)	–	–
Transfer from Stage 2 to Stage 3	–	(73,945,277)	73,945,277	–
Transfer from Stage 3 to Stage 1	126,870,005	–	(126,870,005)	–
Transfer from Stage 3 to Stage 2	–	12,711,440	(12,711,440)	–
Movements in outstanding balance	(4,326,720,778)	(17,618,981)	(43,707,560)	(4,388,047,319)
Financial assets derecognized during the period	(2,179,038,467)	(171,595,378)	(227,119,207)	(2,577,753,052)
New financial assets purchased or originated	12,355,403,977	393,809,142	427,319,763	13,176,532,882
Write-offs	–	–	(219,895,034)	(219,895,034)
Foreclosures	–	(345,827,887)	(343,119,703)	(688,947,590)
<b>Gross carrying amount as at December 31, 2018</b>	<b>₱33,723,246,843</b>	<b>₱315,392,099</b>	<b>₱1,104,932,295</b>	<b>₱35,143,571,237</b>

	ECL Staging			Total
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	
<b>Corporate and commercial lending</b>				
<b>Gross carrying amount as at January 1, 2018</b>	<b>₱30,874,616,669</b>	<b>₱1,562,602,556</b>	<b>₱2,148,500,654</b>	<b>₱34,585,719,879</b>
Transfers:				
Transfer from Stage 1 to Stage 2	(589,783,426)	589,783,426	–	–
Transfer from Stage 1 to Stage 3	(236,439,670)	–	236,439,670	–
Transfer from Stage 2 to Stage 1	390,037,749	(390,037,749)	–	–
Transfer from Stage 2 to Stage 3	–	(586,197,153)	586,197,153	–
Transfer from Stage 3 to Stage 1	18,487,247	–	(18,487,247)	–
Transfer from Stage 3 to Stage 2	–	73,367,687	(73,367,687)	–
Movements in outstanding balance	(596,475,641)	(46,124,321)	(66,602,842)	(709,202,804)
Financial assets derecognized during the period	(7,442,674,551)	(194,106,806)	(117,902,931)	(7,754,684,288)
New financial assets purchased or originated	5,398,110,901	29,174,956	10,290,428	5,437,576,285
Foreclosures	–	(75,839,259)	(46,065,725)	(121,904,984)
<b>Gross carrying amount as at December 31, 2018</b>	<b>₱27,815,879,278</b>	<b>₱962,623,337</b>	<b>₱2,659,001,473</b>	<b>₱31,437,504,088</b>

	ECL Staging			Total
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	
<b>Others</b>				
<b>Gross carrying amount as at January 1, 2018</b>	<b>₱25,475,321</b>	<b>₱4,638,772</b>	<b>₱8,638,680</b>	<b>₱38,752,773</b>
Transfers:				
Transfer from Stage 2 to Stage 1	1,244,663	(1,244,663)	–	–
Transfer from Stage 2 to Stage 3	–	(764,873)	764,873	–
Movements in outstanding balance	(7,518,460)	(1,276,131)	(2,376,511)	(11,171,102)
Financial assets derecognized during the period	(8,249,393)	(1,502,122)	(2,797,369)	(12,548,884)
New financial assets purchased or originated	1,268,976	231,065	430,310	1,930,351
<b>Gross carrying amount as at December 31, 2018</b>	<b>₱12,221,107</b>	<b>₱82,048</b>	<b>₱4,659,983</b>	<b>₱16,963,138</b>

	ECL Staging			Total
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	
<b>Unquoted debt securities</b>				
<b>Gross carrying amount as at January 1, 2018</b>	<b>₱102,911,415</b>	<b>₱–</b>	<b>₱151,836,309</b>	<b>₱254,747,724</b>
Financial assets derecognized during the period	(102,911,415)	–	–	(102,911,415)
<b>Gross carrying amount as at December 31, 2018</b>	<b>₱–</b>	<b>₱–</b>	<b>₱151,836,309</b>	<b>₱151,836,309</b>

	ECL Staging			Total
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	
<b>Sales contract receivable</b>				
<b>Gross carrying amount as at January 1, 2018</b>	<b>₱606,136,479</b>	<b>₱38,396,511</b>	<b>₱149,734,353</b>	<b>₱794,267,343</b>
Transfers:				
Transfer from Stage 1 to Stage 2	(58,893,812)	58,893,812	–	–
Transfer from Stage 3 to Stage 2	–	61,918,069	(61,918,069)	–
Movements in outstanding balance	(63,336,236)	(4,012,117)	(15,645,998)	(82,994,351)
Financial assets derecognized during the period	(40,674,650)	(2,576,589)	(10,047,890)	(53,299,129)
New financial assets purchased or originated	200,509,352	12,701,528	49,531,977	262,742,857
<b>Gross carrying amount as at December 31, 2018</b>	<b>₱643,741,133</b>	<b>₱165,321,214</b>	<b>₱111,654,373</b>	<b>₱920,716,720</b>





