

GROWING EMPOWERING SERVING

ANNUAL
REPORT
2012



Corporate Information

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Our Mission

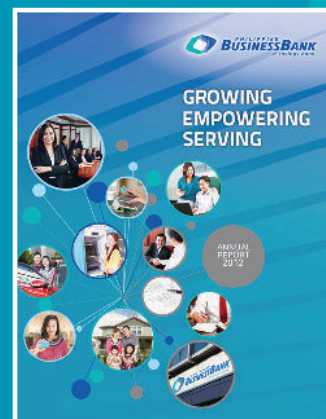
The basis for the Bank's growth shall be our commitment for higher standards everyday, in everything we do in providing competitive products and services and through enthusiastic execution and teamwork in producing satisfaction - for our customers, our shareholders, our associates and our communities.

Our Vision

By making things happen today, Philippine Business Bank will help build strong business communities where people can achieve their dreams.

About the Cover

Philippine Business Bank (PBB) has gained a reputation for growing and empowering business enterprises and people, through a whole spectrum of innovative banking services and expanding network of branches nationwide. All of these define PBB's sterling performance in 2012, making it a bank of choice by small and medium enterprises (SMEs) complementing a wide range of the Bank's fast-growing clientele.



Main Office Branch

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Website: www.pbb.com.ph

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A proud member of
BancNet
Non-Stop Banking Network

Member: PDIC.
Maximum Deposit Insurance for Each Depositor P500,000

Financial Highlights

(Amounts in billions)

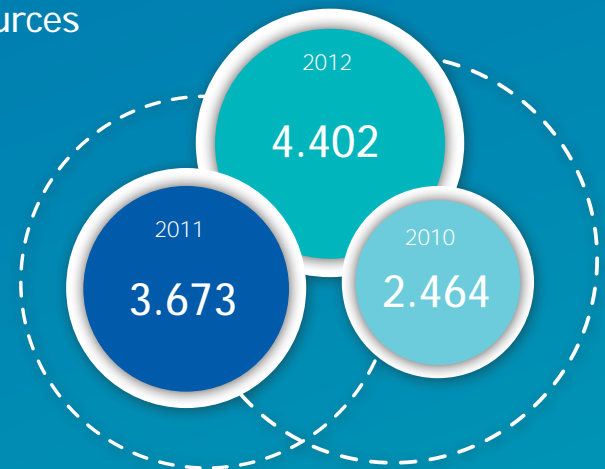
*Net Income in millions



Total Resources



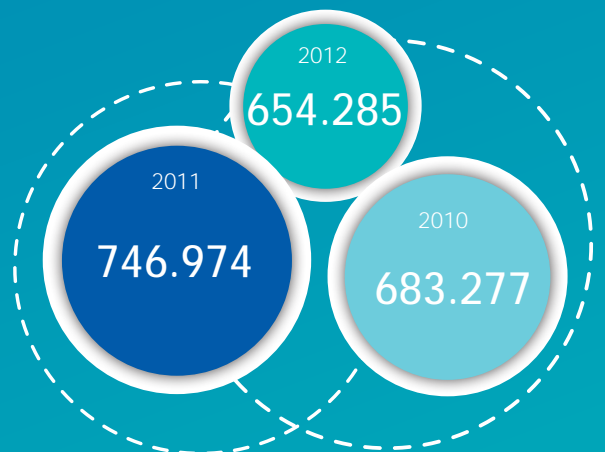
Total Loans



Capital Funds



Total Deposit



Net Income

Letter to Stockholders




Alfredo M. Yao
Chairman Emeritus

The key for PBB is to drive innovation at every level – service, product, brand, nation-wide presence, operations, events, and communications. That's at the core of our growth strategy.

TO OUR SHAREHOLDERS, CUSTOMERS, PARTNERS AND EMPLOYEES:

2012 was a big year for Philippine Business Bank.

Amidst the challenges the bank has faced we are delighted with the success we have achieved and working together to have delivered modest results which positioned PBB for a promising future. Thus, PBB's 15 years of stable growth reflects our passion and commitment to make a big leap in the banking industry. We delivered a good operating performance that puts us in the top tier in our industry while we generated significant operating cash flow.

- With a net income of P654 million, our performance in 2012 is attributed to good interest earnings arising from higher deposits, loan levels, investment portfolio, and noteworthy contribution from trading business and fee-based incomes.
- A significant growth of 25% in the Bank's loan portfolio amounting to P20.869 billion in 2012 was registered.
- PBB also posted a 25% increase in its total deposits amounting to P26.449 billion.
- With PBB's track record of sustaining shareholder value, the bank posted 20% growth as of December 31, 2012, amounting to P 4.402 billion compared to P 3.673 billion from the prior year.
- Our total resources grew significantly by 27% from P25.885B in 2011 to P33.097 this year.
- The Bank's total CAR is 18.86% and the Tier 1 CAR is 18.17%, significantly above the 10 percent minimum requirement of the BSP. This proves that PBB is adequately capitalized to expand its operations.

We delivered these results while preparing a pipeline of products that will be launched in the years ahead.

We use the strength of our portfolio to manage risk and attack our biggest growth opportunities. It's the source of our financial capital. It gives us the scale necessary to drive down costs.

We see huge opportunity to drive growth by executing on our strategy to transform the marketplace. We're on the ground around the country – identifying key markets, connecting with consumers and assessing retail opportunities.

PBB particularly serves the small and medium scale companies or the SMEs.

We partner with them by providing the appropriate financial services that is tailored fit to their needs.

We have invested in the right equipment and technology. PBB's Information Technology (IT) has played a vital role in our business success - the growth in our productivity and acted as a major tool in reaching new markets. By partnering with a leading provider of treasury management solutions, that will be used to manage PBB's entire treasury operation, covering dealing, risk management, settlement, accounting and reporting.

In 2012, we also increased our emphasis on our people—from leadership development to rotational assignments to experiential learning programs. Our people set us apart and attracting, retaining, retraining and developing them remain our biggest advantages and continuing challenges.

The key for PBB is to drive innovation at every level – service, product, brand, nation-wide presence, operations, events, and communications. That's at the core of our growth strategy.

At the end of 2012, PBB has opened 13 branches in Metro Manila and in key cities of the different provincial areas having a total of 78 branch network, operating in strategic locations. To help widen our reach, 25 ATMs were added in the same year, including the one located at the check-in area of Terminal 4, Domestic Airport in Pasay City.

Our expansion program is not only geared to serve clients on the deposit side but also in meeting the needs of the borrowers, individual and corporations with the various products and services PBB can offer. The locations were also deliberately studied to further reach the market PBB has identified. This move will help achieve our commitment to raise the awareness of Filipinos most especially the SMEs.

PBB is poised to transform from a strong savings bank to the next level in banking, with its initial public offering (IPO) to be launched first quarter of 2013. The listing of its shares at the PSE will offer at least 29.5% of its stake to the public.

With this move, PBB can now push through with an aggressive branch expansion plan to complete the targeted 100 branches by the end of 2013.

The expansion plan will cater to the SMEs, the bank's primary target market. PBB is uniquely positioned as the bank of choice of small and medium businesses because of its track record and advocacy of helping these entrepreneurs. Providing them quality customer service is one of our strategies, resulting to loyal, trusting and lasting relationship.

Let us close by saying that this has been another year of satisfactory performance. We added a net income of Php 654 million to you, our shareholders—of that we are proud. Now that Accomplishment with a driven Purpose goes hand in hand, we can see that the evidence is mounting—what is good for the society and what is good for our business are the same thing. We are making progress on all fronts. It is hugely encouraging and, though the backdrop can be difficult, we have the resources, the ingenuity and the desire to keep moving forward successfully. Of that, we are certain. We are "Making things happen for you...today!"




Francis T. Lee
Chairman

Operational Highlights



The Prime Mover

2012 marks Philippine Business Bank's 15th year in the Philippine banking industry. While still in its early stages of banking operations, PBB has surpassed expectations through significant achievements and continuing expansion in branch network nationwide. By all indications, PBB is fast moving to the next level in banking, at the same time remaining ever true to its firm commitment to serve small and medium enterprises (SMEs) and stand as a prime mover in their business growth and stability.



Operational Highlights



PETER N. YAP
Vice Chairman & COO

PBB Participates in BusinessWorld Entrepreneurs Forum

Aiming to nurture the development of small and medium enterprises (SMEs) in the Philippines, BusinessWorld Publishing Corporation has been organizing the BusinessWorld Entrepreneurs Forum since 2005, which primarily intends to provide valuable information and insights on the various aspects and concerns regarding SMEs. The forum was held on April 19, 2012 at the Centennial A of Manila Hotel.

To further reinforce their reputation of being the quintessential business bank for the small and medium enterprises (SMEs), the Philippine Business Bank (PBB) had participated in the 7th year run of the BusinessWorld Entrepreneurs Forum as a platinum sponsor. PBB saw this event as a great opportunity to enhance brand awareness, most especially for their target market—the SMEs.

The said forum was attended by PBB's President and CEO, Mr. Rolando R. Avante, who discussed the Bank's strategies. Also in attendance during the forum were PBB's Vice Chairman and COO, Mr. Peter N. Yap, and some of the Bank's officers namely Anthony Fajardo, Judith Songlingco, Dulce Dy, Queenie Sy, Butch Serrano, and Consorcia Lagunzad, who acted as resource persons during a Q&A portion regarding PBB's banking services.

PBB stays on FIIA 2012's Top 30 for Two Consecutive Years

For two years in a row (in 2011 and 2012), PBB prides itself to be included in the Top 30 banks in the Asia/Pacific Region noted for their banking innovations and achievements by the International Data Group (IDC) Financial Insights.

The IDC Financial Insights Innovation Awards (FIIA) 2012 was held at the Marina Bay Sands, Singapore, last February 29, 2012. FIIA, which is one of the most anticipated banking awards in the Asia-Pacific region, had reduced their rankings from Top 40 to Top 30—making the competition more stringent. Aside from that, the competing entries went up from last year's 153 to 172 this year.

PBB's Information and Technology Group (ITG) and International Banking Group (IBG) last year's entry in the implementation of its Society for Worldwide Interbank Financial Transfers (S.W.I.F.T.) on SaaS, managed to stay and rank 15th among the Top 30 cited technology initiatives. Awarded along with PBB are the three of the country's biggest commercial banks—proving that the Philippine banking industry is progressively rising and is at par with other big international banks.

For PBB, this citation is a testament that the Bank's technology initiatives' capacity to serve its client's needs have gone a notch higher than last year and is now able to compete in the international banking scene.

PBB celebrates their Crystal Anniversary

With fifteen years of successfully rising up to the challenges in the changing banking landscape, PBB celebrated their Crystal Anniversary with much delight and euphoria last February 10, 2012 at the Golden Bay Seafood Restaurant.

The event, entitled "Rising to the Challenge. Focused to Serve.", was attended by more than a thousand of PBB's valued clients, special guests from different corporations, the media, and friends. To jumpstart the celebration, PBB's VP Consorcia G. Lagunzad led the invocation and was followed by a welcome speech from Chairman Francis T. Lee. The event's emcees, Tsinoy TV's Willord Chua and Dorenett Yu, added zest to the affair by showing off their singing talents. PBB employees also had their time under the spotlight as they entertained the guests with dance numbers. The crooner, Mr. Richard Poon, raised the romantic ambiance of the venue as he serenaded the guests with love songs that complemented the night's sumptuous dinner.

Excitement filled the air as the Bank's board members, Mr. Patrick Cheng, and BSP Gov. Amando M. Tetangco drew exciting raffle prizes ranging from Zesto products, gift certificates, LED TVs, and Zest-Air tickets.

Truly, PBB's Crystal Anniversary celebration was an event that speaks volumes about the Bank's fifteen years of successful operations, phenomenal growth, and rising position in the Philippine banking industry.

PBB Opens More Branches

There is no stopping PBB's expansion as it opened 20 new branches in Metro Manila and in key provincial areas. Last May 15, 2012, three new branches were simultaneously opened in areas with a favorable consumer market, namely Sucat, Parañaque; Adriatico, Malate; and Congressional Avenue, Quezon City. Further widening the Bank's reach, 25 ATMs were established all throughout the country. On the last quarter, PBB opened their 76th, 77th, and 78th branch in Salcedo Village-Makati, Tagbilaran City, and Lucena City respectively. And this expansion is only a preview of bigger things to come.

PBB was one of the seven banks that was recently authorized by the Bangko Sentral ng Pilipinas (BSP) to put up branches in eight restricted areas of Metro Manila—Makati,



ROLANDO R. AVANTE
President and CEO

Operational Highlights

Mandaluyong, Manila, Paranaque, Pasay, Pasig, Quezon City, and San Juan.

According to PBB president Rolando Avante, 22 more branches are in the pipeline and are expected to operate in 2013, bringing the total number of PBB branches to 100. Mr. Avante added that this aggressive expansion is not only geared to serve clients on the deposit side but also to meet the needs of borrowers—individual and corporate. This move will help the Bank achieve their goal of reaching out to their target market—the SMEs—and be their bank of choice.

PBB Supports Zest Air's "The Amazing Zest 2012"

With new international itineraries to boast of, PBB's sister company Zest Air showcased its recent product update through a series of events dubbed as "The Amazing Zest 2012". The three-part series was held at Milky Way Café, Makati City, Century Park Hotel, Manila, and Harold's Hotel, Cebu City.

PBB was proud to participate in the said event which highlighted Zest Air's growth and expansion. As a gesture of appreciation, the Bank distributed tokens to all the attendees. Aside from that, the event presented an opportunity for PBB to feature the Bank's ATM Card—the PBB Business Card—which does not only function as a usual ATM card but also provides the convenience for a wide range of services, including the purchase of Zest Air tickets through Bancnet's E-shopping portal.

PCCI Announces Winners of 2012 Alfredo M. Yao Intellectual Property Awards

The Philippine Chamber of Commerce and Industry (PCCI) announced the winners of the 2012 Alfredo M. Yao (AMY) Intellectual Property Awards during the concluding plenary of the 38th Philippine Business Conference and Expo on October 11, 2012 at the historic Manila Hotel. His Excellency, President Benigno S. Aquino III conferred the Awards to the winners together with PCCI President Atty. Miguel B. Varela, 38th PBC Chairman Antonio A. Lopa, and PCCI Chairman Mr. Alfredo M. Yao.

The University of the Philippines Manila won the National AMY IP Award for their entry, "The Diagnosis and Detection of Dengue Virus Infection using Chicken Egg Antibodies," created by the team of Dr. Grace Yu, Ms. Eunice Biteng, Ms. Rhodora Estacio, and Ms. Milagros Leaño.

Ateneo de Manila University won the AMY IP Award for Luzon and NCR for their entry, "Method for Producing Carbon from Glycerol," created by Dr. Erwin Enriquez and Mr. Jerick Imbao.

University of San Carlos won the AMY IP Award for Visayas and Mindanao for their entry, "Integrated Processes in the Treatment of Mango Waste and Recovery of Valuable Products," created by Dr. Evelyn Taboada and Mr. Francis Dave Siacor.

Launched in 2009, the AMY IP Awards is a competition organized by the PCCI in cooperation with the Intellectual Property Office of the Philippines (IPOPHL), geared towards the recognition and development of Filipino-owned intellectual property rights (IPR): owners of patents, utility models, industrial designs, and trademarks which have contributed or have the potential to contribute to economic growth and development.

For this year, the AMY IP Awards focused on inventions created by students, faculty members, inventors, or researchers working within or in collaboration with schools, universities, and Higher Education Institutions (HEIs).

The AMY IP Awards judging was chaired by Atty. Peter Kho, co-chair of the PCCI Intellectual Property Committee. The well-represented panel of judges included Ms. Nora Lacuna, PCCI Vice-President for NCR, Mr. Anton Sayo, PCCI Agriculture Committee member, Director Epifanio Evasco, director of the Bureau of Patents of the IPOPHL, Mr. Robert Dizon, Assistant Secretary of the Department of Science and Technology, and Atty. Julito Vitriolo, Executive Director of the Commission on Higher Education.

Winners were chosen based on the following criteria: Uniqueness and Originality (30 pts.), Readiness for commercialization (40 pts.), Environmental Impact (5 pts.), Social Impact (15 pts.), and Demonstration/Presentation (10 pts.).



Our Clients



True to its reputation of being the bank of choice by small and medium enterprises (SMEs), the Bank will continuously guide MFI through every business endeavors.

MUSAHAMAT FARMS

Famous for its rich produce of fruit variety, Davao City is an ideal fertile ground for fruit growers. Being the biggest financial district in southern Philippines, Davao City has been home to several companies that are engaged in fruit production including Musahamat Farms Incorporated (MFI).

Starting their business in December 2008, MFI is considered a young company involved in the production and export of fresh Cavendish bananas to different countries. Be that as it may, MFI has already established a solid reputation in the Middle East and now in parts of Asia.

But the difference that distinguish MFI from the others in the industry are their commitment to the wellness of Filipinos, the protection of the environment, and creation of jobs and training programs for local residents. The Company's presence in the region has enormously contributed to Davao's business community as well as to the banana production industry.

MFI continues to expand their business in Mabini and Pantukan, Compostella Valley Province, and in Trento, Agusan del Sur.

The Philippine Business Bank (PBB) is all out in supporting the business goals and banking needs of MFI. Since 2009, PBB has been providing MFI with excellent financial services such as clean loan facility, on-line payroll system, and check payment. True to its reputation of being the bank of choice by small and medium enterprises (SMEs), the Bank will continuously guide MFI through every business endeavors.

Our Clients

GENESIS TRANSPORT

For Manilaños, it would seem unusual to see EDSA without hundreds of buses racing their way to a sea of commuters scrambling for that bus ride. That is why when one hears the words “EDSA” and “bus,” countless of nerve-wracking scenes come to mind—from over-speeding buses to yelling conductors, etc. Perhaps, they haven’t tried riding with Genesis Transport.

For 21 years, Genesis Transport has established a name in the Philippine transportation industry by being fervently committed in providing safe, efficient, reliable, and cost effective services in all their routes. Unfazed by their larger contemporaries, Genesis Transport strives to stand out through service excellence—which starts from the acquisition of buses from reputable manufacturers to regular maintenance schedules and proper training of their staff, crew, and drivers.

Planning to operate with a maximum of 25 buses, Genesis Transport saw the great demand for their services and was prompted to expand and increase the number of their fleet. And so Genesis Transport went ahead with the expansion process with the assistance of Philippine Business Bank (PBB).

Since 2007, Genesis Transport has been relying on PBB with their banking needs. This reliance established a strong and personal relationship between the Genesis Transport and the Bank. Ms. Riza Moises, Genesis Transport’s President and General Manager, commends PBB’s fast and hassle-free services. Having a personal relationship with the Bank also helped in finding a solution to her company’s banking needs.

In 2011, PBB was instrumental in Genesis Transport’s acquisition of Dagupan and Saulog. The Bank’s Bus Loan, specially intended for entrepreneurs in the transportation industry, helped finance the Company’s big purchases with the lowest interest possible.

In the next three years, tourism is believed to be the next big industry. Genesis Transport is aiming to further strengthen their tours and charters to be at the forefront of route tourism. PBB will remain a nurturing partner in Genesis Transport’s future growth and continuously support its business plans in the coming years.

PBB will remain a nurturing partner in Genesis Transport’s future growth and continuously support its business plans in the coming years.



Riza A. Moises
President / General Manager



Our Leadership Team



ALFREDO M. YAO
Chairman Emeritus



FRANCIS T. LEE
Chairman



PETER N. YAP
Vice Chairman & COO



ROLANDO R. AVANTE
President and CEO



HONORIO O. REYES-LAO
Director



JEFFREY S. YAO
Director



AMADOR L. VALLEJOS
Director



DR. LETICIA M. YAO
Director



BENJAMIN R. STA. CATALINA, JR.
Independent Director



PATERNO H. DIZON
Independent Director

Our Committees



Alfredo M. Yao
Chairman Emeritus



Francis T. Lee
Chairman
Executive Committee
Asset and Liability Committee
Credit Committee
Trust Committee



Peter N. Yap
Vice Chairman & COO
Executive Committee
Management Committee
Asset and Liability Committee
Credit Committee



Rolando R. Avante
President/CEO
Executive Committee
Management Committee
Asset and Liability Committee
Credit Committee
IT Committee
Trust Committee



Honorio O. Reyes-Lao
Director
Risk Management Committee
Trust Committee



Jeffrey S. Yao
 Director
 Credit Committee
 Audit Committee



Amador T. Vallejos, Jr.
 Director
 IT Committee
 Audit Committee
 Corporate Governance Committee/
 Nomination Committee
 Risk Management Committee



Dr. Leticia M. Yao
 Director
 Trust Committee



Benjamin R. Sta. Catalina, Jr.
 Independent Director
 Audit Committee
 Corporate Governance Committee/
 Nomination Committee
 Risk Management Committee



Paterno H. Dizon
 Independent Director
 Audit Committee
 Corporate Governance Committee/
 Nomination Committee
 Risk Management Committee

Our Committees



Alice P. Rodil
SVP/ Head Comptroller
Executive Committee
Management Committee
Asset and Liability Committee
IT Committee



Raymond T. Co
SVP/ Head of AMG I
Executive Committee
Management Committee
Asset and Liability Committee
IT Committee



Agustin E. Dingle, Jr.
FVP/ Head of Compliance
Management Committee
IT Committee



Felipe V. Friginal
FVP/Head of Branch Banking
Executive Committee
Management Committee
Asset and Liability Committee
IT Committee



Joseph Edwin S. Cabalde
FVP/Treasurer
Management Committee
Asset and Liability Committee



Keith S. Chan
FVP/ Head of Information Technology
Management Committee
IT Committee



Amelita H. Carrillo
VP/ Head of Risk Management
Management Committee
Risk Management Committee



Consorcia Luz G. Lagunzad
VP/Head of Consumer Banking
Management Committee



Eduardo R. Que
VP/Head of AMG III
Management Committee



Joselito D. De Rivera
VP/ Head of AMG II
Management Committee



Francisco M. Lopez
VP/ Head of Human Resources
Management Committee



Jerry C. Lucas
VP/ Head of Branch Operations & Control
Management Committee

Our Committees



Liza Jane T. Yao
VP/ Head of General Services
Management Committee



Manuel C. Valdez
VP/ Head of International Banking
Management Committee



Miami V. Torres
VP/ Head of Credit Services
Management Committee
Credit Committee



Atty. Roberto S. Santos
VP/ Head of Legal
Management Committee



Roselle M. Baltazar
VP/ Head of Central Operations
Management Committee
IT Committee



Efren P. Mercado
AVP/ Head of Branch Lending
Management Committee



Judith C. Songlingco

AVP/ Head of Product Development & Corporate Affairs
Management Committee



Luningning T. Ramos

AVP/ Head of Systems & Methods
Management Committee
IT Committee



Ma. Doris G. de Chavez

AVP/ Head of Credit Review
Management Committee



Teresita S. Sion

AVP/ Head of Trust & Investment
Management Committee
Trust Committee



Laurence R. Rapanut

AVP/ Head of Internal Audit
Management Committee
Audit Committee

Our Products & Services



Deposit Products

Savings Account
Checking Account
ATM
Automatic Transfer Account (ATA)
Payroll Account
Campus Savers (Kiddie Account)
Time Deposit (Regular & 5-Year TD)
FCDU (SA & TD)
Hi-Green Fund

Trust Products and Services

PBB Diamond Fund-a UITF
Living Trust
Trustee of Pre-Need Plans
Escrow Agency
Safekeeping and Depository
Mortgage Trust
Investment Management
Arrangement- Personal or Corporate





Commercial, Industrial, and Developmental Loans

- Bills Purchase
- Term Loan
- Omnibus Line
- Discounting Line
- Trade Finance
- Agricultural Loans
- Specialized Lending Facilities for SMEs
- Floor Stock/ Inventory Financing



Loan Products

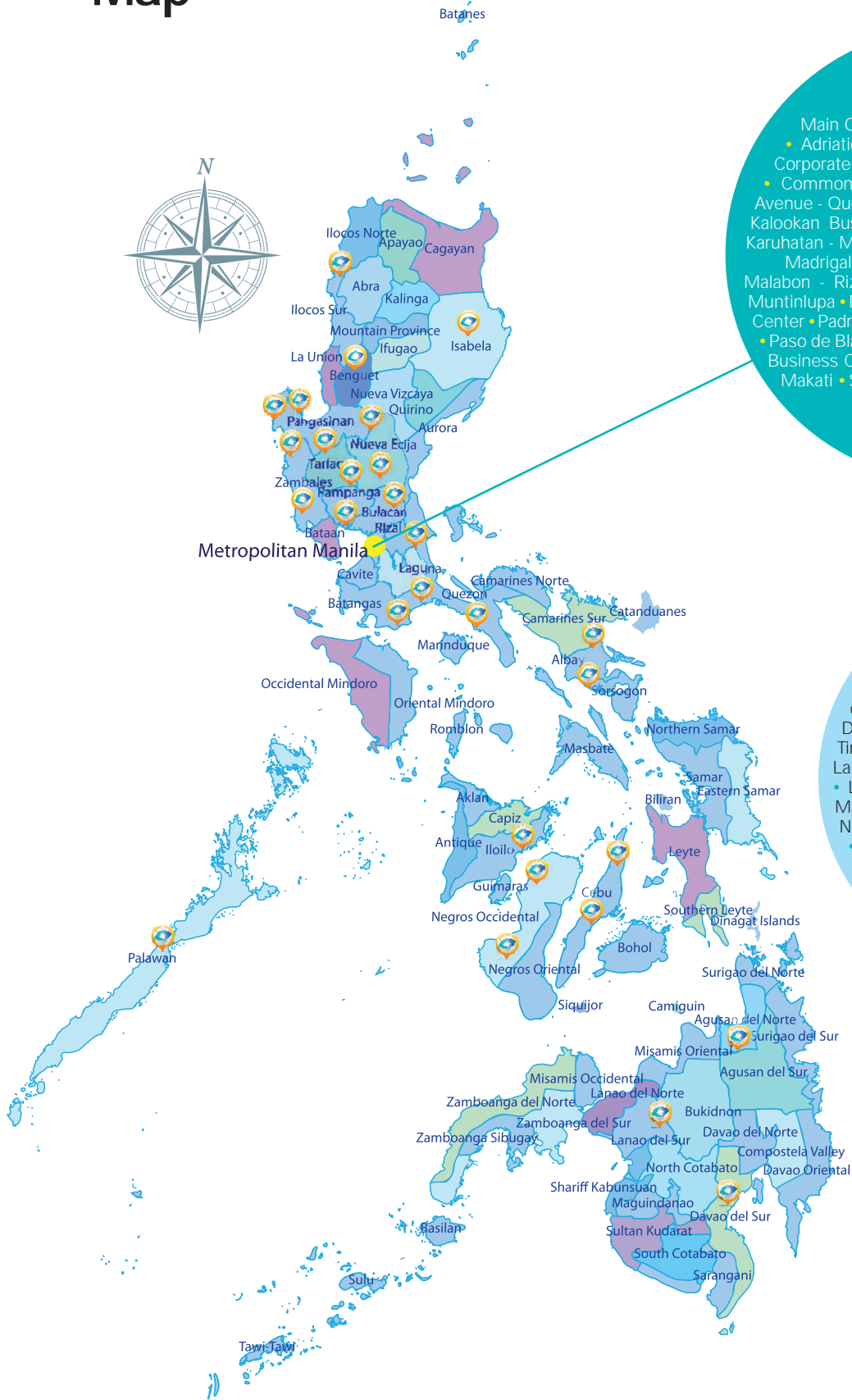
- Auto loan
- Housing Loan
- Bus Loan
- Contract to Sell (CTS)
- Financing Facilities



Other Business Services

- Remittance Service
- Safety Deposit Box Facilities
- Payroll Services
- Manager's Checks/ Gift Checks/ Demand Drafts

Our Location Map



METROPOLITAN MANILA

- Main Office (Caloocan) • A. Mabini C-3
- Adriatico, Malate • Banawe • Binondo Corporate Center • Camarin • Carmen Planas
- Commonwealth - Fairview • Congressional Avenue - Quezon City • Cubao • Del Monte • Edsa-Kalookan Business Center • Elcano • Greenhills • Karuhatan - Malinta • Kaybiga, Caloocan • Las Piñas • Madrigal Business Park Makati • Malabon • Malabon - Rizal Avenue Mandaluyong • Marikina • Muntinlupa • Navotas • Novaliches • Ortigas Business Center • Padre Algue • Pasay • Pasig Blvd. - Kapitolyo • Paso de Blas • Pedro Gil - Paco • Quintin Paredes Business Center • Roosevelt • Salcedo Village, Makati • Samson Road • Sucat, Paranaque • The Fort • Valenzuela • West Avenue

PROVINCE

- Angeles • Antipolo • Bacolod
- Baguio • Bajada, Davao • Baliuag
- Batangas • Cabanatuan • Cagayan de Oro • Cainta • Calamba • Dagupan • Downtown, Cebu City • Gapan • General Tinio • General Santos • Iloilo • Imus • Lapu-Lapu City, Cebu • Legazpi City • Lipa City • Lucena City • Malolos • Mandaue City • Masinag, Antipolo • Meycauayan • Muzon • Naga • Olongapo • Puerto, Princesa Palawan • Sales, Davao • San Fernando, La Union • San Fernando, Pampanga • Sta. Maria, Bulacan • Sta. Rosa, Laguna • Tagbilaran, Bohol • Tarlac • Urdaneta, Pangasinan

NEWLY OPENED BRANCHES

- Roosevelt • Tagbilaran • Lucena City • Puerto Princesa • Pedro Gil Paco • Legazpi City • Salcedo Village Makati

ADDITIONAL OFF-SITE ATM Terminal 4

Check-in area, Terminal 4, Domestic Airport Pasay City

Our Branches

METRO MANILA BRANCHES

Main Office Branch

350 Rizal Ave. Ext cor 8th Ave.,
Grace Park, Caloocan City
Phone: (632) 363-3333
Fax: (632) 363-0291

A. Mabini C-3

200 A. Mabini St.,
Maypajo, Caloocan City
Phone: (632) 287-8895; 287-6621
Fax: (632) 288-1249

Adriatico, Malate

G/F Hostel 1632 Adriatico St.,
Malate, Manila
Phone: (632) 353-3258; 450-1482
Fax: (632) 353-3262

Banawe

Unit 5-7 Solmac Bldg.,
84 Dapitan cor Banawe Sts.,
Sta. Mesa Heights, Quezon City
Phone: (632) 708-5810; 4108656
410-9019
Fax: (632) 410-8656

Binondo Corporate Center

1126 Soler St. Binondo, Manila
Phone: (632) 242-0601; 310-3785
242-7927
Fax: (632) 310-3784

Camarin

Zabarte Town Center,
588 Camarin Rd. cor. Zabarte Rd.
North, Caloocan City
Phone: (632) 962-0160; 962-0627
Fax: (632) 962-0232

Carmen Planas

869 Carmen Planas St. Binondo, Manila
Phone: (632) 245-5083; 245-5066
Fax: (632) 245-5226

Commonwealth - Fairview

G/F Datamex - College of St. Adeline,
Commonwealth, Ave. East Fairview
Park Subd., Quezon City
Phone: (632) 376-9477; 428-7104
Fax: (632) 376-2358

Congressional Avenue - Quezon City

622 Congressional Avenue,
Brgy. Bahay, Toro, Quezon City
Phone: (632) 921-2919; 921-2932
Fax: (632) 453-7242

Cubao

Units D, E, F Timbol Bldg.,
915 Aurora Blvd., Cubao,
Quezon City
Phone: (632) 709-3649
Fax: (632) 709-3695

Del Monte

284-286 Del Monte Ave., Q.C.
Phone: (632) 749-9089; 749-9103
414-2726
Fax: (632) 742-2655

Edsa-Kalookan Business Center

574 Epifanio de los Santos,
EDSA Highway, Kalookan City
Phone: (632) 363-2493/ 0165
Fax: (632) 363-1635

Elcano

730 Elcano ST., Binondo, Manila
Phone: (632) 241-9824; 241-5629
Fax: (632) 241-4287

Greenhills

G/F LGI Bldg, Ortigas Ave.,
Greenhills, San Juan City
Phone: (632) 234-9018; 576-8365
Fax: (632) 234-9016

Karuhatan - Malinta

G/F HPS Bldg., Mac Arthur Highway,
Karuhatan, Valenzuela City
Phone: (632) 444-3688; 922-0898
Fax: (632) 922-0891

Kaybiga, Caloocan

Guilmar Marble Corporation Bldg.,
#297 General Luis Street,
Kaybiga, Caloocan City
Phone: (632) 417-0165; 352-7872
Fax: (632) 352-7791

Las Piñas

Unit 1 & 2 G/F San Beda Commercial,
Zapote Alabang Rd., Las Piñas
Phone: (632) 874-7966; 871-0092
Fax: (632) 875-0589

Madrigal Business Park

Unit 102 G/F Corporate Centre,
1906 Finance Dr. Madrigal Business Park,
Muntinlupa City
Phone: (632) 822-6646; 822-6716
Fax: (632) 822-2706

Makati

137 Yakal Street, Makati City
Phone: (632) 892-6768; 817-5720
892-8498
Fax: (632) 812-4755

Malabon

155 Gov. Pascual Ave.,
Malabon City
Phone: (632) 288-0078; 446-3444
287-7873

Malabon - Rizal Avenue

726 Rizal Ave. Brgy. Tanong,
Malabon City
Phone: 376-1434; 376-1433
447-6044

Mandaluyong

Unit I, Facilities Centre, Shaw Blvd.,
Mandaluyong City
Phone: (632) 470-3244; 718-0103
Fax: (632) 531-3537

Marikina

306 J. P. Rizal St., Sta. Elena,
Marikina City
Phone: (632) 646-5864; 933-3109
Fax: (632) 646-6294

Muntinlupa

G/F Units 1 & 2
50 National Road Putatan,
Muntinlupa City
Phone: (632) 511-7354; 798-0284
Fax: (632) 551-0010

Navotas

North Bay Boulevard,
(Honorio Lopez Blvd.)
Navotas, Metro Manila
Phone: (632) 355-4143; 355-4159
383-1410
Fax: (632) 355-4274

Novaliches

Krystle Bldg., 858 Quirino Highway,
Novaliches, Quezon City
Phone: (632) 936-3467; 938-4038
Fax: (632) 418-3132

Ortigas Business Center

Ortigas Business Center,
#1 Julia Vargas Ave. cor.
Meralco Ave. Brgy. Ugong,
Pasig City
Phone: (632) 570-6862; 914-7032
470-7944
Fax: (632) 570-6863

Padre Algue

1105 F. M. Guerrero Street,
corner Padre Algue Street,
G/F City Square Residences
Tondo, Manila
Phone: (632) 353-7146; 353-7147
353-6695

Our Branches

Pasay

2241 C. K. Sy Bldg.
Taft Ave., Pasay City
Phone: (632) 551-5830
836-7108; 836-7109
Fax: (632) 551-5833

Pasig Blvd. - Kapitolyo

G/F Unit 4 Elements on
Rosemarie Building,
Pasig Boulevard corner
Rosemarie St., Pasig City
Phone: (632) 234-0607; 466-0183
Fax: (632) 234-0608

Paso de Blas

Paso de Blas road cor. P. Santiago St.,
Barangay Paso de Blas, Valenzuela City
Phone: (632) 292-3575; 292-4136
293-1933
Fax: (632) 293-1933

Region 2 Office

294-6239

Pedro Gil - Paco

1077 Pedro Gil Street Paco, Manila
Phone: (632)498-1952

Quintin Paredes Business Center

G/F Downtown Center Bldg.,
Quintin Paredes Street Binondo, Manila
Phone: (632) 242-8039; 242-0871
Fax: 241-7123

Office of the Vice-Chairman

Phone: 522-9594
Local: 5005

Region 1 Office

Phone: 522-5609
BLU 522-5611

Roosevelt

Sun Square Bldg. 323 Roosevelt Avenue,
Brgy. San Antonio, San Francisco Del Monte,
Quezon City
Phone: (632)411-6345; 376-1426
Fax: 376-1135

Salcedo Village, Makati

Unit GDA-1, LPL Center 130 L. P. Leviste St.,
Salcedo Village, Makati City
Phone: (632) 550-2480; 550-2482

Samson Road

117 D & E Samson Road, Caloocan City
Phone: (632) 310-9068; 332- 8506
Fax: (632) 332-9495

Sucab, Parañaque

Unit B-10-A Jaka Plaza Mall,
A. Santos Avenue, Sucab, Parañaque
Phone: (632) 552-2548; 501-6247
Fax: (632) 552-2547

The Fort

Units 104-105 Forbeswood Towers,
Forbestown Center, Rizal Drive cor. Burgos
Circle, Bonifacio Global City, Taguig City
Phone: (632) 856-6653 to 54
Fax: (632) 856-6652
DL: (632) 556-3206