*Investment securities at amortized cost*

	ECL Staging			Total
	Stage 1	Stage 2	Stage 3	
	12-month ECL	Lifetime ECL	Lifetime ECL	
<b>Debt securities</b>				
Gross carrying amount as at January 1, 2018	₱5,201,830,514	₱-	₱-	₱5,201,830,514
Movements in outstanding balance	111,082,189	-	-	111,082,189
Financial assets derecognized during the period	(44,100,000)	-	-	(44,100,000)
New financial assets purchased or originated	3,452,219,037	-	-	3,452,219,037
<b>Gross carrying amount as at December 31, 2018</b>	<b>₱8,721,031,740</b>	<b>₱-</b>	<b>₱-</b>	<b>₱8,721,031,740</b>

*Financial assets at FVOCI*

	ECL Staging			Total
	Stage 1	Stage 2	Stage 3	
	12-month ECL	Lifetime ECL	Lifetime ECL	
<b>Debt securities</b>				
Gross carrying amount as at January 1, 2018	₱735,290,352	₱-	₱-	₱735,290,352
Movements in outstanding balance	(20,036,683)	-	-	(20,036,683)
Financial assets derecognized during the period	(47,056,935)	-	-	(47,056,935)
New financial assets purchased or originated	384,875,194	-	-	384,875,194
<b>Gross carrying amount as at December 31, 2018</b>	<b>₱1,053,071,928</b>	<b>₱-</b>	<b>₱-</b>	<b>₱1,053,071,928</b>

*Other financial assets*

	ECL Staging			Total
	Stage 1	Stage 2	Stage 3	
	12-month ECL	Lifetime ECL	Lifetime ECL	
<b>Accounts receivable and accrued interest receivable</b>				
Gross carrying amount as at January 1, 2018	₱889,752,026	₱74,133,639	₱434,758,483	₱1,398,644,148
Transfers:				
Transfer from Stage 1 to Stage 2	(5,198,892)	5,198,892	-	-
Transfer from Stage 1 to Stage 3	(3,310,421)	-	3,310,421	-
Transfer from Stage 2 to Stage 1	21,755,214	(21,755,214)	-	-
Transfer from Stage 2 to Stage 3	-	(90,823,813)	90,823,813	-
Transfer from Stage 3 to Stage 1	4,362,316	-	(4,362,316)	-
Transfer from Stage 3 to Stage 2	-	30,274,604	(30,274,604)	-
Movements in outstanding balance	(74,328,638)	73,576,928	273,360,086	272,608,376
Financial assets derecognized during the period	(74,924,360)	(30,613,115)	(25,656,901)	(131,194,376)
New financial assets purchased or originated	15,283,510	(776,877)	(8,688,107)	5,818,526
Write-offs	-	-	4,470,824	4,470,824
Foreclosures	-	682,223	6,976,182	7,658,405
<b>Gross carrying amount as at December 31, 2018</b>	<b>₱773,390,753</b>	<b>₱39,897,268</b>	<b>₱744,717,882</b>	<b>₱1,558,005,903</b>

Movement in allowance for impairment and credit losses of financial assets for the year ended December 31, 2017 follow (amounts in thousands):

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

\*Excludes allowance for impairment losses on nonfinancial assets amounting to ₱1.30 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, 2018 and 2017, Due from BSP amounting to ₱6.80 billion and ₱6.77 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 0.50% to 3.00% in 2018, from 0.25% to 1.50% in 2017 and from 0.25% to 1.75% in 2016, while peso-denominated deposit liabilities bear interest rates ranging from 0.25% to 7.50% in 2018, from 0.50% to 4.75% in 2017 and from 0.25% to 5.50% in 2016.

## 16. Accruals and Other Liabilities

### Accrued Interest and Other Expenses

This account consists of:

	2018	2017
Accrued interest payable	₱224,511,939	₱105,725,782
Accrued other expenses	194,339,048	161,116,500
	<b>₱418,850,987</b>	<b>₱266,842,282</b>

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

### Other Liabilities

This account consists of:

	2018	2017
<b>Financial</b>		
Accounts payable (Note 24)	₱836,030,557	₱889,378,524
Other credits – dormant	95,167,204	83,919,568
Security deposit (Note 24)	79,325,328	3,885,646
Due to the Treasurer of the Philippines	8,059,717	9,224,406
Bills purchased	1,297,783	7,842,548
Other payable	6,224,905	5,437,792
	<b>₱1,026,105,493</b>	<b>₱999,688,484</b>
<b>Nonfinancial</b>		
Accrued gross receipts tax	56,228,058	16,754,796
Taxes payable	49,041,011	41,586,661
Retirement liability (Note 20)	–	106,046,713
Miscellaneous	54,263,296	211,775,450
	<b>159,532,365</b>	<b>376,163,620</b>
	<b>₱1,185,637,858</b>	<b>₱1,375,852,104</b>