Valenzuela

215 McArthur Highway,
Karuhatan, Valenzuela City
Phone: (632) 443-8113 or 18 292-3296
Fax: (632) 443-9030

West Avenue

No. 53 West Avenue,
Brgy. Paltok, Quezon City
Phone: (632) 709-7109; 411-0355
Fax: (632)709-7110

OFF-SITE ATM

Fiesta Market ATM Center

Market, Market Bonifacio Global, Taguig City

Rugay Maternity Hospital

M. Cruz St. Sabang Baliuag, Bulacan

PROVINCIAL BRANCHES

Angeles

Lot 5 Blk 1 McArthur Highway, Angeles City
Phone: (045) 626-2088 to 89; 888-7205
Fax: (045) 626-2087
Local: 6006

Antipolo

Units 3 & 4 Megathon Bldg., Circumferential
Road, Brgy. San Roque, Antipolo City
Phone: (632) 697-3051 or 54
Fax: (632) 697-3018
Digitel: 630-5186

Bacolod

Philamlife Bacolod Bldg., Lacson St.,
corner Galo Street, Bacolod City
Phone: (034) 435-5745; 435-5734
435-5683
Fax: (034) 435-5744
Local: 6018

Baguio

G/F CTTL Bldg. Abanao Ext., Baguio City
Phone: (074) 447-2692; 447-2694
Fax: (074) 447-2693
Local: 6011

Bajada, Davao

G/F DCCCII Building,
J.P. Laurel Avenue, Davao City
Phone: (082) 222-5146; 300-4386
222-2316
Fax: (082) 300-4385
Local: 5010

Baliuag

B.S. Aquino Ave. Bagong Nayon,
Baliuag, Bulacan
Phone: (044) 673-5216; 673-5452
Fax: (044) 766-3485
Local: 6005

Batangas

Cifra Plaza, No. 114 Rizal Ave. cor. Zamora St.,
Brgy 16, Batangas City
Phone: (043) 702-1162; 702-1182
702-2385
Fax: (043) 425-0053

Cabanatuan

Paco Roman St. Cabanatuan City, Nueva Ecija
Phone: (044) 940-1470; 464-417; 464-7411
Fax: (044) 940-1491
Local: 6009

Cagayan de Oro

Door 1 & 2 Surposa Bldg. 281 Recto Ave.,
Lapasan Highway, Cagayan de Oro City
Phone: (088) 231-6680; 231- 6681
231-6682; 231-6683
Local: 6013

Cainta

Soliven St. cor. Felix Ave., Cainta
Phone: 249-2390; 249-2391
681-1658
Fax: 647-5622

Calamba

G/F Unit 2 Kim-Kat Annex Bldg. Parian,
Calamba City, Laguna
Phone: (049) 508-0059; 545-0980
834-3283
Fax: 420-8207
Local: 6014

Dagupan

Rizal St., Dagupan City, Pangasinan
Phone: (075) 523-4701; 516-2045
523-4781
Fax: (075) 523-4732
Local: 6001

Downtown, Cebu City

G1/F Lianting Bldg. 130,
F. Gonzales Street, Cebu City
Phone: (032) 255-6607; 253-2518
255-6490
Fax: 253-2366
Local: 6015

Gapan

Tinio St. Brgy. San Vicente,
Gapan City, Nueva Ecija
Phone: (044) 486-1439; 486-2437
486-0893
Fax: (044) 862-2437
Local : 6016

General Tinio

Poblacion Central (Papaya),
Gen. Tinio, Nueva Ecija
Phone: (044) 973-0468; 973- 0598
973-0716
Fax: (044) 973-0468
Local: 6017

General Santos

GSC SunCity Suites B-1-03 & B-1-04,
National Highway, General Santos City
Phone: (083) 552-0591; 301-6014
301-6015
Fax: (083) 301-6014

Iloilo

25 Quezon Street, Iloilo City
Phone: (033) 336-5250; 336-5933
336-9086; 336-9472
Fax: (033) 336-9472
Local: 5012

Imus

Aguinaldo Highway, Tanzang Luma,
Imus, Cavite
Phone: (046) 472-3664; 472-3663
Fax: (02) 529-8630
Manila Line: 875-1854
Local: 6019

Laoag

Brgy. 19 J. P. Rizal St., Laoag City
Phone: (077) 772-3027; 772-3041
777-3042; 771-1523

Lapu-Lapu City, Cebu

G/F AMCO Bldg., ML Quezon National Road,
Pajo, Lapu-Lapu City, Cebu
Phone: (032) 495-2831; 236-3018
Fax: (032) 238-8590
Local: 5013

Legazpi City

D' Executive Bldg, Rizal St.Brgy. Tinago,
Legazpi City, Albay
Phone: (052) 736-0011; 736-0019

Lipa City

Units 1, 2, 2 & 4 Trinity Business Centre,
Ayala Highway, Brgy. Balintawak
Lipa City, Batangas
Phone : (043) 455-1020; 706-1310
706-1312
Local : 5016

Lucena City

Quezon Avenue, Lucena City
Phone: (042) 322-0086; 797-1838
7971839; 797-0528

Malolos

Paseo del Congreso Catmon,
Malolos City, Bulacan
Phone: (044) 760-4833 to 36
Fax: (044) 760-4834
Local: 6007

Mandaue City

Unit 1-2 Wireless Plaza Bldg.,
H. Cortes Avenue cor. Hi-way
Seno Subangdaku, Mandaue City
Phone: (032) 345-4462; 345-2657
345-5274; 345-1520
Fax: (032) 345-2657
Local: 5004

Masinag, Antipolo

Unit 104 G/F Rikland Centre,
Marcos Highway, Mayamot, Antipolo City
Phone: 654-6654; 250-2135
Fax: 654-6034

Meycauayan

Medical Plaza Bldg.McArthur Highway,
Banga, Meycauayan, Bulacan
Phone: (044)769-6329; 769-6327

Muzon

807 Luwasan Muzon City of
San Jose del Monte, Bulacan
Phone: (044) 760-4703; 760-4709
691-2141
Fax: 7604711
Local: 5006

Naga

Unit C G/F CBD Plaza Hotel Ninoy and Cory
Avenue,Central Business District II,
Triangulo, Naga City
Phone: (054) 811-2816; 811-2854
811-2193; 473-6303
Fax: (054) 473-6309

Olongapo

2420 Rizal Avenue Brgy East Bajac-Bajac,
Olongapo City
Phone: (047) 222-9949; 222-9950
222-9951; 222-9957

Puerto, Princesa Palawan

New Carlos Building # 271 Rizal Avenue,
Central Business District, Maningning,
Puerto Princesa City, Palawan
Phone: (048) 433-0151; 433-0159
433-0060; 433-0049
Local: 5019

Sales, Davao

Door 7 & 8 JM Bldg.Governor Sales St.,
Davao City
Phone: (082) 222-4281; 2224452
Fax: (082) 222-4457
Local: 5008

San Fernando, La Union

G/F Virginia Bldg. Quezon Ave. cor. Flores St.,
Dominion Bus Terminal, National Highway,
San Fernando City, La Union
Phone: (072)242-0350; 242-0210
242-3836
Fax: (072) 242-0372
Local: 6020

San Fernando, Pampanga

Hyatt Garden Bldg., McArthur Highway,
Dolores, San Fernando, Pampanga
Phone: (045) 961-0524; 961-1854
860-3858
Fax: (045) 961-0523
Local: 6002

Sta. Maria

Angelica Bldg.Gov. F. Halili Ave., Bagbaguin,
Sta. Maria, Bulacan
Phone: (044) 641-2546; 815-3983
288-2713
Fax: 299-6326
Local: 6010

Sta. Rosa, Laguna

#100 Balibago along National Highway, cor.
Roque Lasaga St. Balibago,Sta. Rosa, Laguna
Phone: (049) 534-5622; 534-5627
534-5627; 534-5624
Digitel Line: (049) 837-2324
Local: 6008

Tagbilaran

EB Gallares Building C. P. Garcia Avenue,
Tagbilaran City, Bohol
Phone: (038) 411-0831; 411-0832
411-0837

Tarlac

Liwayway Bldg. F. Tañedo Street, Tarlac City
Phone: (045) 491-1353; 491-1350
491-4795
Fax: (045) 491-1352
Local: 5007

Urdaneta

Unit 1, The Pentagon GNC Bldg.,
Mac Arthur Highway, Nancayasan
Urdaneta, Pangasinan
Phone: (075) 656-3012; 568-5886
568-1073; 656-2108; 568-5876
Fax: (075) 568-5876
Local 6004

Our CSR

Corporate Social Responsibility

Philippine Business Bank (PBB) believes that every business decision and activity entails a responsibility to the community at large. Thus, PBB's objective is strongly guided by their fervent commitment not only to achieve success but also to spur positive change in the lives of underprivileged yet deserving people.

PBB's CSR Unit, Alfredo M. Yao (AMY) Foundation, Inc., had been keen in improving the lives of the less fortunate since its inception in 2003. 2012 had been a fruitful year for the Bank's social arm as they held and joined activities that would further help promote their advocacy on youth and education.

The Bank's success is not solely reflected in their record performance but also in the lives they have uplifted through their various CSR initiatives. To date, AMY Foundation has more than a hundred graduates and close to a hundred existing scholars enrolled in different universities nationwide.

PBB Supports Cortal SQR's Run for Education

Running enthusiasts gathered last May 27, 2012 at the Parade Ground of Quirino Grandstand in Manila to support Cortal SQR's Run & Fly Away from Pain fun run. This event, which is spearheaded by Pharmarex from AMY Group of Companies, aims to raise funds for the benefit of AMY Foundation, Inc.'s academic scholars and various projects.

The successful event was attended by one thousand two hundred running enthusiasts. Among these runners were PBB Vice Chairman and COO Mr. Peter N. Yap and 457 PBB employees who were passionately driven to reach the finish line and be agents of positive change to deserving recipients of the academic support. Aside from the rewarding experience of running for a noble cause, PBB was awarded the "Group Winner" for having the most number of participants in a group.

This proves that the Bank's real strength comes from the compassion and social responsiveness of its employees sharing of themselves in making a difference in the lives of others.

PBB Takes Part at Buildex 2012

Bringing together industry stakeholders in the housing sector, Bulacan Chamber of Commerce and Industry hosted the first ever Bulacan Builders' Exposition which was held at Hiyas Convention Center in Malolos, Bulacan last October 15-17, 2012. PBB proudly took part in the

said event as support to the growing business community in Bulacan.

Also dubbed as Buildex 2012, is the largest exposition for real estate. This event aimed to support the property and construction industry of Bulacan, as well as promote the province as ideal place to live in. The said event drew hundreds of participants with at least eighty exhibitors from the real estate industry, including subdivision development, construction, architecture, interior design services, furniture and decors.

PBB's support in Bulacan's business community is part of the Bank's corporate social responsibility. The Bank believes that the province is a strong market for PBB's products and services and PBB's participation in the said event will further enhance the Bank's corporate image in the province.

AMY Foundation Participates in the 4th Tsinoy National Convention

An opportunity to tap young hearts has presented itself through the 4th Tsinoy National Convention. AMY Foundation proudly participated in the said event which was held last November 30 to December 1, 2012 at the Kaisa-Angelo King Heritage Center, Intramuros, Manila.

Designed to hone Tsinoy youths to be catalysts of positive change among different communities, the Tsinoy National Convention tackles the Tsinoy programs and projects in governance, sustainable development, education, health, and culture. The said event was well-attended by university students, professionals, entrepreneurs, and community leaders. Economist Solita "Mareng Winnie" Monsod opened the convention's sessions with her challenging yet inspiring talk.

Representatives from AMY Foundation were present in the said event to answer all inquiries from the participants, opening doors for possible partnerships with organizations and people who share the same advocacy with the Foundation.

Balik-Eskuwela Project Fuel Young Mind's Love for Education

AMY Foundation's thrusts in community building are guided by Mr. Alfredo Yao's belief in equal opportunity to education, thus the year 2012 was filled with activities that would fulfill Mr. Yao's

vision. The Foundation's Balik-Eskuwela Project has been providing street children and elementary students school kits to fuel their love for education.

To jumpstart the school year, AMY Foundation held its Balik-Eskuwela 2012. This event was made possible through the Foundation's cooperation with Barangay Chairman Dwight Mance and Kagawad Thelma Nicdao. School kits containing basic school supplies such as notebooks, pencils, crayons, and papers were distributed to the Barangay's Nursery and Kindergarten students.

To date, AMY Foundation's Balik-Eskuwela Project has provided more than 1000 street children and elementary students with their basic school necessities.

AMY Foundation Reflects the Spirit of Christmas

The year 2012 was a year of abundance and blessings for PBB. Coincidentally, the Bank's CSR unit—AMY Foundation, is celebrating its 9th year of spearheading positive change to the community. Thus, the Foundation has increased the number of their outreach programs for this year. AMY Foundation's number of activities reached its peak last December 2012 as they sponsored events to bring the Christmas spirit to the less fortunate situated in Caloocan and Manila.

Starting the merriments for the Yuletide Season, Pasko para sa Bata—a Christmas party for the street children—was held last December 8, 2012 in Barangay 74 in Caloocan City. The party was enjoyed by 150 street children as PBB officers and staff from the Bank's Samson Road branch assisted the distribution of meals, toys, and loot bags.

In celebration of Ninos Inocentes Day, another party was held in Barangays 373 and 374 in Sta. Cruz, Manila on December 27, 2012. The AMY Foundation provided the 100 children with scrumptious meals while PBB officers and staff, volunteers, and the Bank's friends from abroad made the event extra-meaningful with their donations. Meanwhile, Galing ng Kababaihan (GK) took charge of all the needed logistics for the said event. In gratitude, the kids from the barangays took time to impress the crowd with their dancing talents.

Lastly, AMY Foundation's helping hand continues to guide Barangay 374, Zone 12, District 1 of Caloocan City (Balik-Eskuwela Project's place) as the Foundation donated 60 school kits containing notebooks, writing pads, pencils, and crayons. These provisions were distributed by Kagawad Thelma Nicdao during the area's Christmas party.



Statement of Management's Responsibility for Financial Statements


The management of **Philippine Business Bank, Inc. A Savings Bank** (the Bank), is responsible for the preparation and fair presentation of the financial statements for the three years ended December 31, 2012, 2011 and 2010, in accordance with financial reporting standards in the Philippines (FRSP) for banks, including the following additional supplemental information filed separately from the basic financial statements:

- a. Supplementary Schedules Required under Annex 68-E of the Securities Regulation Code Rule 68;
- b. Reconciliation of Retained Earnings Available for Dividend Declaration; and,
- c. Schedule of Philippine Financial Reporting Standards and Interpretations Adopted by the Securities and Exchange Commission and the Financial Reporting Standards Council as of December 31, 2012.

Management responsibility on the financial statements includes designing and implementing internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error, selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances.

The Board of Directors reviews and approves the financial statements, and the additional supplementary information, and submits the same to the stockholders.

Punongbayan & Araullo, the independent auditors appointed by the stockholders, has examined the financial statements of the Bank in accordance with Philippine Standards on Auditing and, in its report to the Board of Directors and stockholders, has expressed its opinion on the fairness of presentation upon completion of such examination.



FRANCIS T. LEE
Chairman of the Board



ROLANDO R. AVANTE
President and Chief Executive Officer



ALICE P. RODIL
Senior Vice President and Head Comptroller

Report of Independent Auditors

The Board of Directors and Stockholders
Philippine Business Bank, Inc. A Savings Bank
350 Rizal Avenue Extension corner 8th Avenue
Grace Park, Caloocan City

Report on the Financial Statements

We have audited the accompanying financial statements of Philippine Business Bank, Inc. A Savings Bank, which comprise the statements of financial position as at December 31, 2012, 2011 and 2010, and the statements of income, statements of comprehensive income, statements of changes in equity and statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting standards in the Philippines for banks as described in Note 2 to the financial statements, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Philippine Business Bank, Inc. A Savings Bank as at December 31, 2012, 2011 and 2010, and its financial performance and its cash flows for the years then ended in accordance with financial reporting standards in the Philippines for banks as described in Note 2 to the financial statements.

Report on Other Legal and Regulatory Requirements

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information for the year ended December 31, 2012 required by the Bureau of Internal Revenue as disclosed in Note 28 to the financial statements is presented for purposes of additional analysis and is not a required part of the basic financial statements prepared in accordance with financial reporting standards in the Philippines for banks. Such supplementary information is the responsibility of management. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

PUNONGBAYAN & ARAULLO

By: 
Benjamin P. Valdez
Partner

CPA Reg. Nu. 0028485
TIN 136-619-880
PTR No. 3671439, January 2, 2013, Makati City
SEC Group A Accreditation
Partner - No. 0009-AR-3 (until Dec. 9, 2014)
Firm - No. 0002-FR-3 (until Jan. 18, 2015)
BIR AN 08-002511-11-2011 (until Sept. 22, 2014)
Firm's BOA/PRC Cert. of Reg. No. 0002 (until Dec. 31, 2015)

April 15, 2013

Statements of Financial Position

December 31, 2012, 2011 and 2010
(Amounts in Philippine Pesos)

	Notes	2012	2011	2010
RESOURCES				
CASH AND OTHER CASH ITEMS	7	P 435,898,545	P 297,076,011	P 243,967,572
DUE FROM BANGKO SENTRAL NG PILIPINAS	7	3,073,180,153	1,119,319,376	383,659,746
DUE FROM OTHER BANKS	8	1,000,089,458	630,690,655	385,008,004
FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS	9	-	207,742,896	-
AVAILABLE-FOR-SALE SECURITIES	10	5,784,536,589	5,710,865,520	6,623,022,640
LOANS AND OTHER RECEIVABLES - Net	11	20,869,152,721	16,704,655,545	13,369,671,794
BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT - Net	12	398,495,157	340,824,112	320,370,895
INVESTMENT PROPERTIES - Net	13	549,237,420	397,393,144	282,528,711
OTHER RESOURCES - Net	14	<u>986,674,737</u>	<u>476,251,433</u>	<u>506,994,058</u>
TOTAL RESOURCES		<u>P 33,097,264,780</u>	<u>P 25,884,818,692</u>	<u>P 22,115,223,420</u>
LIABILITIES AND EQUITY				
DEPOSIT LIABILITIES	15			
Demand		P 366,102,479	P 318,440,285	P 403,363,157
Savings		8,569,873,133	8,733,282,429	8,870,638,774
Time		<u>17,512,911,126</u>	<u>12,143,265,403</u>	<u>8,313,404,494</u>
Total Deposit Liabilities		26,448,886,738	21,194,988,117	17,587,406,425
BILLS PAYABLE	16	765,489,517	121,482,599	1,213,002,192
ACCRUED EXPENSES AND OTHER LIABILITIES	17	<u>1,480,537,015</u>	<u>895,612,333</u>	<u>850,971,692</u>
Total Liabilities		28,694,913,270	22,212,083,049	19,651,380,309
EQUITY	18	<u>4,402,351,510</u>	<u>3,672,735,643</u>	<u>2,463,843,111</u>
TOTAL LIABILITIES AND EQUITY		<u>P 33,097,264,780</u>	<u>P 25,884,818,692</u>	<u>P 22,115,223,420</u>

See Notes to Financial Statements.

Statements of Income

For the Years Ended December 31, 2012, 2011 and 2010
(Amounts in Philippine Pesos)

	Notes	2012	2011 (As Restated - See Note 18)	2010 (As Restated - See Note 18)
INTEREST INCOME				
Loans and other receivables	11	P 1,284,470,654	P 1,031,440,553	P 1,082,179,944
Investment and trading securities	9, 10	346,975,551	547,812,982	231,480,010
Securities purchased under reverse repurchase agreements	11	52,927,125	59,436,144	30,144,778
Due from Bangko Sentral ng Pilipinas and other banks	7, 8	<u>22,489,319</u>	<u>19,281,830</u>	<u>15,037,573</u>
		<u>1,706,862,649</u>	<u>1,657,971,509</u>	<u>1,358,842,305</u>
INTEREST EXPENSE				
Deposit liabilities	15	608,049,195	536,224,396	400,269,297
Bills payable	16	<u>25,917,742</u>	<u>36,235,312</u>	<u>48,625,871</u>
		<u>633,966,937</u>	<u>572,459,708</u>	<u>448,895,168</u>
NET INTEREST INCOME		1,072,895,712	1,085,511,801	909,947,137
IMPAIRMENT LOSSES	11, 13	<u>72,417,710</u>	<u>50,000,000</u>	<u>199,320,155</u>
NET INTEREST INCOME AFTER IMPAIRMENT LOSSES		<u>1,000,478,002</u>	<u>1,035,511,801</u>	<u>710,626,982</u>
OTHER INCOME				
Trading gains - net	9, 10, 11	713,001,287	594,880,835	608,212,620
Service charges, fees and commissions		67,727,501	65,543,065	113,694,316
Miscellaneous	19	<u>104,216,068</u>	<u>102,527,458</u>	<u>58,810,180</u>
		<u>884,944,856</u>	<u>762,951,358</u>	<u>780,717,116</u>
OTHER EXPENSES				
Salaries and other employee benefits	20	322,525,023	255,380,658	211,786,006
Taxes and licenses	28	223,137,873	178,324,986	170,294,814
Management and other professional fees		94,039,960	91,047,068	87,208,614
Depreciation and amortization	12, 13, 14	77,573,667	63,197,800	49,076,217
Insurance		61,805,245	47,580,555	40,960,409
Representation and entertainment		23,656,561	23,829,965	18,478,070
Miscellaneous	19	<u>371,967,383</u>	<u>292,566,630</u>	<u>227,518,674</u>
		<u>1,174,705,712</u>	<u>951,927,662</u>	<u>805,322,804</u>
PROFIT BEFORE TAX		710,717,146	846,535,497	686,021,294
TAX EXPENSE	22	<u>56,431,793</u>	<u>99,561,375</u>	<u>2,744,217</u>
NET PROFIT		<u>P 654,285,353</u>	<u>P 746,974,122</u>	<u>P 683,277,077</u>
Earnings Per Share	27			
Basic		<u>P 2.29</u>	<u>P 3.09</u>	<u>P 2.82</u>
Diluted		<u>P 2.29</u>	<u>P 3.09</u>	<u>P 2.82</u>

See Notes to Financial Statements.

Statements of Comprehensive Income

For the Years Ended December 31, 2012, 2011 and 2010
(Amounts in Philippine Pesos)

	Note	<u>2012</u>	<u>2011</u>	<u>2010</u>
NET PROFIT		P <u>654,285,353</u>	P <u>746,974,122</u>	P <u>683,277,077</u>
OTHER COMPREHENSIVE INCOME				
Fair value gain on available-for-sale securities during the year - net	10	185,130,710	467,638,969	45,184,502
Fair value loss (gain) recycled to profit or loss	10	<u>(384,450,196)</u>	<u>(5,720,559)</u>	<u>20,885,122</u>
		<u>(199,319,486)</u>	<u>461,918,410</u>	<u>66,069,624</u>
TOTAL COMPREHENSIVE INCOME		P <u><u>454,965,867</u></u>	P <u><u>1,208,892,532</u></u>	P <u><u>749,346,701</u></u>

See Notes to Financial Statements.

Statements of Changes in Equity

For the Years Ended December 31, 2012, 2011 and 2010
(Amounts in Philippine Pesos)

	Capital Stock (See Note 18)		Surplus (See Note 18)		Unrealized Fair Value Gains (Losses) on Available-for-sale Securities (See Note 10)	Total Equity
	Preferred Stock	Common Stock	Appropriated	Unappropriated		
BALANCE AS OF JANUARY 1, 2012	P 245,000,000	P 420,000,000	P 277,564	P 2,485,562,793	P 521,895,286	P 3,672,735,643
Appropriation for trust reserves	-	-	595,934	(595,934)	-	-
Collection of subscription receivable	375,000,000	-	-	-	-	375,000,000
Stock dividends	-	2,000,000,000	-	(2,000,000,000)	-	-
Cash dividends	-	-	-	(100,350,000)	-	(100,350,000)
Total comprehensive income (loss)	-	-	-	654,285,353	(199,319,486)	454,965,867
BALANCE AS OF DECEMBER 31, 2012	<u>P 620,000,000</u>	<u>P 2,420,000,000</u>	<u>P 873,498</u>	<u>P 1,038,902,212</u>	<u>P 322,575,800</u>	<u>P 4,402,351,510</u>
BALANCE AS OF JANUARY 1, 2011	P 245,000,000	P 420,000,000	-	P 1,738,866,235	P 59,976,876	P 2,463,843,111
Appropriation for trust reserves	-	-	277,564	(277,564)	-	-
Total comprehensive income	-	-	-	746,974,122	461,918,410	1,208,892,532
BALANCE AS OF DECEMBER 31, 2011	<u>P 245,000,000</u>	<u>P 420,000,000</u>	<u>P 277,564</u>	<u>P 2,485,562,793</u>	<u>P 521,895,286</u>	<u>P 3,672,735,643</u>
BALANCE AS OF JANUARY 1, 2010	P 245,000,000	P 420,000,000	P 120,000,000	P 935,589,158	(P 6,092,748)	P 1,714,496,410
Appropriation for trust reserves	-	-	(120,000,000)	120,000,000	-	-
Total comprehensive income	-	-	-	683,277,077	66,069,624	749,346,701
BALANCE AS OF DECEMBER 31, 2010	<u>P 245,000,000</u>	<u>P 420,000,000</u>	<u>P -</u>	<u>P 1,738,866,235</u>	<u>P 59,976,876</u>	<u>P 2,463,843,111</u>

See Notes to Financial Statements.

Statements of Cash Flows

For the Years Ended December 31, 2012, 2011 and 2010
(Amounts in Philippine Pesos)

	Notes	2012	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES				
Profit before tax	P	710,717,146	P 846,535,497	P 686,021,294
Adjustments for:				
Depreciation and amortization	12, 13, 14	77,573,667	63,197,800	49,076,217
Impairment losses	11, 13	72,417,710	50,000,000	199,320,155
Loss (gain) on sale of properties - net	19	(12,226,663)	(9,199,762)	11,838,992
Gain on foreclosure - net	19	(1,018,455)	(32,028,960)	(9,096,006)
Operating profit before working capital changes		847,463,405	918,504,575	937,160,652
Decrease (increase) in financial assets at fair value through profit or loss		207,742,896	(207,742,896)	-
Increase in loans and other receivables		(7,269,632,998)	(1,933,185,215)	(1,180,853,654)
Decrease (increase) in other resources		(477,888,382)	43,823,968	32,418,175
Increase in deposit liabilities		5,253,898,621	3,607,581,692	4,904,643,951
Increase (decrease) in accrued expenses and other liabilities		594,039,215	64,639,680	(288,486,569)
Cash generated from (used in) operations		(844,377,243)	2,493,621,804	4,404,882,555
Cash paid for income taxes		(98,405,502)	(132,455,753)	(96,281,826)
Net Cash From (Used in) Operating Activities		(942,782,745)	2,361,166,051	4,308,600,729
CASH FLOWS FROM INVESTING ACTIVITIES				
Acquisition of available-for-sale (AFS) securities	10	(13,528,772,418)	(10,977,153,805)	(21,905,757,726)
Proceeds from sale of AFS securities	10	13,255,781,863	12,351,229,335	18,573,608,137
Proceeds from sale of investment and other properties	13, 14	128,569,761	47,147,364	40,651,005
Net acquisitions of bank premises, furniture, fixtures and equipment	12	(123,371,264)	(71,418,634)	(39,122,345)
Net payment for merger consideration		-	-	(15,005,533)
Net Cash From (Used In) Investing Activities		(267,792,058)	1,349,804,260	(3,345,626,462)
CASH FLOWS FROM FINANCING ACTIVITIES				
Net borrowings (payments) of bills payable		644,006,917	(1,091,519,591)	(1,711,644)
Collection of subscription receivable	18	375,000,000	-	-
Payment of cash dividends	18	(100,350,000)	-	-
Net Cash From (Used in) Financing Activities		918,656,917	(1,091,519,591)	(1,711,644)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		(291,917,886)	2,619,450,720	961,262,623
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR				
Cash and other cash items	6	297,076,011	243,967,572	192,825,023
Due from Bangko Sentral ng Pilipinas	6	1,119,319,376	383,659,746	207,555,347
Due from other banks	8	630,690,655	385,008,004	202,992,329
Securities purchased under reverse repurchase agreements	11	2,754,000,000	1,169,000,000	617,000,000
		4,801,086,042	2,181,635,322	1,220,372,699
CASH AND CASH EQUIVALENTS AT END OF THE YEAR				
Cash and other cash items	7	435,898,545	297,076,011	243,967,572
Due from Bangko Sentral ng Pilipinas	7	3,073,180,153	1,119,319,376	383,659,746
Due from other banks	8	1,000,089,458	630,690,655	385,008,004
Securities purchased under reverse repurchase agreements	11	-	2,754,000,000	1,169,000,000
		P 4,509,168,156	P 4,801,086,042	P 2,181,635,322

Supplemental Information on Noncash Operating, Investing and Financing Activities

- (1) In 2012, the Bank's stockholders approved the declaration of stock dividends amounting to P2.0 billion. This was distributed to stockholders in the same year (see Note 18).
- (2) Transfers from loans and other receivables to investment properties as a result of foreclosures amounted to P279.0 million, P127.9 million and P16.1 million in 2012, 2011 and 2010, respectively (see Note 13), while transfers from loans and other receivables to other resources in 2012, 2011 and 2010 are disclosed in Note 14. Amounts mentioned were exclusive of gains on foreclosure amounting to P1.0 million, P32.0 million and P9.1 million in 2012, 2011 and 2010, respectively (see Note 19).
- (3) The fair values of the resources and liabilities of Kabalikang Rural Bank, Inc. that were absorbed by the Bank on March 3, 2010 were P25.3 million and P59.1 million, respectively (see Note 14).

See Notes to Financial Statements.

Notes to Financial Statements

December 31, 2012, 2011 and 2010
(Amounts in Philippine Pesos, Except Per Share Data or As Indicated)

1. CORPORATE MATTERS

1.01 Incorporation and Operations

Philippine Business Bank, Inc. A Savings Bank (the Bank or PBB) was incorporated in the Philippines on January 28, 1997 to engage in the business of thrift banking. It was authorized to engage in foreign currency deposit operations on August 27, 1997 and in trust operations on November 13, 2003. As a banking institution, the Bank's operations are regulated and supervised by the Bangko Sentral ng Pilipinas (BSP). In this regard, the Bank is required to comply with rules and regulations of the BSP such as those relating to adoption and use of safe and sound banking practices as promulgated by the BSP.

As of December 31, 2012 and 2011, the Bank operates within the Philippines with 79 and 65 branches, respectively, located nationwide. For the years ended December 31, 2012 and 2011, 14 and 10 branches, respectively, were opened.

The Bank's registered address, which is also its principal place of business, is at 350 Rizal Avenue Extension corner 8th Avenue, Grace Park, Caloocan City.

As indicated in Note 23, the Bank's unissued common shares were subsequently approved for initial public offering and were listed at the main board of the Philippine Stock Exchange (PSE) on February 19, 2013.

1.02 Approval of the Financial Statements

The financial statements of the Bank as of and for the year ended December 31, 2012 (including the comparatives for the years ended December 31, 2011 and 2010) were authorized for issue by the Board of Directors (BOD) on April 15, 2013.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies that have been used in the preparation of these financial statements are summarized below and in the succeeding pages. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.01 Basis of Preparation of Financial Statements

(a) Statement of Compliance with Financial Reporting Standards in the Philippines for Banks

The financial statements of the Bank have been prepared in accordance with the financial reporting standards in the Philippines (FRSP) for banks. FRSP for banks are similar to Philippine Financial Reporting Standards (PFRS), except for the reclassification of certain financial assets previously classified under available-for-sale (AFS) securities due to the tainting of held-to-maturity (HTM) portfolio to HTM category, which are not allowed under PFRS, but allowed under FRSP as permitted by the BSP for prudential regulation, and by the Securities and Exchange Commission (SEC) for financial reporting purposes.

Under PFRS, the Bank is not allowed to classify financial assets under HTM investments for at least two years upon tainting of its investments in 2006. However, in 2008, the Bank reclassified financial assets previously classified as AFS securities due to tainting of HTM investments portfolio back to HTM category for prudential reporting purposes (see Note 10) as allowed under FRSP. The unamortized fair value gains related to debt securities previously reclassified from AFS securities to HTM investments amounted to P0.2 million, P0.5 million and P2.7 million for 2012, 2011 and 2010, respectively.

PFRS are adopted by the Financial Reporting Standards Council from the pronouncements issued by the International Accounting Standards Board (IASB).

These financial statements have been prepared using the measurement bases specified by PFRS for each type of resource, liability, income and expense. The measurement bases are more fully described in the accounting policies in the succeeding pages.

(b) Presentation of Financial Statements

The financial statements are presented in accordance with Philippine Accounting Standard (PAS) 1, *Presentation of Financial Statement*. The Bank presents the "Statement of Comprehensive Income" in two statements: a "Statement of Income" and a "Statement of Comprehensive Income".

Two comparative periods are presented for the statement of financial position when the Bank applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements, or reclassifies items in the financial statements.

In 2012, the Bank presented two comparative periods for the statements of financial position due to reclassification of the interest income previously presented as Interest Income from Investment and Trading Securities to Interest Income from Loans and Other Receivables. The reclassification did not result in any adjustment to the beginning balance of surplus in all the years presented (see Note 18.03).

Also, in 2012, the Company early adopted PAS 1 (Amendment), *Presentation of Financial Statements – Clarification of the Requirements for Comparative Information*, which is mandatorily effective for annual periods beginning January 1, 2013. Accordingly, as allowed under this amendment, the comparative note disclosures to the 2010 statement of financial position were no longer presented [see Note 2.02 (c)].

(c) *Functional and Presentation Currency*

These financial statements are presented in Philippine pesos, the Bank's functional and presentation currency, and all values represent absolute amounts except when otherwise indicated.

Items included in the financial statements of the Bank are measured using its functional currency. Functional currency is the currency of the primary economic environment in which the Bank operates. The financial statements of the Bank's foreign currency deposit unit (FCDU) which is reported in its functional currency, the United States (US) dollars, are translated using the closing exchange rate (for the statement of financial position accounts) and average exchange rate during the year (for profit and loss accounts).

2.02 Adoption of New and Amended PFRS

(a) *Effective in 2012 that are Relevant to the Bank*

In 2012, the Bank adopted the following amendments to PFRS that are relevant to the Bank and effective for financial statements for the annual period beginning on or after July 1, 2011 or January 1, 2012:

PFRS 7 (Amendment)	:	Financial Instruments: Disclosures – Transfers of Financial Assets
PAS 12 (Amendment)	:	Income Taxes – Deferred Tax: Recovery of Underlying Assets

Discussed below are the relevant information about these amended standards.

- (i) PFRS 7 (Amendment), *Financial Instruments: Disclosures – Transfers of Financial Assets*. The amendment requires additional disclosures that will allow users of financial statements to understand the relationship between transferred financial assets that are not derecognized in their entirety and the associated liabilities; and, to evaluate the nature of, and risk associated with any continuing involvement of the reporting entity in financial assets that are derecognized in their entirety. The Bank did not transfer any financial asset involving this type of arrangement; hence, the amendment did not result in any significant change in the Bank's disclosures in its financial statements.
- (ii) PAS 12 (Amendment), *Income Taxes – Deferred Tax: Recovery of Underlying Assets*. The amendment introduces a rebuttable presumption that the measurement of a deferred tax liability or asset that arises from investment property measured at fair value under PAS 40, *Investment Property* should reflect the tax consequence of recovering the carrying amount of the asset entirely through sale. The presumption is rebutted for depreciable investment property (e.g., building) that is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the asset over time, rather than through sale. Moreover, Standing Interpretation Committee 21, *Income Taxes – Recovery of Revalued Non-Depreciable Assets*, is accordingly withdrawn and is incorporated under PAS 12 requiring that deferred tax on non-depreciable assets that are measured using the revaluation model in PAS 16, *Property, Plant and Equipment* should always be measured on a sale basis of the asset. The amendment has no significant impact on the Bank's financial statements as the Bank's investment properties and land classified as bank premises, furniture, fixture, and equipment are measured at cost.

(b) *Effective in 2012 that is not Relevant to the Bank*

PFRS 1, *First-time Adoption of PFRS*, was amended to provide relief for first-time adopters of PFRS from having to reconstruct transactions that occurred before the date of transition to PFRS and to provide guidance for entities emerging from severe hyperinflation either to resume presenting PFRS financial statements or to present PFRS financial statements for the first time. The amendment became effective for annual periods beginning on or after July 1, 2011 but is not relevant to the Bank's financial statements.