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 teller 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, 2018 and 2017, 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, 2018			December 31, 2017		
	Within twelve months	Over twelve months	Total	Within twelve months	Over twelve months	Total
<b>Financial assets</b>						
Cash and cash equivalents	₱13,551,253	₱-	₱13,551,253	₱11,534,523	₱-	₱11,534,523
Financial assets at FVPL	-	-	-	135,398	-	135,398
Financial assets at FVOCI	49,592	1,032,272	1,081,864	-	-	-
AFS financial assets	-	-	-	31,966	2,261,703	2,293,669
Investment securities at amortized cost	3,041,187	5,679,845	8,721,032	-	-	-
HTM financial assets	-	-	-	-	3,502,818	3,502,818
Loans and receivables	23,870,264	43,800,327	67,670,591	22,040,434	43,474,735	65,515,169
Other assets						
AIR	820,791	-	820,791	685,256	-	685,256
Accounts receivable	737,215	-	737,215	713,388	-	713,388
RCOCI	11,914	-	11,914	96,299	-	96,299
	<b>42,082,216</b>	<b>50,512,444</b>	<b>92,594,660</b>	<b>35,237,264</b>	<b>49,239,256</b>	<b>84,476,520</b>
<b>Nonfinancial assets</b>						
NCAHS	379,193	-	379,193	212,031	-	212,031
Property and equipment	-	2,968,385	2,968,385	-	2,805,037	2,805,037
Investment properties	-	3,986,019	3,986,019	-	4,069,861	4,069,861
Branch licenses	-	74,480	74,480	-	74,480	74,480
Software costs	-	161,122	161,122	-	155,265	155,265
Deferred tax asset	-	613,401	613,401	-	338,325	338,325
Other assets						
NPAP	-	1,241,290	1,241,290	-	1,242,740	1,242,740
CWT	316,892	-	316,892	310,133	-	310,133
Documentary stamp tax	66,618	-	66,618	89,326	-	89,326
Advance rental deposits	62,069	-	62,069	42,471	-	42,471
Prepaid expenses	36,811	-	36,811	12,170	-	12,170
Stationery and supplies	-	21,792	21,792	34,684	-	34,684
Other equity investments	42,474	-	42,474	-	21,792	21,792
Retirement asset	6,096	-	6,096	-	-	-
Miscellaneous	240,489	-	240,489	74,569	-	74,569
	<b>1,150,642</b>	<b>9,062,540</b>	<b>10,213,182</b>	<b>775,384</b>	<b>8,707,500</b>	<b>9,482,884</b>
	<b>43,232,858</b>	<b>59,574,984</b>	<b>102,807,842</b>	<b>36,012,648</b>	<b>57,946,756</b>	<b>93,959,404</b>
Allowances for impairment and credit losses (Note 14)			(4,656,292)			(4,687,119)
Unearned interest and discounts (Note 8)			(47,159)			(32,544)
Accumulated depreciation and amortization (Notes 10, 11 and 12)			(2,328,631)			(2,061,805)
			<b>(7,073,842)</b>			<b>(6,781,468)</b>
			<b>₱95,779,703</b>			<b>₱87,177,936</b>

(Forward)



	December 31, 2018			December 31, 2017		
	Within twelve months	Over twelve months	Total	Within twelve months	Over twelve months	Total
<b>Financial liabilities</b>						
Deposit liabilities	₱77,082,720	₱7,518,752	₱84,601,472	₱63,532,626	₱12,904,457	₱76,437,083
Manager's checks	484,180	–	484,180	731,802	–	731,802
Accrued interest and other expenses	418,851	–	418,851	266,842	–	266,842
<b>Other liabilities</b>						
Accounts payable	836,031	–	836,031	889,379	–	889,379
Other credits - dormant	–	95,167	95,167	–	83,920	83,920
Security deposit	–	79,325	79,325	–	3,886	3,886
Due to the Treasurer of the Philippines	8,060	–	8,060	9,224	–	9,224
Bills purchased	1,298	–	1,298	7,842	–	7,842
Other payable	6,225	–	6,225	5,438	–	5,438
	<b>78,837,365</b>	<b>7,693,244</b>	<b>86,530,609</b>	<b>65,443,153</b>	<b>12,992,263</b>	<b>78,435,416</b>
<b>Nonfinancial liabilities</b>						
Income tax payable	345	–	345	293	–	293
Retirement liability	–	–	–	–	106,047	106,047
Other liabilities	159,533	–	159,533	270,116	–	270,116
	<b>159,878</b>	<b>–</b>	<b>159,878</b>	<b>270,409</b>	<b>106,047</b>	<b>376,456</b>
	<b>₱78,997,243</b>	<b>₱7,693,244</b>	<b>₱86,690,487</b>	<b>₱65,713,562</b>	<b>₱13,098,310</b>	<b>₱78,811,872</b>

## 18. Equity

The Bank's authorized common shares amounted to 134.00 million in 2018 and 2017 and 74.00 million in 2016. The Bank's authorized preferred shares amounted to 6.00 million in 2018, 2017 and 2016.

As of December 31, 2018, 2017 and 2016, the Bank's capital stock consists of:

	2018		2017		2016	
	Shares	Amount	Shares	Amount	Shares	Amount
<b>Preferred stock - ₱100 par value</b>						
Balance at beginning and end of year	21,642	₱2,164,200	21,642	₱2,164,200	21,642	₱2,164,200
<b>Common stock - ₱100 par value</b>						
Balance at beginning of year	100,414,149	10,041,414,900	74,000,000	7,400,000,000	37,056,482	3,705,648,200
Issuance of capital stock	5,000,000	500,000,000	–	–	–	–
Application of DFFS to issued stock	–	–	26,414,149	2,641,414,900	36,943,518	3,694,351,800
Balance at end of year	<b>105,414,149</b>	<b>10,541,414,900</b>	<b>100,414,149</b>	<b>10,041,414,900</b>	<b>74,000,000</b>	<b>7,400,000,000</b>
	<b>105,435,791</b>	<b>₱10,543,579,100</b>	<b>100,435,791</b>	<b>₱10,043,579,100</b>	<b>74,021,642</b>	<b>₱7,402,164,200</b>

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

- Non-voting and non-participating;
- Preference at liquidation, including declared dividends which have not been distributed;
- 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;
- 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
- 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, 2018 and 2017, the total number of stockholders is 1,545.

#### Capital Infusions

Details of the Parent Bank's capital infusions to the Bank in support of the Bank's planned business growth and expansion follow:

Date	Amount
June 6, 2018	₱500,000,000
December 31, 2016	1,500,000,000
September 29, 2016	1,000,000,000
December 16, 2015	2,000,000,000

The capital infusion to the Bank in 2018 amounting to ₱500.00 million was approved by the Parent Bank's BOD on June 6, 2018.

#### 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 and Surplus Reserves

##### *Surplus*

As of December 31, 2018 and 2017, surplus included the amount of ₱5.68 million and ₱15.96 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*

In compliance with BSP regulations, 10.00% of the Bank's profit from trust business is appropriated to surplus reserve as of December 31, 2017. In 2018, with the surrender of the its trust license, the Bank transferred surplus reserves of ₱22.76 million to free surplus.



### **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, 2018 and 2017.

### 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 Bank 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 Bank. The level and structure of capital are assessed and determined in light of the Parent Bank'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, 2018 and 2017 are shown in the tables below (amounts in thousands).

	2018	2017
Tier 1 capital	<b>₱7,600,177</b>	₱7,514,474
Tier 2 capital	<b>678,978</b>	700,804
Total qualifying capital	<b>₱8,279,155</b>	₱8,215,278
Risk weighted assets	<b>₱73,010,289</b>	₱71,852,728
<b>Capital adequacy ratio</b>	<b>11.34%</b>	11.43%

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.

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## 19. Miscellaneous Income and Expenses

Miscellaneous income comprise the following:

	<b>2018</b>	2017	2016
Bancassurance activities	<b>₱45,535,304</b>	₱26,605,451	₱14,735,877
Recovery on charged off assets	<b>44,407,274</b>	14,741,456	7,979,599
Net foreign exchange gain	<b>2,264,729</b>	728,740	25,547,803
Dividends	<b>1,262,000</b>	3,786,000	4,452,356
Trust fee income	<b>415,381</b>	4,365,005	4,288,480
Others (Note 13)	<b>6,861,823</b>	40,327,931	27,819,684
	<b>₱100,746,511</b>	₱90,554,583	₱84,823,799

On April 11, 2017, the Bureau of Treasury paid the Bank the final tax withheld from the proceeds of the Poverty Eradication and Alleviation Certificates (PEACe) bonds last October 18, 2011, plus 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' in 2017.

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





Miscellaneous expenses consist of:

	<b>2018</b>	2017	2016
Supervision and administrative expenses	<b>₱45,298,605</b>	₱52,380,309	₱55,974,037
Repairs and maintenance fees	<b>27,177,731</b>	33,935,818	20,137,202
Advertising	<b>12,774,411</b>	20,922,480	23,598,573
Clearing and processing fees	<b>4,668,605</b>	4,932,604	2,853,729
Others	<b>72,987,876</b>	52,977,630	46,778,419
	<b>₱162,907,228</b>	₱165,148,841	₱149,341,960

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.