(c) *Early Adoption of PAS 1 (Amendment), Presentation of Financial Statements*

In the preparation of the 2012 financial statements, the Bank adopted PAS 1 (Amendment), *Presentation of Financial Statements – Clarification of the Requirements for Comparative Information*, which is mandatorily effective from January 1, 2013. The amendment clarifies the requirements for presenting comparative information for the following:

- Requirements for the opening statement of financial position

If an entity applies an accounting policy retrospectively, or makes a retrospective restatement or reclassification of items that has a material effect on the information in the statement of financial position at the beginning of the preceding period (i.e., opening statement of financial position), it shall present such third statement of financial position.

Other than disclosure of certain specified information in Note 18.03, related notes to the opening statement of financial position as at the beginning of the preceding period are not required to be presented.

- Requirements for additional comparative information beyond minimum requirements

If an entity presented comparative information in the financial statements beyond the minimum comparative information requirements, the additional financial statements information should be presented in accordance with PFRS including disclosure of comparative information in the related notes for that additional information. Presenting additional comparative information voluntarily would not trigger a requirement to provide a complete set of financial statements.

In 2012, the Bank presented only two comparative periods in the notes to financial position accounts as a result of the early adoption of this amendment. The Bank presented the Statement of Comprehensive Income, Statement of Cash Flows and Statement of Changes in Equity for the three most recent completed fiscal years, in accordance with the requirements of the Securities Regulation Code Rule 68, as amended.

(d) *Effective Subsequent to 2012 but not Adopted Early*

There are new PFRS, amendments, annual improvements and interpretation to existing standards that are effective for periods subsequent to 2012. Management has initially determined the following pronouncements, which the Bank will apply in accordance with their transitional provisions, to be relevant to its financial statements.

- (i) PAS 1 (Amendment), *Financial Statements Presentation – Presentation of Items of Other Comprehensive Income* (effective from July 1, 2012). The amendment requires an entity to group items presented in Other Comprehensive Income into those that, in accordance with other PFRS: (a) will not be reclassified subsequently to profit or loss; and, (b) will be reclassified subsequently to profit or loss when specific conditions are met. The Bank's management expects that this will not affect the presentation of items in other comprehensive income since the Bank's other comprehensive income only includes unrealized fair value gains or losses on AFS securities which can be reclassified to profit or loss when specified conditions are met.
- (ii) PAS 19 (Revision), *Employee Benefits* (effective from January 1, 2013). The revision made a number of changes as part of the improvements throughout the standard. The main changes relate to defined benefit plans as follows:
 - eliminates the corridor approach under the existing guidance of PAS 19 and requires an entity to recognize all gains and losses arising in the reporting period;
 - streamlines the presentation of changes in plan assets and liabilities resulting in the disaggregation of changes into three main components of service costs, net interest on net defined benefit obligation or asset, and remeasurement; and,
 - enhances disclosure requirements, including information about the characteristics of defined benefit plans and the risks that entities are exposed through participation in those plans.

Currently, the Bank is using the corridor approach and its unrecognized actuarial loss as of December 31, 2012 amounted to P22.4 million (see Note 20.02) which will be retrospectively recognized as loss in other comprehensive income in 2013.

- (iii) PFRS 7 (Amendment), *Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities* (effective from January 1, 2013). The amendment requires qualitative and quantitative disclosures relating to gross and net amounts of recognized financial instruments that are set-off in accordance with PAS 32, *Financial Instruments: Presentation*. The amendment also requires disclosure of information about recognized financial instruments which are subject to enforceable master netting arrangements or similar agreements, even if they are not set-off in the statement of financial position, including those which do not meet some or all of the offsetting criteria under PAS 32 and amounts related to a financial collateral. These disclosures will allow financial statement users to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with recognized financial assets and financial liabilities on the Bank's financial position. The Bank is yet to assess the impact of this new standard.
- (iv) PFRS 13, *Fair Value Measurement* (effective from January 1, 2013). This standard aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across PFRS. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards. Management is in the process of reviewing its valuation methodologies for conformity with the new requirements and has yet to assess the impact of the new standard on the Bank's financial statements
- (v) PAS 32 (Amendment), *Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities* (effective from January 1, 2014). The amendment provides guidance to address inconsistencies in applying the criteria for offsetting financial assets and financial liabilities. It clarifies that a right of set-off is required to be legally enforceable in the normal course of business; in the event of default and in the event of insolvency or bankruptcy of the entity and all of the counterparties. The amendment also clarifies the principle behind net settlement and includes an example of a gross settlement system with characteristics that would satisfy the criterion for net settlement. The Bank does not expect this amendment to have a significant impact on its financial statements.

- (vi) PFRS 9, *Financial Instruments: Classification and Measurement* (effective from January 1, 2015). This is the first part of a new standard on financial instruments that will replace PAS 39, *Financial Instruments: Recognition and Measurement*, in its entirety. This chapter covers the classification and measurement of financial assets and financial liabilities and it deals with two measurement categories for financial assets: amortized cost and fair value. All equity instruments will be measured at fair value while debt instruments will be measured at amortized cost only if the entity is holding it to collect contractual cash flows which represent payment of principal and interest. The accounting for embedded derivatives in host contracts that are financial assets is simplified by removing the requirement to consider whether or not they are closely related, and, in most arrangement, does not require separation from the host contract.

For liabilities, the standard retains most of the PAS 39 requirements which include amortized cost accounting for most financial liabilities, with bifurcation of embedded derivatives. The main change is that, in case where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than in profit or loss, unless this creates an accounting mismatch.

To date, other chapters of PFRS 9 dealing with impairment methodology and hedge accounting are still being completed.

Further, in November 2011, the IASB tentatively decided to consider making limited modifications to International Financial Reporting Standard (IFRS) 9's financial asset classification model to address certain application issues.

The Bank does not expect to implement and adopt PFRS 9 until its effective date or until all chapters of this new standard have been published. In addition, management is currently assessing the impact of PFRS 9 on the financial statements of the Bank and it plans to conduct a comprehensive study of the potential impact of this standard prior to its mandatory adoption date to assess the impact of all changes.

- (vii) 2009-2011 Annual Improvements to PFRS. Annual improvements to PFRS (2009-2011 Cycle) made minor amendments to a number of PFRS, which are effective for annual period beginning on or after January 1, 2013. Among those improvements, only PAS 32 (Amendment), *Financial Instruments – Presentation – Tax Effect of Distributions to Holders of Equity Instruments*, is relevant to the Company but management does not expect a material impact on the Company's financial statements:

The amendment clarifies that the consequences of income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction shall be accounted for in accordance with PAS 12. Accordingly, income tax relating to distributions to holders of an equity instrument is recognized in profit or loss while income tax related to the transaction costs of an equity transaction is recognized in equity.

2.03 Business Combinations

Business acquisitions are accounted for using the acquisition method of accounting.

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of a business combination over the Bank's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Subsequent to initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed (see Note 2.16).

Negative goodwill which is the excess of the Bank's interest in the net fair value of net identifiable assets acquired over acquisition cost is charged directly to income.

For the purpose of impairment testing, goodwill is allocated to cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose. The cash-generating units or groups of cash-generating units are identified according to operating segment.

If the business combination is achieved in stages, the acquirer is required to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognize the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate.

Any contingent consideration to be transferred by the Bank is recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognized in accordance with PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, either in profit or loss or as a change to other comprehensive income. Contingent consideration that is classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

2.04 Segment Reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Bank's chief operating decision-maker. The chief operating decision-maker is responsible for allocating resources and assessing performance of the operating segments.

In identifying its operating segments, management generally follows the Bank's products and services as disclosed in Note 6.

Each of these operating segments is managed separately as each of these services requires different technologies and resources as well as marketing approaches. All inter-segment transfers are carried out at arm's length prices.

The measurement policies of the Bank used for segment reporting under PFRS 8, *Operating Segments*, is the same as those used in its financial statements. In addition, corporate resources which are not directly attributable to the business activities of any operating segment are not allocated to a segment.

There have been no changes from prior periods in the measurement methods used to determine reported segment profit or loss.

The Bank's operations are organized according to the nature of the products and services provided. Financial performance on operating segments is presented in Note 6.

2.05 Financial Instruments

2.05.01 Financial Assets

Financial assets, which are recognized when the Bank becomes a party to the contractual terms of the financial instrument, include cash and other financial instruments. Financial assets other than those designated and effective as hedging instruments are classified into the following categories: financial assets at fair value through profit or loss (FVTPL), loans and receivables, held-to-maturity (HTM) investments and AFS securities. Financial assets are assigned to the different categories by management on initial recognition, depending on the purpose for which the investments were acquired. The designation of financial assets is re-evaluated at every reporting date at which date a choice of classification or accounting treatment is available, subject to compliance with specific provisions of applicable accounting standards.

Regular purchases and sales of financial assets are recognized on their trade date. All financial assets that are not classified as at FVTPL are initially recognized at fair value, plus any directly attributable transaction costs. Financial assets carried at FVTPL are initially recognized at fair value and transaction costs related to it are recognized in profit or loss.

The foregoing categories of financial instruments of the Bank are more fully described below.

(a) Financial Assets at FVTPL

This category includes financial assets that are either classified as held for trading or that meets certain conditions and are designated by the Bank to be carried at FVTPL upon initial recognition. All derivatives fall into this category, except for those designated and effective as hedging instruments.

Financial assets at FVTPL are measured at fair value, and changes therein are recognized in profit or loss. Financial assets (except derivatives and financial instruments originally designated as financial assets at FVTPL) may be reclassified out of fair value through profit or loss category if they are no longer held for the purpose of being sold or repurchased in the near term.

(b) AFS Financial Assets

This category includes non-derivative financial assets that are either designated to this category or do not qualify for inclusion in any of the other categories of financial assets. The Bank's AFS securities include government securities and corporate bonds.

All financial assets within this category are measured at fair value, unless otherwise disclosed, with changes in value recognized in other comprehensive income. When the financial asset is disposed of or is determined to be impaired, the cumulative gain or loss recognized in other comprehensive income is reclassified from revaluation reserve in equity to profit or loss and presented as a reclassification adjustment within other comprehensive income.

Reversal of impairment losses are recognized in other comprehensive income, except for financial assets that are debt securities which are recognized in profit or loss only if the reversal can be objectively related to an event occurring after the impairment loss was recognized.

(c) HTM Investments

This includes non-derivative financial assets with fixed or determinable payments and a fixed date of maturity. Investments are classified as HTM if the Bank has the positive intention and ability to hold them until maturity. Investments intended to be held for an undefined period are not included in this classification.

If the Bank sells other than an insignificant amount of HTM investments, the entire category would be tainted and reclassified to AFS securities under PFRS, and the Bank will be prohibited from holding investments under the HTM category for the next two financial reporting years after the year the tainting occurred. Under FRSP, however, the Bank was allowed to reclassify from AFS to HTM category in 2008 despite being tainted until 2008. The tainting provision under PFRS will not apply if the sales or reclassifications of HTM investments are (i) so close to maturity or the financial asset's call date that changes in the market rate of interest would not have a significant effect on the financial asset's fair value; (ii) occur after the Bank has collected substantially all of the financial asset's original principal through scheduled payments or prepayments; or (iii) are attributable to an isolated event that is beyond the control of the Bank, is nonrecurring and could not have been reasonably anticipated by the Bank.

Subsequent to initial recognition, the HTM investments are measured at amortized cost using the effective interest method, less impairment losses, if any. Impairment loss, which is the difference between the carrying value and the present value of estimated future cash flows of the investment, is recognized when there is objective evidence that the investment has been impaired. Any changes to the carrying amount of the investment, including impairment loss, are recognized in profit or loss.

(d) *Loans and Receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money or services directly to a debtor with no intention of trading the receivables. Included in this category are financial assets arising from direct loans to customers, securities purchased under reverse repurchase agreements (SPURRA), sales contract receivables and all receivables from customers and other banks.

The Bank's financial assets categorized as loans and receivables are presented as Cash and Other Cash Items, Due from BSP, Due from Other Banks, Loans and Other Receivables, and Security deposits, Petty cash fund and Foreign currency notes and coins on hand (presented as part of Other Resources) in the statement of financial position. For purposes of reporting cash flows, cash and cash equivalents include cash and other cash items, due from BSP and other banks and SPURRA.

Loans and receivables are subsequently measured at amortized cost using the effective interest method, less impairment losses, if any. Any change in their value is recognized in profit or loss, except for increases in fair values of reclassified financial assets under PAS 39 and PFRS 7. Increases in estimates of future cash receipts from such financial assets shall be recognized as an adjustment to the effective interest rate from the date of the change in estimate rather than as an adjustment to the carrying amount of the financial asset at the date of the change in estimate.

Impairment loss is provided when there is objective evidence that the Bank will not be able to collect all amounts due to it in accordance with the original terms of the receivables. The amount of the impairment loss is determined as the difference between the assets' carrying amount and the present value of estimated future cash flows. Impairment is established through an allowance account which is charged to expense. Loans and receivables are written off against the allowance for impairment when management believes that the collectibility of the principal is unlikely, subject to BSP regulations.

For investments that are actively traded in organized financial markets, fair value is determined by reference to exchange-quoted market bid prices at the close of business on the reporting period. For investments where there is no quoted market price, fair value is determined by reference to the current market value of another instrument which is substantially the same or is calculated based on the expected cash flows of the underlying net asset base of the investment.

Non-compounding interest and other cash flows resulting from holding financial assets are recognized in profit or loss when earned, regardless of how the related carrying amount of financial assets is measured.

Derecognition of financial assets occurs when the contractual rights to receive cash flows from the financial instruments expire and substantially all of the risks and rewards of ownership have been transferred.

2.05.02 Offsetting Financial Instruments

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

2.05.03 Impairment of 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. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (events) has (have) an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Bank about certain loss events, including, among others: (i) significant financial difficulty of the issuer or debtor; (ii) a breach of contract, such as a default or delinquency in interest or principal payments; (iii) it is probable that the borrower will enter bankruptcy or other financial reorganization; (iv) the disappearance of an active market for that financial asset because of financial difficulties; or (v) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group.

(a) *Assets Carried at Amortized Cost*

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

If there is objective evidence that an impairment loss on loans and other receivables or HTM investments carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit loss that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the profit or loss. If loans and other receivables or HTM investments have a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Bank may measure impairment on the basis of an instrument's fair value using an observable market price. 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 foreclosures less costs for obtaining and selling the collateral, whether or not the foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e., on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past due status and other relevant factors). 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.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Bank and historical loss experience for assets with credit risk characteristics similar to those in the Bank. 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 for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group 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.

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures, including approval from the management and the BOD, have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in profit or loss.

When 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.

(b) Assets Carried at Fair Value

The Bank assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as AFS, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired.

If any such evidence exists for AFS securities, 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 profit or loss – is removed from equity and recognized in profit or loss.

Impairment losses recognized in the statement of income on equity instruments are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as AFS securities increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the statement of income.

(c) Assets Carried at Cost

The Bank assesses at the end of each reporting period whether there is objective evidence that any of the unquoted equity securities which are carried at cost, may be impaired. The amount of impairment loss is the difference between the carrying amount of the equity security and the present value of the estimated future cash flows discounted at the current market rate of return of a similar asset. Impairment losses on assets carried at cost cannot be reversed.

2.05.04 Financial Liabilities

Financial liabilities include deposit liabilities, bills payable and accrued expenses and other liabilities (excluding tax payables and post-employment benefit obligation) and are recognized when the Bank becomes a party to the contractual terms of the instrument. All interest-related charges are recognized as Interest Expense in the statement of income.

Deposit liabilities and bills payable are recognized initially at fair value, which is the issue proceeds (fair value of consideration received) net of direct issue costs.

Borrowings are subsequently stated at amortized cost using effective interest method for maturities beyond one year, less settlement payments; any difference between proceeds net of transaction costs and the redemption value is recognized in the statement of income over the period of the borrowings.

Accrued expenses and other liabilities are recognized initially at their fair value and subsequently measured at amortized cost, using effective interest method for maturities beyond one year, less settlement payments.

Dividend distributions to shareholders are recognized as financial liabilities upon declaration by the Bank subject to the approval of the BSP.

Financial liabilities are derecognized from the statement of financial position only when the obligations are extinguished either through discharge, cancellation or expiration.

2.06 Other Resources

Other resources pertain to other assets controlled by the Bank as a result of past events. These are recognized in the financial statements when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably.

2.07 Bank Premises, Furniture, Fixtures and Equipment

Land is stated at cost. Bank premises, furniture, fixtures and equipment are carried at acquisition cost less accumulated depreciation and amortization and any impairment losses.

The cost of an asset comprises its purchase price and directly attributable cost of bringing the asset to working condition for its intended use. Expenditures for additions, major improvements and renewals are capitalized; expenditures for repairs and maintenance are charged to expense as incurred.

Depreciation is computed on a straight-line basis over the estimated useful lives of the assets as follows:

Building	50 years
Furniture, fixtures and equipment	5-7 years
Transportation equipment	5 years

Leasehold improvements are amortized over the term of the lease or the estimated useful life of the improvements of 5 to 20 years, whichever is shorter.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see Note 2.16).

The residual values and estimated useful lives of Bank premises, furniture, fixtures and equipment (except land) are reviewed and adjusted if appropriate, at the end of each reporting period.

An item of bank premises, furniture, fixtures and equipment, including the related accumulated depreciation, amortization and impairment loss, is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. 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 item) is included in profit or loss in the year the item is derecognized.

2.08 Investment Properties

Investment properties are stated under the cost model. The cost of an investment property comprises its purchase price and directly attributable cost incurred. These also include land and building acquired by the Bank from defaulting borrowers. For these assets, cost is recognized initially at fair value of the investment properties unless: (i) the exchange transaction lacks commercial substance; or (ii) neither the fair value of the asset received nor the asset given up is reliably measurable. The difference between the fair value of the asset received and the carrying amount of the loan settled through foreclosure of investment properties is recognized as gain or loss on foreclosure under Miscellaneous Income or Expense in the statement of income. Investment properties except land are depreciated over a period of five to ten years.

Investment property is derecognized upon disposal or when permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gain or loss on the retirement or disposal of an investment property is recognized as gain or loss on sale of properties - net under Miscellaneous Income or Expenses in the year of retirement or disposal.

2.09 Intangible Assets

Intangible assets include goodwill, acquired branch licenses and computer software included as part of other resources which are accounted for under the cost model. The cost of the asset is the amount of cash or cash equivalents paid or the fair value of the other considerations given to acquire an asset at the time of its acquisition.

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and install the specific software. Costs associated with maintaining computer software and those costs associated with research activities are recognized as expense in profit or loss as incurred.

Goodwill represents the excess of the cost of acquisition over the fair value of the net assets acquired and branch licenses at the date of acquisition.

Goodwill and branch licenses are classified as intangible assets with indefinite useful life, and thus, not subject to amortization but to an annual test for impairment (see Note 2.16). For purposes of impairment testing, goodwill and branch licenses are allocated to cash-generating units (see Note 2.16) and is subsequently carried at cost less any accumulated impairment losses.

2.10 Provisions and Contingencies

Provisions are recognized when present obligations will probably lead to an outflow of economic resources and they can be estimated reliably even if the timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive commitment that has resulted from past events, for example, legal disputes or onerous contracts.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the end of the reporting period, including the risks and uncertainties associated with the present obligation. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. When time value of money is material, long-term provisions are discounted to their present values using a pre-tax rate that reflects market assessments and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense. Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate.

In those cases where the possible outflow of economic resource as a result of present obligations is considered improbable or remote, or the amount to be provided for cannot be measured reliably, no liability is recognized in the financial statements. Similarly, possible inflows of economic benefits to the Bank that do not yet meet the recognition criteria of an asset are considered contingent assets, hence, are not recognized in the financial statements. On the other hand, any reimbursement that the Bank is virtually certain to collect from a third party with respect to the obligation is recognized as a separate asset not exceeding the amount of the related provision.

2.11 Equity

Preferred and common shares represent the nominal value of the shares that have been issued.

Appropriated surplus pertains to appropriations made by the Bank for a portion of the Bank's income from trust operations set-up in compliance with BSP regulations.

Unappropriated surplus includes all current and prior period results of operations as disclosed in the statement of income, less appropriated surplus and dividends declared.

Unrealized fair value gains (losses) on AFS securities pertain to cumulative mark-to-market valuation of AFS securities, net of amortization of fair value gains or losses on reclassified financial assets.

2.12 Related Party Relationships and Transactions

Related party transactions are transfers of resources, services or obligations between the Bank and its related parties, regardless whether a price is charged.

Parties are considered to be related if one party has the ability to control the other party or exercises significant influence over the other party in making financial and operating decisions. These parties include: (a) individuals owning, directly or indirectly through one or more intermediaries, control or are controlled by, or under common control with the Bank; (b) associates; (c) individuals owning, directly or indirectly, an interest in the voting power of the Bank that gives them significant influence over the Bank and close members of the family of any such individual; and (d) funded retirement plan administered by a trustee bank.

In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely on the legal form.

2.13 Revenue and Expense Recognition

Revenue is recognized to the extent that it is probable that the revenue can be reliably measured; it is probable that future economic benefits will flow to the Bank; and the expenses and costs incurred and to be incurred can be measured reliably. Expenses and costs, if any, are recognized in profit or loss upon utilization of the assets or services or at the date these are incurred. The following specific recognition criteria of income and expenses must also be met before revenue and expense are recognized:

2.13.01 Interest Income and Expense

Interest income and expense are recognized in the statement of income for all financial instruments using the effective interest method.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognized using the rate of interest used to discount future cash flows for the purpose of measuring the impairment loss.

2.13.02 Trading Gains

Trading gains are recognized when the ownership of the security is transferred to the buyer and is computed as the difference between the selling price and the carrying amount of the security. Trading gains also result from the mark-to-market valuation of the securities at the valuation date.

Costs and expenses are recognized in the statement of income upon utilization of the goods or services or at the date they are incurred.

2.13.03 Service Charges, Fees and Commissions

Service charges, fees and commissions are generally recognized on an accrual basis when the service has been provided. Other service fees are recognized based on the applicable service contracts, usually on a time-appropriate basis.

2.14 Leases

The Bank accounts for its leases as follows:

(a) Bank as Lessee

Leases, which do not transfer to the Bank substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments (net of any incentive received from a lessor) are recognized as expense in the statement of income on a straight-line basis over the lease term. Associated costs, such as insurance and repairs and maintenance, are expensed as incurred.

(b) Bank as Lessor

Leases which do not transfer to the lessee substantially all the risks and benefits of ownership of the asset are classified as operating leases. Lease income from operating leases is recognized in profit or loss on a straight-line basis over the lease term.

The Bank determines whether an arrangement is, or contains, a lease based on the substance of the arrangement. It makes 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.

2.15 Foreign Currency Transactions and Translation

The accounting records of the Bank's regular banking unit are maintained in Philippine pesos while the FCDU are maintained in US dollars, its functional currency. Foreign currency transactions during the period are translated into the functional currency at exchange rates which approximate those prevailing on transaction dates.

Foreign exchange gains and losses resulting from the settlement of foreign currency denominated transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of income.

2.16 Impairment of Non-financial Assets

The Bank's premises, furniture, fixtures and equipment, investment properties, goodwill, branch licenses, other properties held for sale (classified as Miscellaneous under Other Resources) and other non-financial assets are subject to impairment testing. Intangible assets with an indefinite useful life or those not yet available for use are tested for impairment at least annually. All other individual assets or cash-generating units are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized for the amount by which the asset or cash-generating unit's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of fair value, reflecting market conditions less costs to sell and value in use, based on an internal discounted cash flow evaluation. In determining value in use, management estimates the expected future cash flows from each cash-generating unit and determines the suitable interest rate in order to calculate the present value of those cash flows. Impairment loss is charged pro rata to the other assets in the cash generating unit.

All assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist and the carrying amount of the asset is adjusted to the recoverable amount resulting in the reversal of the impairment loss.

2.17 Employee Benefits

Post-employment benefits are provided to employees through a defined benefit plan, as well as a defined contribution plan.

(a) Defined Benefit Plan

A defined benefit plan is a post-employment plan that defines an amount of post-employment benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and salary. The legal obligation for any benefits from this kind of post-employment plan remains with the Bank, even if plan assets for funding the defined benefit plan have been acquired. Plan assets may include assets

specifically designated to a long-term benefit fund, as well as qualifying insurance policies. The Bank's defined benefit post-employment plan covers all regular full-time employees. The post-employment plan is tax-qualified, non-contributory and administered by a trustee bank.

The liability recognized in the statement of financial position for defined benefit post-employment plans is the present value of the defined benefit obligation (DBO) at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs. The DBO is calculated annually by independent actuaries using the projected unit credit method. The present value of the DBO is determined by discounting the estimated future cash outflows using interest rates based on zero coupon government bonds as published by Philippine Dealing and Exchange Corporation that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related post-employment liability.

Actuarial gains and losses are not recognized as an income or expense unless the total unrecognized gain or loss exceeds 10% of the greater of the obligation and related plan assets. The amount exceeding this 10% corridor is charged or credited to profit or loss over the employees' expected average remaining working lives. Actuarial gains and losses within the 10% corridor are disclosed separately.

Past service costs are recognized immediately in profit or loss, unless the changes to the post-employment plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortized on a straight-line basis over the vesting period.

(b) *Defined Contribution Plan*

A defined contribution plan is a post-employment plan under which the Bank pays fixed contributions into an independent entity (e.g. Social Security System and Philhealth). The Bank has no legal or constructive obligations to pay further contributions after payment of the fixed contribution. The contributions recognized in respect of defined contribution plans are expensed as they fall due. Liabilities and assets may be recognized if underpayment or prepayment has occurred and are normally of a short-term nature.

(c) *Termination Benefits*

Termination benefits are payable when employment is terminated by the Bank before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Bank recognizes termination benefits when it is demonstrably committed to either:

(i) terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or (ii) providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the end reporting period are discounted to present value.

(d) *Bonus Plans*

The Bank recognizes a liability and an expense for employee bonuses, based on a formula that is fixed regardless of the Bank's income after certain adjustments and does not take into consideration the profit attributable to the Bank's shareholders. The Bank recognizes a provision where it is contractually obliged to pay the benefits, or where there is a past practice that has created a constructive obligation.

(e) *Compensated Absences*

Compensated absences are recognized for the number of paid leave days (including holiday entitlement) remaining at the end of the reporting period. They are included in the Accrued Expenses and Other Liabilities account in the statement of financial position at the undiscounted amount that the Bank expects to pay as a result of the unused entitlement.

2.18 *Income Taxes*

Tax expense recognized in profit or loss comprises the sum of deferred tax and current tax not recognized in other comprehensive income or directly in equity, if any.

Current income tax assets or liabilities comprise those claims from, or obligations to, fiscal authorities relating to the current or prior reporting period, that are uncollected or unpaid at the reporting period. They are calculated according to the tax rates and tax laws applicable to the fiscal periods to which they relate, based on the taxable profit for the year. All changes to current tax assets or liabilities are recognized as a component of tax expense in the statement of income.

Deferred tax is provided using the liability method on temporary differences at the end of the reporting period between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes. Under the liability method, with certain exceptions, deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets are recognized for all deductible temporary differences and the carryforward of unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the deferred tax asset can be utilized. Unrecognized deferred tax assets are reassessed at the end of each reporting period and are recognized to the extent that it has become probable that future taxable profit will be available to allow all or part of the deferred tax asset to be utilized.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in 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 end of the reporting period.

Most changes in deferred tax assets or liabilities are recognized as a component of tax expense in profit or loss. Only changes in deferred tax assets or liabilities that relate to items recognized in other comprehensive income or directly to equity are recognized in other comprehensive income or credited directly in equity.

2.19 Earnings Per Share (EPS)

Basic earnings per share are determined by dividing net profit by the weighted average number of common shares subscribed and issued during the period, after retroactive adjustment for any stock dividend declared in the current period.

The diluted earnings per common share are also computed by dividing net profit by the weighted average number of common shares subscribed and issued during the period. However, net profit attributable to common shares and the weighted average number of common shares outstanding are adjusted to reflect the effects of potentially dilutive convertible preferred shares as approved by the SEC. Convertible preferred shares are deemed to have been converted to common shares at the issuance of preferred shares.

As of December 31, 2012 and 2011, the Bank has no convertible preferred shares (see Note 18.01).

2.20 Trust Operations

The Bank acts as trustee and in other fiduciary capacity that result in the holding or placing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions. These assets and their income arising thereon are excluded from these financial statements, as these are neither resources nor income of the Bank.

2.21 Events After the End of the Reporting Period

Any post-year-end event that provides additional information about the Bank's financial position at the end of the reporting period (adjusting event) is reflected in the financial statements. Post-year-end events that are not adjusting events, if any, are disclosed when material to the financial statements.

3. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The Bank's financial statements prepared in accordance with FRSP for banks require management to make judgments and estimates that affect the amounts reported in the financial statements and related notes. 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. Actual results may ultimately differ from these estimates.

3.01 Critical Management Judgments in Applying Accounting Policies

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

(a) Classifying Financial Assets as HTM Investments

The Bank follows the guidance of PAS 39 in classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as HTM investments. This classification 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 at maturity other than for the allowed specific circumstances – for example, selling an insignificant amount close to maturity – it will be required to reclassify the entire class to AFS securities. The investments would therefore be measured at fair value and not at amortized cost. However, the tainting provision will not apply if the sales or reclassifications of HTM investments are so close to maturity or the financial asset's call date that changes in the market rate of interest would not have a significant effect on the financial asset's fair value; occur after the Bank 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 control of the Bank, is nonrecurring and could not have been reasonably anticipated by the Bank.

In 2008, the BSP and the SEC allowed the reclassification of certain financial assets that were previously classified under FVTPL and AFS categories, due to the tainting in 2006, back to HTM investments or loans and receivables. Accordingly, despite the tainting prohibition until 2008, the Bank reclassified its investments in debt securities previously classified under FVTPL and AFS securities to HTM investments amounting to P18.8 million and P2,130.8 million, respectively, representing the fair value of the reclassified investments on September 11, 2008, the effective date of reclassification (see Note 10), as allowed under FRSP.

On September 14, 2009, however, the Bank reclassified its remaining HTM investments to AFS securities with carrying value of P2,621.7 million (see Note 10). As such, the Bank was not allowed to classify as HTM investments its existing and new acquisitions of financial assets due to tainting until 2011. Starting 2012, the tainting of the Bank has been lifted.

(b) *Impairment of AFS Securities*

The Bank follows the guidance of PAS 39 in determining when an investment is permanently impaired. This determination requires significant judgment. In making this judgment, the Bank evaluates, among other factors, the duration and extent to which the fair value of an investment is less than its cost; and the financial health of and near-term business outlook for the investee, including factors such as industry and sector performance, changes in technology and operational and financing cash flow. Based on the recent evaluation of information and circumstances affecting the Bank's AFS securities, management concluded that no assets are impaired as of December 31, 2012 and 2011. Future changes in those information and circumstance might significantly affect the carrying amount of the assets.

(c) *Distinction between Investment Properties and Owner-occupied Properties*

The Bank determines whether a property qualifies as investment property. In making this judgment, the Bank considers whether the property generates cash flows largely independent of the other assets held by an entity. Owner-occupied properties generate cash flows that are attributable not only to other assets used in the production or supply process.

Some properties may comprise a portion that is held to earn rental or for capital appreciation and another portion that is held for use in providing services or for administrative purposes. If these portions can be sold separately (or leased out separately under finance lease), the Bank accounts for the portions separately. If the portions cannot be sold separately, the property is accounted for as investment property only if an insignificant portion is held for use in providing services or for administrative purposes.

Judgment is applied in determining whether ancillary services are so significant that a property does not qualify as investment property. The Bank considers each property separately in making its judgment.

(d) *Classification of Acquired Properties and Fair Value Determination of Other Properties Held-for-Sale and Investment Properties*

The Bank classifies its acquired properties as Bank Premises, Furniture, Fixtures and Equipment if used in operations, as other properties held for sale presented as Miscellaneous under Other Resources if the Bank expects that the properties (including properties other than land and building) will be recovered through sale rather than use, as Investment Properties if the Bank intends to hold the properties for capital appreciation or as Financial Assets in accordance with PAS 39. At initial recognition, the Bank determines the fair value of acquired properties based on fair valuations performed by both internal and external appraisers. The appraised value is determined based on the current economic and market conditions as well as the physical condition of the property.

(e) *Distinction between Operating and Finance Leases*

The Bank has entered into various lease agreements. Critical judgment was exercised by management to distinguish each lease agreement as either an operating or finance lease by looking at the transfer or retention of significant risk and rewards of ownership of the properties covered by the agreements. Failure to make the right judgment will result in either overstatement or understatement of assets and liabilities.

(f) *Recognition of Provisions and Contingencies*

Judgment is exercised by management to distinguish between provisions and contingencies. Policies on recognition and disclosure of provisions and contingencies are discussed in Note 2.10 and relevant disclosures are presented in Note 24.

3.02 Key Sources of Estimation Uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of resources and liabilities within the next financial year:

(a) *Impairment Losses on Financial Assets (AFS Securities and Loans and Other Receivables)*

The Bank reviews its AFS securities and loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in profit or loss, the Bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from the portfolio before the decrease can be identified with an individual item in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers or issuers in a group, or national or local economic conditions that correlate with defaults on assets in the group.

Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

The carrying value of AFS securities and loans and other receivables and the analysis of the related allowance for impairment on such financial assets are shown in Notes 10 and 11, respectively.

(b) *Fair Value of Financial Instruments*

Management applies valuation techniques to determine the fair value of financial instruments where active market quotes are not available. This requires management to develop estimates and assumptions based on market inputs, using observable data that market participants would use in pricing the instrument.

Where such data is not observable, management uses its best estimate. Estimated fair values of financial instruments may vary from the actual prices that would be achieved in an arm's length transaction at the reporting date.

The carrying values of the Bank's financial assets at FVTPL and AFS securities and the amounts of fair value changes recognized on those assets are disclosed in Notes 9 and 10, respectively.

(c) *Fair Value of Financial Assets and Liabilities*

Financial assets and liabilities measured at fair value in the statement of financial position are categorized in accordance with the fair value hierarchy based on PFRS 7. This hierarchy groups financial assets and liabilities into three levels based on the significance of inputs used in measuring the fair value of the financial assets and liabilities. The fair value hierarchy has the following levels:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the resource or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and,
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The level within which the financial asset or liability is classified is determined based on the lowest level of significant input to the fair value measurement.

As of December 31, 2012, AFS securities amounting to P5,784.5 million, are the only financial assets (nil for liabilities) measured at fair value while as of December 31, 2011, financial assets at FVTPL and AFS securities amounting to P207.7 million and P5,710.9 million, respectively, are the only financial assets (nil for liabilities) measured at fair value. The financial asset values are determined under Level 1 of the fair value hierarchy.

There have been no significant transfers among Levels 1, 2 and 3 in the reporting periods.

The following table summarizes the cost and fair values of those financial assets and liabilities not presented in the statement of financial position as financial assets at FVTPL and AFS securities:

	December 31, 2012	
	Cost	Fair Value
<i>Financial Resources:</i>		
Cash and other cash items	P 435,898,545	P 435,898,545
Due from BSP	3,073,180,153	3,073,180,153
Due from other banks	1,000,089,458	1,000,089,458
Loans and other receivables	21,426,766,835	20,869,152,721
Other resources	46,303,372	46,303,372
<i>Financial Liabilities:</i>		
Deposit liabilities	P 26,448,886,738	P 26,448,886,738
Bills payable	765,489,517	765,489,517
Accrued expenses and other liabilities	1,426,270,239	1,426,270,239
	December 31, 2011	
	Cost	Fair Value
<i>Financial Resources:</i>		
Cash and other cash items	P 297,076,011	P 297,076,011
Due from BSP	1,119,319,376	1,119,319,376
Due from other banks	630,690,655	630,690,655
Loans and other receivables	17,196,311,580	16,704,655,545
Other resources	28,366,598	28,366,598
<i>Financial Liabilities:</i>		
Deposit liabilities	P 21,194,988,117	P 21,194,988,117
Bills payable	121,482,599	121,482,599
Accrued expenses and other liabilities	883,657,913	883,657,913

(i) *Due from BSP and other banks*

Due from BSP pertains to deposits made by the Bank to BSP for clearing and reserve requirements. Due from other banks includes interbank deposits and items in the course of collection. The fair value of floating rate placements and overnight deposits is their carrying amount. The estimated fair value of fixed interest-bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity, which for short-term deposits approximates the nominal value.

(ii) *Loans and other receivables*

Loans and other receivables are net of impairment losses. The estimated fair value of loans and other receivables represents the discounted amount of estimated future cash flows expected to be received. Long term interest-bearing loans are periodically repriced at interest rates equivalent to the current market rates, to determine fair value.

(iii) *Other resources*

Other resources are composed of foreign currency notes and coins, security deposits and petty cash fund. Due to their short duration, the carrying amounts of these items in the statement of financial position are considered to be reasonable approximation of their fair values.