## 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, 2018. The principal actuarial assumptions as of December 31, 2018 and 2017 used in determining the retirement obligation for the Bank's retirement plans are shown below:

	<b>2018</b>	2017
Discount rate	<b>7.27%</b>	5.63%
Salary increase rate	<b>6.00%</b>	6.00%

As of December 31, 2018 and 2017, retirement asset (liability) comprised the following:

	<b>2018</b>	2017
Fair value of plan assets	<b>₱293,708,323</b>	₱210,827,701
Present value of defined benefit obligation	<b>287,612,811</b>	316,874,414
Net defined benefit asset (liability) (Note 16)	<b>₱6,095,512</b>	(₱106,046,713)



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

	2018											
	Net benefit cost					Remeasurements in other comprehensive income						
	January 1, 2018	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 financial assumptions	Changes in remeasurement gains	Contribution by employer	December 31, 2018
(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	₱210,827,701	₱-	₱11,869,600	₱-	₱11,869,600	(₱20,759,123)	(₱17,817,755)	₱-	₱-	(₱17,817,755)	₱109,587,900	₱293,708,323
Present value of defined benefit obligation	316,874,414	88,207,080	17,840,029	-	106,047,109	(₱20,759,123)	-	(46,522,338)	(68,027,251)	(114,549,589)	-	287,612,811
<b>Net defined benefit asset (liability)</b>	<b>(₱106,046,713)</b>	<b>(₱88,207,080)</b>	<b>(₱5,970,429)</b>	<b>₱-</b>	<b>(₱94,177,509)</b>	<b>₱-</b>	<b>(₱17,817,755)</b>	<b>₱46,522,338</b>	<b>₱68,027,251</b>	<b>₱96,731,834</b>	<b>₱109,587,900</b>	<b>₱6,095,512</b>

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

	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 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
<b>Net defined benefit asset (liability)</b>	<b>(₱130,185,501)</b>	<b>(₱86,542,444)</b>	<b>(₱6,613,423)</b>	<b>₱-</b>	<b>(₱93,155,867)</b>	<b>₱-</b>	<b>(₱10,053,576)</b>	<b>₱2,984,308</b>	<b>₱26,363,923</b>	<b>₱19,294,655</b>	<b>₱98,000,000</b>	<b>(₱106,046,713)</b>

\* 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 ₱135.57 million to its defined retirement plan in 2019.

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):

	<b>2018</b>	2017
Cash and cash equivalents (Note 24)	<b>₱148,119</b>	₱137,105
Debt instruments	<b>145,120</b>	73,485
Accrued interest receivable	<b>917</b>	1,208
Other accountabilities	<b>(448)</b>	(970)
	<b>₱293,708</b>	₱210,828

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, 2018 and 2017, assuming if all other assumptions were held constant (in thousands):

	<b>2018</b>	2017
Discount rate		
1.00%	<b>(₱28,746)</b>	(₱39,471)
(1.00%)	<b>37,942</b>	50,838
Salary increase rate		
1.00%	<b>36,802</b>	48,520
(1.00%)	<b>(28,456)</b>	(38,611)

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

	<b>2018</b>	2017
Less than five years	<b>₱90,920</b>	₱82,734
More than five years to ten years	<b>210,666</b>	178,995
More than ten years to fifteen years	<b>715,067</b>	635,724
More than fifteen years to twenty years	<b>972,734</b>	1,034,331
More than twenty years	<b>11,606,160</b>	10,283,386

The average duration of the defined benefit obligation as at December 31, 2018 and 2017 is 17 and 18 years, respectively.

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## 21. Lease Contracts

The Bank leases the premises occupied by its branches. The lease contracts are for periods ranging from one (1) to forty (40) 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 15.00%.

For the years ended December 31, 2018, 2017 and 2016, annual rentals of the Bank on these lease contracts included in 'Occupancy costs' in the statements of income amounted to ₱194.87 million, ₱167.11 million and ₱185.13 million, respectively.



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

	2018	2017
Within one year	<b>₱13,908,533</b>	₱44,978,174
After one year but not more than five years	<b>451,281,010</b>	238,887,143
After more than five years	<b>405,493,219</b>	419,975,843
	<b>₱870,682,762</b>	₱703,841,160

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:

	2018	2017
Within one year	<b>₱1,838,685</b>	₱8,285,993
After one year but not more than five years	<b>6,485,653</b>	16,802,167
After more than five years	<b>15,465,672</b>	5,998,491
	<b>₱23,790,010</b>	₱31,086,651

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## 22. Income and Other Taxes

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

Republic Act (RA) No. 9337, *An Act Amending National Internal Revenue Code*, provides 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.

Effective in May 2004, RA No. 9294 restored the tax exemption of FCDUs and offshore banking units (OBUs). Under such law, 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.

Interest income on deposit placements with other FCDUs and OBUs is taxed at 7.50% (now 15.00% effective January 1, 2018), while all other income of the FCDU is subject to the 30.00% corporate tax.



#### Relevant Tax Updates

RA No. 10963, *The Tax Reform for Acceleration and Inclusion (TRAIN)*, is the first package of the comprehensive tax reform program of the government. The bill was signed into law on December 19, 2017 and took effect on January 1, 2018, amending some provisions of the old Philippine tax system.

Except for resident foreign corporations, which is still subject to the existing rate of 7.50%, tax on interest income of foreign currency deposit was increased to 15.00% under TRAIN. Documentary stamp tax on bank checks, drafts, certificate of deposit not bearing interest, all debt instruments, bills of exchange, letters of credit, mortgages, deeds and others are now subjected to a higher rate.

#### Revenue Regulations No. 4-2011

On March 15, 2011, the Bureau of Internal Revenue (BIR) issued Revenue Regulations (RR) No. 4-2011 which prescribed the attribution and allocation of expenses between FCDUs/EFCDUs or OBU and RBU and within RBU.

On April 6, 2015, the Parent Bank and other member banks of the Bankers Association of the Philippines (BAP), filed a Petition for Declaratory Relief with Application for Temporary Restraining Order (TRO) and/or Writ of Preliminary Injunction with the Regional Trial Court of Makati (Makati Trial Court). Further, in Civil Case No. 15-287, the Bank and other BAP member banks assailed the validity of RR 4-2011 on the ground, among others, that (a) the RR violates the petitioner-banks substantive due process rights; (b) it is not only illegal but also unfair; (c) that it serves as a deterrent to banks to invest in capital market transactions to the prejudice of the economy; (d) it sets a dangerous precedent for the disallowance of full deductions due to the prescribes method of allocation; and (e) it violates the equal protection clause of the Constitution.

On April 8, 2015, the Makati Trial Court issued a TRO enjoining the BIR from enforcing RR 4-2011. Also, on April 25, 2015, Makati Trial Court issued a Writ of Preliminary Injunction enjoining the BIR from enforcing, carrying out, or implementing in any way or manner RR 4-2011 against the Bank and other BAP member banks, including issuing Preliminary Assessment Notice or Final Assessment Notice against them during the pendency of the litigation, unless sooner dissolved.

On June 10, 2015, the Makati Trial Court issued a Confirmatory Order stating that the TRO and Writ of Preliminary Injunction also prohibits the BIR from ruling or deciding on any administrative matter pending before it in relation to the subject revenue regulations and insofar as the Bank and other BAP member banks are concerned.

On May 25, 2018, the Makati Trial Court issued a decision annulling RR 4-2011 and making the Writ of Preliminary Injunction permanent.

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.



Benefit from income tax consists of:

	2018	2017	2016
Current			
RCIT	₱-	₱48,389,561	₱61,725,020
Final tax	66,770,216	58,912,148	54,814,973
Excess MCIT over RCIT	46,643,385	-	-
	113,413,601	107,301,709	116,539,993
Deferred*	(307,637,017)	(357,535,678)	(198,350,719)
	₱194,223,416	(₱250,233,969)	(₱81,810,726)

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

Components of net deferred tax asset are as follows:

	2018	2017
Deferred tax asset on		
Allowance for impairment and credit losses	₱597,500,029	₱210,656,114
Difference between book base and tax base of investment property	182,366,247	256,055,219
Retirement liability	-	15,907,007
	779,866,276	482,618,340
Deferred tax liability on		
Fair value adjustment on investment property	(160,070,026)	(136,137,628)
Revaluation increment on condominium properties credited to surplus free	(2,435,946)	(6,695,755)
Retirement asset	(1,828,654)	-
Accrued lease receivable	(2,130,478)	(1,460,063)
	(166,465,104)	(144,293,446)
	₱613,401,172	₱338,324,894

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:

	2018	2017
Tax effects of		
Allowance for impairment and credit losses	₱2,338,647,887	₱3,337,499,761
NOLCO	288,559,350	-
Excess MCIT over RCIT	46,643,385	101,094
Unamortized past service cost	4,879,741	5,948,983
Retirement liability	-	53,023,357
Accruals	-	51,957,668
	₱2,678,730,363	₱3,448,530,863

Details of the Bank's NOLCO are as follows:

Inception year	Original amount	Used	Expired	Balance	Expiry year
2018	₱288,559,350	₱-	₱-	₱288,559,350	2021



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

Inception year	CBS pre-merger	PDB pre-merger	CBS post-merger	Used*	Balance	Expiry year
2014	₱16,153,157	₱20,846,141	N/A	₱36,999,298	₱-	2017
2015	11,908,638	23,505,563	N/A	35,414,201	-	2018
2018	N/A	N/A	46,643,385	-	46,643,385	2021
	<b>₱28,061,795</b>	<b>₱44,351,704</b>	<b>₱46,643,385</b>	<b>₱72,413,499</b>	<b>₱46,643,385</b>	

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

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

	2018	2017	2016
Statutory income tax	<b>₱52,692,059</b>	₱75,392,474	₱45,517,055
Tax effects of			
Movement in unrecognized deferred tax assets	<b>(193,685,105)</b>	(370,953,625)	(92,999,457)
Nontaxable and tax-paid income	<b>(118,015,818)</b>	(95,886,205)	(87,905,039)
Nondeductible expenses	<b>63,161,866</b>	146,459,332	90,574,684
FCDU loss (income)	<b>1,623,582</b>	(5,245,945)	(36,997,969)
Effective income tax	<b>(₱194,223,416)</b>	(₱250,233,969)	(₱81,810,726)

## 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 as of December 31, 2017 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.