(iv) *Deposits and bills payable*

The estimated fair value of demand deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand. The estimated fair value of long-term fixed interest-bearing deposits and bills payable without quoted market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity. The carrying amounts of deposits and bills payable already approximate their fair values.

(v) *Accrued expenses and other liabilities*

Accrued expenses and other liabilities, except for post-employment benefit obligation and tax liabilities, are recognized initially at their fair value and subsequently measured at amounts to which they are to be paid. Fair value of these short-term liabilities approximates their carrying values.

(d) *Determining Useful Lives of Bank Premises, Furniture, Fixtures and Equipment and Investment Properties Except Land*

The Bank estimates the useful lives of bank premises, furniture, fixtures and equipment and investment properties based on the period over which the assets are expected to be available for use. The estimated useful lives of bank premises, furniture, fixtures and equipment and investment properties are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets. The carrying amounts of bank premises, furniture, fixtures and equipment and investment properties are analyzed in Notes 12 and 13, respectively. Based on management assessment, there is no change in the estimated useful lives of these assets during the year. Actual results, however, may vary due to changes in estimates brought about by changes in factors mentioned above.

(e) *Determining Realizable Amount of Deferred Tax Assets*

The Bank reviews its deferred tax assets at the end of each reporting period and reduces the carrying amount 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. The carrying value of deferred tax assets, which the management assessed to be fully utilized within the next two to three years, as of December 31, 2012 and 2011 is disclosed in Notes 14 and 22.

(f) *Impairment of Non-financial Assets*

Except for intangible assets with indefinite useful lives (i.e. goodwill and acquired branch licenses), PFRS requires that an impairment review be performed when certain impairment indications are present. The Bank's policy on estimating the impairment of non-financial assets is discussed in detail in Note 2.16. Though management believes that the assumptions used in the estimation of fair values reflected in the financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable values and any resulting impairment loss could have a material adverse effect on the results of operations.

Allowance for impairment recognized on investment properties and other properties held for sale (presented under Miscellaneous) are discussed in Notes 13 and 14. There are no impairment losses recognized in goodwill, acquired branch licenses, bank premises, furniture, fixtures and equipment.

(g) *Valuation of Post-employment Benefits*

The determination of the Bank's obligation and cost of post-employment benefit plan is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in Note 20.02 and include, among others, discount rates, expected rate of return on plan assets and expected rate of salary increases. In accordance with PFRS, actual results that differ from the assumptions are accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods.

The amounts of post-employment benefit obligation and expense and an analysis of the movements in the estimated present value of DBO are presented in Note 20.02.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES

PBB, as a financial institution, is in the business of risk taking. Its activities expose the Bank to credit, market and liquidity, and operational risks. Credit risk emanates from exposures to borrowing from customers, counterparty risk in trading activities, and contingent credit risks arising from trade finance exposures. Market risk covers price, liquidity and interest rate risks in the Bank's investment portfolio. Liquidity risk may arise from shortage in funding and/or lack of market for sale of its assets. Operational risk covers potential losses other than market and credit risk arising from failures of people, process, systems and information technology and external events, including legal risk but excludes reputational risk.

Although risks are inherent in the Bank's activities, these are carefully managed through a process of identification, measurement, and monitoring subject to prudent limits and stringent controls as established in its risk management framework and governance structure. The ability to manage risks effectively is vital for the Bank to sustain its growth and continue to create value for its shareholders.

4.01 Risk Management Milestones for 2012

For the year 2012, various initiatives were taken by the Bank to ensure that it continually improve on its risk management practices to protect its stakeholders and ensure compliance with best practices on risk management.

On risk capital calculation for market risks, the Bank adopted The Standardized Approach ("TSA") under which a general market risk charge for trading portfolio is calculated based on the instrument's coupon and remaining maturity with risk weights ranging from 0% for items with very low market risk (i.e., tenor of less than 30 days) to a high of 12.5% for high risk-items (i.e., tenor greater than 20 years). Capital requirements for specific risk were also calculated for exposures with risk weights ranging from 0% to 8% depending on the issuer's credit rating. This was an off-shoot regulatory requirement after the Bank has been granted by the BSP with Type 3 Limited End-User Authority for FX Swaps.

Under credit risk management, a more comprehensive monthly red flag reporting to the BOD through the Risk Management Committee was initiated.

For market risks, various policies were implemented and revisited to support Treasury's strategy while ensuring that risk tolerance is within acceptable level as set by the BOD. Among the policies include the FX position limits, Value at Risk (VAR) limit, loss limit, and tenor limit, as well as the Maximum Cumulative Outflow (MCO) and Earnings at Risk (EAR) limits. Furthermore, new reports were employed for both market and liquidity risk aimed to closely look into the Bank's trading risks, and interest rate and liquidity position.

As for operational risk, the Bank has completed its bankwide business impact analysis and risk assessment to further improve on the Bank's business continuity management infrastructure. 2012 also marks the year the Risk Management Center (RMC) has taken over the information security risk of the Bank with the turnover of the Information Security Unit to the RMC. During the year, the unit now known as Information Security and Technology Risk Unit, has completed two risk frameworks namely Information Technology (IT) Risk Framework/Manual and the Information Security Manual. Moreover, monthly Information Security and Technology Risk report, such as, security administration profile, virus attacks and security violations form part of the BOD risk reports.

4.02 Enterprise Risk Management Framework

The Bank adopts an Enterprise Risk Management framework as its integrated approach to the identification, measurement, control and disclosure of risks. The Bank's BOD formulates the corporate risk policy, sets risk tolerances and appetite and provide risk oversight function through the Risk Management Committee (RiskCom), which in turn supervises the Chief Risk Officer and Head of the Risk Management Center in the development and implementation of risk policies, processes and guidelines. The Bank's BOD regularly evaluates applicability of key assumptions used in the framework and any changes therein are forthwith considered. The framework covers operational, market and liquidity, credit and counterparty and other downside risks within the context of the supervision by risk guidelines of the BSP and aligned best practices on risk management.

4.03 Credit Risk

Credit risk pertains to the risk to income or capital due to non-payment by borrowers or counterparties of their obligations, either in full or partially as they fall due, deterioration in the credit quality of a borrower, issuer or counterparty, and the reduced recovery from a credit facility in the event of default. This is inherent in the Bank's lending, investing, and trading and is managed in accordance with the Bank's credit risk framework of risk identification, measurement, control and monitoring.

Credit risk is managed through a continuing review of credit policies, systems, and procedures. It starts with the definition of business goals and setting of risk policies by the BOD. Account officers and credit officers directly handle credit risk as guided by BOD-approved policies and limits. The Risk Management Center, as guided by the RiskCom, performs an independent portfolio oversight of credit risks and reports regularly to the BOD and the RiskCom.

On the transactional level, exposure to credit risk is managed through a credit review process wherein a regular analysis of the ability of the obligors and potential obligors to meet interest and capital repayment obligations is performed. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees. Moreover, in accordance with best practices, the Bank also adopts an internal credit risk rating system (ICRRS) for

the purpose of measuring credit risk for every exposure in a consistent manner as accurately as possible and uses this information as a tool for business and financial decision-making. This rating system covers companies with assets of over P15.0 million and is adopted from the Banker's Association of the Philippines (BAP) model which has been approved by the BSP as a minimum standard for an internal risk rating system under BSP Circular 439. This rating system has two components namely: (a) Borrower Risk Rating System which provides an assessment of credit risk without considering the security arrangements and; (b) Facility Risk Rating which takes into account the collateral and other credit risk mitigants. The rating scale consists of ten (10) grades, the top six (6) of which falls under unclassified accounts and the bottom four (4) under classified accounts, consistent with regulatory provisioning guidelines.

Pursuant to regulatory requirements and best practices, the Bank also conducts sensitivity analysis and stress testing of the credit portfolio to assess sensitivity of the Bank's capital to BOD-approved credit risk scenarios.

The following table shows the Bank's maximum exposure to credit risk on loans and other receivables as of December 31, 2012 and 2011 (amounts in thousands):

	2012	2011
Individually impaired		
Wholesale and retail trade	P 421,951	P 366,921
Real estate, renting and construction	409,315	373,836
Manufacturing	87,631	592,291
Consumption	28,688	56,376
Others	<u>1,125,617</u>	<u>1,066,372</u>
Gross amount	2,073,202	2,455,796
Allowance for impairment	<u>(451,979)</u>	<u>(449,295)</u>
Carrying amount	<u>1,621,223</u>	<u>2,006,501</u>
Collectively impaired		
Wholesale and retail trade	-	6,721
Others	<u>2,805</u>	<u>18,130</u>
Gross amount	2,805	24,851
Allowance for impairment	<u>(2,805)</u>	<u>(5,759)</u>
Carrying amount	<u>-</u>	<u>19,092</u>
Past due but not impaired		
Carrying amount	<u>4,629</u>	<u>22,570</u>
Neither past due nor impaired		
Gross amount	19,346,130	14,693,095
Allowance for impairment	<u>(102,830)</u>	<u>(36,602)</u>
Carrying amount	<u>19,243,300</u>	<u>14,656,493</u>
Total carrying amount	<u>P 20,869,152</u>	<u>P 16,704,656</u>

In addition to default and concentration risk arising from lending activities, the Bank has an incremental issuer credit risk exposure emanating from Investment Securities and Due from Other Banks amounting to P5,784.5 million and P1,000.1 million, respectively, as of December 31, 2012 and P5,918.6 million and P630.7 million, respectively, as of December 31, 2011. These are considered as neither past due nor impaired.

The carrying amount of the above loans and other receivables are partially secured with collateral mainly consisting of real estate and chattel mortgage.

The Due from BSP account represents the aggregate balance of interest-bearing deposit accounts in local currency maintained by the Bank with the BSP primarily to meet reserve requirements and to serve as a clearing account for interbank claims. Hence, no significant credit risk is anticipated for this account.

4.04 Market Risk

The Bank's market risk exposure arises from adverse movements in interest rates and prices of assets that are either carried in the banking book or held as positions in the trading book (financial instruments), mismatches in the contractual maturity of its assets and liabilities, embedded optionality in the loans and deposits due to pre-terminations, and potential cash run offs arising from changes in overall liquidity and funding conditions in the market. Market risk related to the Bank's financial instruments includes foreign currency, interest rate and price risks.

4.04.01 Foreign Currency Risk

The Bank manages its exposure to effects of fluctuations in the foreign currency exchange rates by maintaining foreign currency exposure within the existing regulatory guidelines and at a level that it believes to be relatively conservative for a financial institution engaged in that type of business.

The Bank's foreign currency exposure is primarily limited to the foreign currency deposits, which are sourced within the Philippines or generated from remittances by Filipino expatriates and overseas Filipino workers. Also, foreign currency trading with corporate accounts and other financial institutions is a source of foreign currency exposure for the Bank. At the end of each month, the Bank reports to the BSP on its acquisition and disposition of foreign currency resulting from its daily transactions.

The breakdown of the financial resources and liabilities as to foreign currency (translated into Philippine pesos) and peso-denominated balances as of December 31, 2012 and 2011 follow (amounts in thousands):

	2012		
	Foreign Currency	Peso	Total
<i>Financial Resources:</i>			
Cash and other cash items	P -	P 435,899	P 435,899
Due from BSP	-	3,073,180	3,073,180
Due from other banks	864,129	135,960	1,000,089
AFS securities	1,286,940	4,497,597	5,784,537
Loans and other receivables - net	399,546	20,469,607	20,869,153
Other resources	33,269	13,034	46,303

	2012		
	Currency	Foreign Peso	Total
<i>Financial Liabilities:</i>			
Deposit liabilities	2,131,604	24,317,283	w 26,448,887
Bills payable	-	765,490	765,490
Accrued expenses and other liabilities	210	1,426,060	1,426,270

	2011		
	Foreign Currency	Peso	Total
<i>Financial Resources:</i>			
Cash and other cash items	P -	P 297,076	P 297,076
Due from BSP	-	1,119,319	1,119,319
Due from other banks	539,251	91,440	630,691
Financial assets at FVTPL	97,089	110,654	207,743
AFS securities	1,866,194	3,844,672	5,710,866
Loans and other receivables - net	59,727	16,644,929	16,704,656
Other resources	18,339	10,028	28,367

<i>Financial Liabilities:</i>			
Deposit liabilities	2,300,060	18,894,928	21,194,988
Bills payable	-	121,483	121,483
Accrued expenses and other liabilities	224,593	659,065	883,658

4.04.02 Interest Rate Risk

Interest rate risk is the probability of decline in net interest earnings as a result of an adverse movement of interest rates.

In measuring interest rate exposure from an earnings perspective, the Bank calculates the EAR to determine the impact of interest rate changes on the Bank's accrual portfolio. The EAR is the potential decline in net interest income due to the adverse movement in interest rates. To quantify interest rate exposure, the statement of financial position is first classified into interest rate sensitive and non-interest rate sensitive asset and liability accounts and then divided into pre-defined interest rate sensitivity gap tenor buckets with corresponding amounts slotted therein based on the term to next re-pricing date (the re-pricing maturity for floating rate accounts) and remaining term to maturity (the equivalent re-pricing maturity for fixed rate accounts).

The rate sensitivity gaps are calculated for each time band and on a cumulative basis. The gap amount for each bucket is multiplied by an assumed change

in interest rate to determine EAR. A negative interest rate sensitivity gap position implies that EAR increases with a rise in interest rates, while a positive interest rate sensitivity gap results in a potential decline in net interest rate income as interest rates fall. To supplement the EAR, the Bank regularly employs sensitivity analysis on the Bank's interest rate exposure.

To mitigate interest rate risk, the Bank follows a prudent policy on managing assets and liabilities so as to ensure that exposure to interest rate risk are kept within acceptable levels. The BOD has also approved the EAR Limit which is reviewed regularly.

The analyses of the groupings of resources, liabilities, equity and off-statement of position items as of December 31, 2012 and 2011 based on the expected interest realization or recognition are presented below (amounts in thousands).

	2012					
	Less than One Month	One to Three Months	Three Months to One Year	More than One Year	Non-rate Sensitive	Total
Resources						
Cash and other cash items	P -	P -	P -	P -	P 435,899	P 435,899
Due from BSP	-	-	-	-	3,073,180	3,073,180
Due from other banks	-	-	-	-	1,000,089	1,000,089
Investment securities	-	12,519	-	5,772,018	-	5,784,537
Loans and other receivables - net	13,895,370	2,581,732	1,041,690	2,796,671	553,690	20,869,153
Other resources	-	-	-	-	46,303	46,303
Total Resources	13,895,370	2,594,251	1,041,690	8,568,689	5,109,161	31,209,161
Liabilities and Equity						
Deposit liabilities	4,745,448	8,931,734	3,929,460	342,640	8,499,605	26,448,887
Bills payable	711,342	54,148	-	-	-	765,490
Accrued expenses and other liabilities	-	-	-	-	1,426,270	1,426,270
Total Liabilities	5,456,790	8,985,882	3,929,460	342,640	9,925,875	28,640,647
Equity	-	-	-	-	4,402,352	4,402,352
Total Liabilities and Equity	5,456,790	8,985,882	3,929,460	342,640	14,328,227	33,042,999
On-book Gap	8,438,580	(6,391,631)	(2,887,770)	8,226,049	(9,219,066)	(1,833,838)
Cumulative On-book Gap	8,438,850	2,046,949	(840,821)	7,385,228	(1,833,838)	-
Contingent Resources	29,443	192,181	1,000	1,357,141	-	1,579,765
Contingent Liabilities	-	-	-	-	769,381	769,381
Off-book Gap	29,443	192,181	1,000	1,357,141	(769,381)	810,384
Net Periodic Gap	8,468,023	(6,199,449)	(2,886,770)	9,583,189	(9,988,447)	(1,023,454)
Cumulative Total Gap	P 8,468,023	P 2,268,574	(P 618,197)	P 8,964,992	(P 1,023,454)	P -
		2011				
		One	Three			

	Less than One Month	to Three Months	Months to One Year	More than One Year	Non-rate Sensitive	Total
Resources						
Cash and other cash items	P -	P -	P -	P -	P 297,076	P 297,076
Due from BSP	-	-	-	-	1,119,319	1,119,319
Due from other banks	-	-	-	-	630,691	630,691
Investment securities	112,860	-	10,618	5,795,131	-	5,918,609
Loans and other receivables - net	12,385,755	1,265,648	844,670	1,841,745	366,838	16,704,656
Other resources	-	-	-	-	28,367	28,367
Total Resources	12,498,615	1,265,648	855,288	7,636,876	2,442,291	24,698,718
Liabilities and Equity						
Deposit liabilities	2,710,215	7,916,731	3,269,641	197,135	7,101,266	21,194,988
Bills payable	-	120,925	-	-	558	121,483
Accrued expenses and other liabilities	-	-	-	-	883,658	883,658
Total Liabilities	2,710,215	8,037,656	3,269,641	197,135	7,985,482	22,200,129
Equity	-	-	-	-	3,672,736	3,672,736
Total Liabilities and Equity	2,710,125	8,037,656	3,269,641	197,135	11,658,218	25,872,865
On-book Gap	9,788,400	(6,772,008)	(2,414,353)	7,439,741	(9,215,927)	(1,174,147)
Cumulative On-book Gap	9,788,400	3,016,392	602,039	8,041,780	(1,174,147)	(2,348,294)
Contingent Resources	783,716	-	-	1,148,325	-	1,932,041
Contingent Liabilities	-	-	-	-	1,193,989	1,193,989
Off-book Gap	783,716	-	-	1,148,325	(1,193,989)	738,052
Net Periodic Gap	10,572,116	(6,772,008)	(2,414,353)	8,588,066	(10,409,916)	(436,095)
Cumulative Total Gap	P 10,572,116	P 3,800,108	P 1,385,755	P 9,973,821	(P 436,095)	P -

4.04.03 Price Risk

In measuring the magnitude of exposures related to the Bank's trading portfolio arising from holding government and other debt securities, the Bank employs VaR methodology. VaR is an estimate of the amount of loss that a given risk exposure is unlikely to exceed during a given time period, at a given level of statistical confidence. Analytically, VaR is the product of: (a) the sensitivity of the market value of the position to movement of the relevant market risk factors, and (b) the volatility of the market risk factor for the given time horizon at a specified level of statistical confidence. Typically, the Bank uses a 99% confidence level for this measurement (i.e. losses could exceed the VaR in one out of 100 trading days).