Under BSP Circular Letter No. CL-2019-001 dated January 8, 2019, the BSP approved the Bank's request to surrender its license to conduct trust and other fiduciary business effective immediately in accordance with MB Resolution No. 2050 dated December 6, 2018.

## 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 2018 and 2017 in relation to amounts due from related parties.

#### Transactions with Retirement Plans

The Bank has a business relationship with its retirement plan pursuant to which it provides trust and management services. The total fair value of the retirement fund as of December 31, 2018 and 2017 amounted to ₱293.71 million and ₱210.83 million, respectively. The details of the assets of the fund as of December 31, 2018 and 2017 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, 2018 and 2017, cash and cash equivalents of the retirement plan amounting to ₱73.53 million and ₱134.39 million, respectively, are held by the Bank and earn interest ranging from 6.00% to 6.50% and from 3.00% to 4.25% in 2018 and 2017, respectively.

As of December 31, 2018 and 2017, cash and cash equivalents of the retirement plan amounting to ₱67.47 million and ₱2.72 million, respectively, are held by the Parent Bank and earn interest ranging from 5.60% to 6.75% and from 2.38% to 2.63% in 2018 and 2017, respectively.

Interest income on the retirement plan's cash and cash equivalents amounted to ₱3.08 million and ₱0.43 million in 2018 and 2017, respectively.

#### Remunerations of Directors and other Key Management Personnel

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 thousands):

	2018	2017	2016
Short-term employee benefits	<b>₱38,055</b>	₱40,392	₱35,955
Post-employment benefits	<b>2,835</b>	3,223	2,465
	<b>₱40,890</b>	₱43,615	₱38,420

In 2018, 2017 and 2016, no remunerations were given to the directors of the Bank who are also occupying key management positions with the ultimate parent bank.





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, 2018			
Category	Amount/ Volume	Outstanding Balance	Nature, Terms and Conditions
<b>Key Management Personnel</b>			
Loans		₱-	
Repayments	(₱38,360)		
Deposit liabilities		64,671,792	These are savings and time deposit accounts with annual interest rates ranging from 0.50% to 0.99%.
Deposits	40,988,805		
Withdrawals	(19,318,496)		
<b>Other Related Party</b>			
Deposit liabilities		125,077,872	These deposit accounts earns annual interest ranging from 0.50% to 2.63%.
Deposits	107,654,784		
Withdrawals	(2,340,198)		

December 31, 2017			
Category	Amount/ Volume	Outstanding Balance	Nature, Terms and Conditions
<b>Key Management Personnel</b>			
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)		
<b>Other Related Party</b>			
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)		

As of December 31, 2018 and 2017, 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, 2018, 2017 and 2016 are as follows:

	2018	2017	2016
Interest income	₱7,910	₱9,701	₱201,132
Interest expense	4,100,222	1,230,828	507,635

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

	Parent Bank		
	2018	2017	Nature, Terms and Conditions
<b>Statements of Financial Position</b>			
Due from other banks	₱309,861,476	₱281,193,219	This pertains to cash in bank deposited with CBC that bears annual interest rates ranging from 0.10% to 0.25% in 2018 and from 0.13% to 0.25% in 2017.
Net movements	28,668,257	(434,938,545)	
Accounts receivable	4,857,682	9,835,384	This pertains to receivable from CBC for unpaid rental.
Security deposit	2,269,687	2,444,337	This pertains to the rental deposits for office space leased out to CBC presented under 'Other liabilities'(Note 16).
Accounts payable	-	1,111,153	This pertains to the various expenses advanced by CBC on behalf of the Bank.



<b>Parent Bank</b>				
	<b>2018</b>	2017	2016	<b>Nature, Terms and Conditions</b>
<b>Statements of Income</b>				
Interest income	<b>₱747,418</b>	₱473,729	₱339,552	This pertains to interest income earned from cash in bank deposited with CBC.
Trading and securities gains	-	3,548,612	14,479,079	The Bank earned investment securities gain from its outright sale of securities to CBC.
Income from property rentals	<b>19,937,200</b>	24,209,412	19,940,719	Certain units of the condominium owned by the Bank are being leased to CBC for a term ranging from 5 to 10 years, with an escalation rate of 5%.

<b>Other Related Party</b>				
	<b>2018</b>	2017	2016	<b>Nature, Terms and Conditions</b>
<b>Statements of Financial Position</b>				
Accounts receivable	<b>₱1,279,428</b>	₱2,180,467		This pertains to receivable from China Bank Insurance Brokers (CIBI), a subsidiary of CBC, for unpaid rental.
Accounts payable	<b>32,303,681</b>	44,740,361		These are non-interest bearing insurance premiums held on behalf of loan borrowers to be subsequently remitted to CIBI.
Security deposit	<b>291,347</b>	291,347		These pertain to rental deposits for office space leased out to CIBI presented under 'Other liabilities' (Note 16).

<b>Other Related Party</b>				
	<b>2018</b>	2017	2016	<b>Nature, Terms and Conditions</b>
<b>Statements of Income</b>				
Income from property rentals	<b>₱4,391,532</b>	₱3,806,582	₱3,806,582	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:

	<b>2018</b>	2017	2016
Outright purchase	<b>₱3,455,943,314</b>	₱347,588,893	₱1,835,501,100
Outright sale	-	430,145,157	756,441,947

As of December 31, 2018, 2017 and 2016, the number of common shares held by the Parent Bank are 105.00 million, 99.63 million and 73.21 million, respectively. The Parent Bank does not hold preferred shares of the Bank in 2018, 2017 and 2016.

#### 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:



	2018	2017
Total outstanding DOSRI accounts*	<b>₱322,068,035</b>	₱303,066,462
Total outstanding DOSRI accounts prior to effectivity of BSP Circular No. 423	-	-
Percent of DOSRI accounts to total loans	<b>0.47%</b>	0.47%
Percent of unsecured DOSRI accounts to total DOSRI accounts	<b>2.35%</b>	5.44%
Percent of nonperforming DOSRI accounts to total DOSRI accounts	-	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, 2018 and 2017, 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:

	2018	2017
Credit lines	<b>₱524,162,035</b>	₱2,335,446,073
Standby domestic letters of credit	<b>148,988,582</b>	212,977,965
Late deposits/payments received	<b>36,672,003</b>	11,518,582
Outward bills for collection	<b>1,924,156</b>	1,829,009
Trust department accounts (Note 23)	-	235,267,741
Others	<b>151,625</b>	260,018
	<b>₱711,898,401</b>	₱2,797,299,388

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:

	2018	2017	2016
Return on average equity (ROE)	4.24%	6.19%	3.55%
Return on average asset (ROA)	0.40%	0.60%	0.30%
Net interest margin over average earning assets (NIM)	4.13%	4.74%	4.87%

## 27. Notes to Statements of Cash Flows

The following is a summary of non-cash activities:

	2018	2017	2016
<b>Non-cash operating activities</b>			
Recognition of investment properties from foreclosure of real estate mortgage on loans and receivables (Notes 9 and 11)	₱284,148,134	₱452,437,284	₱407,444,178
Recognition of NCAHS arising from foreclosure of chattel mortgage on loans and receivables (Note 9)	575,410,796	556,689,819	330,621,295
Payment of current tax expense using excess MCIT over RCIT (Note 22)	–	(48,367,048)	(61,725,020)
<b>Non-cash investing activities</b>			
Fair value losses on financial assets at FVOCI (Note 7)	(8,999,107)	–	–
Fair value gains (losses) on AFS financial assets (Note 7)	–	85,284,684	(73,138,076)
Remeasurement losses (gains) on retirement liability (Note 20)	96,731,834	(19,294,655)	68,467,785
Reclassification of AFS financial assets to HTM financial assets (Note 7)	–	–	708,417,631
<b>Non-cash financing activities</b>			
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)
Utilization of prepaid documentary stamps for capital infusion	5,000,000	–	–



## 28. Offsetting of Financial Assets and Liabilities

The amendments to PFRS 7 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, 2018						
Financial assets recognized at end of reporting period by type	Gross carrying amounts (before offsetting)	Gross amounts offset in accordance with the offsetting criteria	Net amount presented in statements of financial position [a-b]	Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria		Net exposure [c-d]
				Financial Instruments	Fair value of financial collateral	
	[a]	[b]	[c]	[d]		[e]
<b>Financial assets</b>						
SPURA (Note 6)	₱3,000,000	₱-	₱-	₱3,000,000	₱3,000,000	₱-
December 31, 2017						
Financial assets recognized at end of reporting period by type	Gross carrying amounts (before offsetting)	Gross amounts offset in accordance with the offsetting criteria	Net amount presented in statements of financial position [a-b]	Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria		Net exposure [c-d]
				Financial Instruments	Fair value of financial collateral	
	[a]	[b]	[c]	[d]		[e]
<b>Financial assets</b>						
SPURA (Note 6)	₱1,404,323	₱-	₱-	₱1,404,323	₱1,404,323	₱-

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.



*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.

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**30. Approval of the Release of Financial Statements**

The accompanying financial statements were authorized for issue by the Bank's BOD on March 21, 2019.

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**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 2018.

Taxes and Licenses

Gross receipts tax	₱228,372,639
Local taxes	22,959,396
Others	4,900,503
	<u>₱256,232,538</u>

Withholding Taxes

Details of total remittances of withholding taxes in 2018 and amounts outstanding as of December 31, 2018 are as follows:

	Total Remittances	Amounts Outstanding
Final withholding taxes	₱279,167,040	₱35,999,305
Withholding taxes on compensation and benefits	101,359,059	7,482,768
Expanded withholding taxes	49,003,254	4,989,980
	<u>₱429,529,353</u>	<u>₱48,472,053</u>

Tax Cases and Assessments

As of December 31, 2018, there are no outstanding deficiency tax assessment and tax cases under investigation, litigation nor prosecution in courts or bodies outside the BIR.