In calculating the severity of the market risk exposure for fixed income securities, the Bank takes into account the cash flow weighted term or modified duration of the securities comprising the portfolio, the yield to maturity, and mark-to-market value of the component securities position in the trading book. As the VaR methodology requires a minimum historical period of reckoning with market movements from a transparent discovery platform, the Bank uses yield and price data from the Philippine Dealing Exchange Corporation and Bloomberg in the calculation of the volatility of rates of return and security prices, consistent with BSP valuation guidelines.

In assessing market risk, the Bank scales the calculated VaR based on assumed defeasance or holding periods that range from one day and 10 days consistent with best practices and BSP standards.

As a prudent market risk control and compliance practice, the BOD has approved a market risk limit system which includes: (1) VaR limit on a per instrument and portfolio; (2) loss limit on per investment portfolio (3) off-market rate limits on per instrument type; and (4) holding period for investment securities.

In recognition of the limitations of VaR related to the assumptions on which the model is based, the Bank supplements the VaR with a wide range of stress tests to model the financial impact of a variety of exceptional market scenarios on individual trading portfolios and the Bank's overall position.

The table below shows the VaR position of the Bank's financial assets at FVTPL and AFS portfolios as at December 31, 2012 and 2011.

Term	2012			VaR	VaR (10-day Defeasance)*
	Yield to Maturity	Rate Volatility			
Over 3 months	--	--	P	--	P --
6 months	0.63%	5.87%		6,075	19,210
1 year	1.10%	4.40%		23,196	73,353
2 years	--	--		--	--
3 years	5.68%	4.32%		68,851	217,725
4 years	3.93%	4.34%		1,299,466	4,109,272
5 years	--	--		--	--
7 years	5.32%	1.49%		4,005,920	12,667,832
10 years	4.01%	2.53%		18,160,894	57,429,789
20 years	5.59%	0.94%		87,452,469	276,548,988

Term	2011			VaR	VaR (10-day Defeasance)*
	Yield to Maturity	Rate Volatility			
Over 3 months	1.38%	20.03%	P	--	P --
6 months	1.55%	11.14%		--	--
1 year	1.58%	12.48%		29,131	92,119
2 years	2.17%	5.49%		49,656	157,026
3 years	3.17%	3.03%		66,802	211,245
4 years	4.20%	2.63%		--	--
5 years	4.21%	2.11%		114,574	362,314
7 years	4.68%	3.41%		6,901,705	21,825,108
10 years	5.08%	2.75%		11,267,914	36,770,694
20 years	6.10%	0.70%		78,981,805	249,762,397

* Blank entries suggest that the Bank has no holdings pertaining to that term

Stress test on the December 31, 2012 and 2011 portfolio shows the potential impact on profit and equity of parallel increase in interest rates of financial assets at FVTPL and AFS securities as follows:

2012				
Currency	Current Market Value	Sensitivities		
		+100 bps	+300 bps	+500 bps
Peso	P 4,497,597,110	(P 510,920,994)	(P 1,532,762,982)	(P 2,554,604,971)
United States (US) Dollar	<u>1,286,939,479</u>	<u>(143,873,333)</u>	<u>(431,620,000)</u>	<u>(719,366,667)</u>
Total	<u>P 5,784,536,589</u>	<u>(P 654,794,327)</u>	<u>(P 1,964,382,982)</u>	<u>(P 3,273,971,638)</u>

2011

Currency	Current Market Value	Sensitivities		
		+100 bps	+300 bps	+500 bps
Peso	P 3,955,326,237	(P 458,062,753)	(P 1,374,188,258)	(P 2,290,313,764)
US Dollar	<u>1,963,282,179</u>	<u>(180,754,563)</u>	<u>(542,263,688)</u>	<u>(903,772,813)</u>
Total	<u>P5,918,608,416</u>	<u>(P 638,817,316)</u>	<u>(P 1,916,451,946)</u>	<u>(P 3,194,086,577)</u>

4.04.04 Liquidity Risk

Liquidity risk is the risk to income and capital as a result of the Bank failing its commitment for funds as they fall due. The Bank manages its liquidity risk through the management's monitoring of various liquidity ratios, Treasury's weekly and regular assessment of liquidity gaps, and the maturity ladder. A maturity ladder relates the inflows to outflows of funds at selected maturity dates and is constructed to measure liquidity exposure. The ladder shows the Bank's statement of financial position distributed into tenor buckets across the term structure on the basis of the term to final maturity or cash flow dates. The amount of net inflows which equals the difference between the amounts of contractually maturing assets (inflows) and liabilities (outflows) is computed per tenor bucket and on a cumulative basis incorporating certain behavioral and hypothetical assumptions regarding the flows from assets and liabilities including contingent commitments over time. The calculated periodic and cumulative gaps constitute the Bank's run off schedule, which indicate the Bank's net funding requirements in local and foreign currency.

To control liquidity gap risks, a quantitative ceiling to the net outflow of funds of the bank called MCO limit is observed per currency based on the recommendation of management, which model and assumptions are reviewed by the Asset and Liability Committee (ALCO) and the RiskCom prior to the confirmation by the BOD.

The analysis of the cash flow gap analysis of resources, liabilities, equity and off-statement financial position items as of December 31, 2012 and 2011 is presented below (amounts in thousands).

	2012				
	Less than One Month	One to Three Months	Three Months to One Year	More than One Year	Total
Resources:					
Cash and other cash items	P 435,899	P -	P -	P -	P 435,899
Due from BSP	3,073,180	-	-	-	3,073,180
Due from other banks	1,000,089	-	-	-	1,000,089
Investment securities	-	12,519	-	5,772,018	5,784,537
Loans and other receivables	4,037,469	5,841,434	5,473,295	5,516,955	20,869,153
Other resources	644,159	-	85,912	1,204,336	1,934,407
Total Resources	<u>9,190,796</u>	<u>5,853,953</u>	<u>5,559,207</u>	<u>12,493,309</u>	<u>33,097,265</u>
Liabilities and Equity:					
Deposit liabilities	11,836,943	2,742,416	1,006,487	10,863,041	26,448,887
Bills payable	117,780	286,344	205,310	156,056	765,490
Accrued expenses and other liabilities	<u>483,263</u>	<u>966,042</u>	<u>1,738</u>	<u>29,494</u>	<u>1,480,537</u>
Total Liabilities	<u>12,437,986</u>	<u>3,994,802</u>	<u>1,213,535</u>	<u>11,048,591</u>	<u>28,694,914</u>
Capital Funds	-	-	-	4,402,351	4,402,351
Total Liabilities and Capital Funds	<u>12,437,986</u>	<u>3,994,802</u>	<u>1,213,535</u>	<u>15,450,942</u>	<u>33,097,265</u>
On-book Gap	<u>(3,247,190)</u>	<u>1,859,151</u>	<u>4,345,672</u>	<u>(2,957,633)</u>	<u>-</u>
Cumulative On-book Gap	<u>(3,247,190)</u>	<u>(1,388,039)</u>	<u>2,957,633</u>	<u>-</u>	<u>-</u>
Contingent Resources	29,443	192,181	1,000	1,357,141	1,579,765
Contingent Liabilities	<u>38,796</u>	<u>277,209</u>	<u>447,650</u>	<u>5,726</u>	<u>769,381</u>
Off-book Gap	<u>(9,353)</u>	<u>(85,028)</u>	<u>(446,650)</u>	<u>1,351,415</u>	<u>810,384</u>
Net Periodic Gap	<u>(3,256,543)</u>	<u>1,774,123</u>	<u>3,899,022</u>	<u>(1,606,218)</u>	<u>810,384</u>
Cumulative Total Gap	<u>(P 3,256,543)</u>	<u>(P 1,482,420)</u>	<u>P 2,416,602</u>	<u>P 810,384</u>	<u>P -</u>

	2011				Total
	Less than One Month	One to Three Months	Three Months to One Year	More than One Year	
Resources:					
Cash and other cash items	P 297,076	P -	P -	P -	P 297,076
Due from BSP	1,119,319	-	-	-	1,119,319
Due from other banks	262,691	368,000	-	-	630,691
Investment securities	-	-	10,618	5,907,991	5,918,609
Loans and other receivables	6,332,128	3,592,324	3,151,993	3,691,211	16,704,656
Other resources	213,535	-	84,428	910,516	1,214,469
Total Resources	8,224,749	3,897,324	3,247,039	10,515,707	25,884,819
Liabilities and Equity:					
Deposit liabilities	14,242,388	4,870,765	1,802,354	279,481	21,194,988
Bills payable	558	120,925	-	-	121,483
Accrued expenses and other liabilities	827,023	2,970	60,460	5,159	895,612
Total Liabilities	15,069,969	4,994,660	1,862,814	284,640	22,212,083
Capital Funds	-	-	-	672,736	3,672,736
Total Liabilities and Capital Funds	15,069,969	4,994,660	1,862,814	3,957,376	25,884,819
On-book Gap	(6,845,220)	(1,097,336)	1,384,225	6,558,331	-
Cumulative On-book Gap	(6,845,220)	(7,942,556)	(6,558,331)	-	-
Contingent Resources	783,716	-	-	1,148,325	1,932,041
Contingent Liabilities	137,228	399,777	637,417	19,567	1,193,989
Off-book Gap	(646,488)	(399,777)	(637,417)	1,128,758	738,052
Net Periodic Gap	(6,198,732)	(1,497,113)	746,808	7,687,089	735,052
Cumulative Total Gap	(P 6,198,732)	(P 7,695,845)	(P 56,949,037)	P 738,052	P -

The negative liquidity gap in the MCO is due to the timing difference in the contractual maturities of assets and liabilities. The MCO measures the maximum funding requirement the Bank may need to support its maturing obligations. To ensure that the Bank maintains a prudent and manageable level of cumulative negative gap, the Bank maintains a pool of highly liquid assets in the form of tradable investment securities. Moreover, the BOD has approved the MCO Limits which reflect the Bank's overall appetite for liquidity risk exposure. Compliance to MCO Limits is monitored and reported to the BOD and senior management. The MCO of the Bank as of December 31, 2012 is much within the MCO Limit set by the Board. In case of breach in the MCO Limit, the Risk Management Center elevates the concern to the Board through the Risk Committee for corrective action.

Additional measures to mitigate liquidity risks include reporting of funding concentration, available funding sources and liquid assets analysis. More frequent analysis of projected funding source and requirements as well as pricing strategies are discussed thoroughly during the weekly Asset and Liability Committee meetings.

5. CAPITAL MANAGEMENT AND REGULATORY CAPITAL

The Bank's lead regulator, the BSP, sets and monitors capital requirements of the Bank. In implementing current capital requirements, the BSP requires the Bank to maintain a prescribed ratio of qualifying capital-to-risk assets.

Under current banking regulations, the combined capital accounts of each bank should not be less than an amount equal to ten percent (10%) of its risk assets. The qualifying capital of the Bank for purposes of determining the capital-to-risk assets ratio is total equity excluding:

- a. unbooked valuation reserves and other capital adjustments as may be required by the BSP;
- b. total outstanding unsecured credit accommodations to Directors, Officers, Stockholders and Related Interests (DOSRI);
- c. deferred tax asset or liability;
- d. goodwill;
- e. sinking fund for redemption of redeemable preferred shares; and,
- f. other regulatory deductions.

Risk assets consist of total assets after exclusion of cash on hand, due from BSP, loans covered by 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 as determined by the Monetary Board of the BSP.

The amount of surplus funds available for dividend declaration is determined also on the basis of regulatory net worth after considering certain adjustments.

The Bank's policy is to maintain a strong capital base in order to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholder's return is also recognized and the Bank recognizes the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

A bank's regulatory capital is analyzed into two tiers, which are Tier 1 Capital plus Tier 2 Capital less deductions from the total of Tier 1 and Tier 2 capital for the following:

- a. Investments in equity of unconsolidated subsidiary banks and other financial allied undertakings, but excluding insurance companies;
- b. Investments in debt capital instruments of unconsolidated subsidiary banks;
- c. Investments in equity of subsidiary insurance companies and non-financial allied undertakings;
- d. Reciprocal investments in equity of other banks/enterprises; and,
- e. Reciprocal investments in unsecured subordinated term debt instruments of other banks/quasi-banks qualifying as Hybrid Tier 1, Upper Tier 2 and Lower Tier 2, in excess of the lower of (i) an aggregate ceiling of 5% of total Tier 1 capital of the bank excluding Hybrid Tier 1; or (ii) 10% of the total outstanding unsecured subordinated term debt issuance of the other bank/quasi-banks,

Provided, that any asset deducted from the qualifying capital in computing the numerator of the risk-based capital ratio shall not be included in the risk-weighted assets in computing the denominator of the ratio.

There were no material changes in the Bank's management of capital during the current year.

As of December 31, 2012 and 2011, the Bank has satisfactorily complied with the capital-to-risk assets ratio (see Note 26).

During 2010, under the then existing BSP circular, thrift and savings banks whose head office is located within Metro Manila, and with FCDU and trust operations, are required to comply with the minimum capital requirement of P650.0 million. As of December 31, 2012 and 2011, the Bank has equity amounting to P4,402.4 million and P3,672.7 million, respectively. Hence, the Bank has complied with the foregoing capitalization requirement.

In 2011, BSP approved the increase of the related minimum capital requirement for thrift and savings bank to P1.0 billion but which shall apply only: (1) upon establishment of a new thrift bank; (2) upon conversion of an existing bank to a thrift bank; and, (3) upon relocation of the head office of a thrift bank in areas of higher classification. None of the three situations mentioned above apply to the Bank, hence, the Bank has complied with the minimum capitalization requirement of P650.0 million for thrift banks with FCDU and trust operations as of December 31, 2012.

6. SEGMENT REPORTING

The Bank's main operating businesses are organized and managed separately according to the nature of services and products provided and the different markets served, with each segment representing a strategic business unit. These are also the basis of the Bank in reporting to its chief operating decision-maker for its strategic decision-making activities.

Management currently identifies the Bank's three service lines as primary operating segments.

(a) *Consumer banking* – includes auto financing, home financing, and salary or personal loans;

(b) *Commercial banking* – includes term loans, working capital credit lines, bills purchase and discounting lines; and,

(c) *Treasury Operations* – manages liquidity of the Bank and is a key component in revenue and income generation through its investment and trading activities.

These segments are the basis on which the Bank reports its segment information. Transactions between the segments are on normal commercial terms and conditions.

Segment revenues and expenses that are directly attributable to primary operating segment and the relevant portions of the Bank's revenues and expenses that can be allocated to that operating segment are accordingly reflected as revenues and expenses of that operating segment. Revenue sharing agreements are used to allocate external customer revenues to a segment on a reasonable basis.

The contribution of these various business activities to the Bank's revenues and income for the years 2012, 2011 and 2010 follow (in millions):

	<u>Commercial Banking</u>	<u>Consumer Banking</u>	<u>Treasury Operations</u>	<u>Total</u>
December 31, 2012				
Statement of Income				
Net interest income	P 825	P 76	P 172	P 1,073
Non-interest income	<u>170</u>	<u>-</u>	<u>715</u>	<u>885</u>
Total income (after interest expense)	995	76	887	1,958
Operating expenses	<u>(745)</u>	<u>(38)</u>	<u>(464)</u>	<u>(1,247)</u>
Pre-tax profit	<u>250</u>	<u>38</u>	<u>423</u>	<u>711</u>
Net profit	<u>P 241</u>	<u>P 35</u>	<u>P 378</u>	<u>P 654</u>
Statement of Financial Position				
Total Resources				
Segment assets	P 20,621	P 1,126	P 10,841	P 32,588
Intangible assets	-	-	-	317
Deferred tax assets	<u>-</u>	<u>-</u>	<u>-</u>	<u>192</u>
	<u>P 20,621</u>	<u>P 1,126</u>	<u>P 10,841</u>	<u>P 33,097</u>
Total Liabilities	<u>P 16,422</u>	<u>P 940</u>	<u>P 11,333</u>	<u>P 28,695</u>
Other segment information				
Depreciation and amortization	<u>P 44</u>	<u>P 3</u>	<u>P 31</u>	<u>P 78</u>
Capital expenditures	<u>P 163</u>	<u>P 9</u>	<u>P 112</u>	<u>P 284</u>

	Commercial Banking	Consumer Banking	Treasury Operations	Total
<u>December 31, 2011</u>				
Statement of Income				
Net interest income	P 627	P 68	P 391	P 1,086
Non-interest income	168	-	595	763
Total income (after interest expense)	795	68	986	1,849
Operating expenses	(600)	(59)	(343)	(1,002)
Pre-tax profit	<u>195</u>	<u>9</u>	<u>643</u>	<u>847</u>
Net profit	<u><u>P 172</u></u>	<u><u>P 7</u></u>	<u><u>P 568</u></u>	<u><u>P 747</u></u>
Statement of Financial Position				
Total Resources				
Segment assets	P 16,216	P 1,054	P 8,338	P 25,608
Intangible assets	-	-	-	117
Deferred tax assets	-	-	-	160
	<u>P 16,216</u>	<u>P 1,054</u>	<u>P 8,338</u>	<u>P 25,885</u>
Total Liabilities	<u>P 11,165</u>	<u>P 924</u>	<u>P 10,123</u>	<u>P 22,212</u>
Other segment information				
Depreciation and amortization	<u>P 32</u>	<u>P 2</u>	<u>P 29</u>	<u>P 63</u>
Capital expenditures	<u>P 80</u>	<u>P 7</u>	<u>P 72</u>	<u>P 159</u>
<u>December 31, 2010</u>				
Statement of Income				
Net interest income	P 564	P 85	P 261	P 910
Non-interest income	173	-	608	781
Total Income	737	85	869	1,691
(after interest expense)	(656)	(49)	(300)	(1,005)
Operating expenses	81	36	569	686
Pre-tax profit	<u>81</u>	<u>36</u>	<u>569</u>	<u>686</u>
Net profit	<u><u>P 80</u></u>	<u><u>P 37</u></u>	<u><u>P 566</u></u>	<u><u>P 683</u></u>
Other segment information				
Depreciation and amortization	<u>P 28</u>	<u>P 3</u>	<u>P 18</u>	<u>P 49</u>
Capital expenditures	<u>P 14</u>	<u>P 1</u>	<u>P 9</u>	<u>P 25</u>

7. CASH AND DUE FROM BSP

This account is composed of the following:

	2012	2011
Cash and other cash items	P 435,898,545	P 297,076,011
Due from BSP		
Mandatory reserves	1,488,180,153	368,000,000
Other than mandatory reserves	<u>1,585,000,000</u>	<u>751,319,376</u>
	<u>3,073,180,153</u>	<u>1,119,319,376</u>
	<u><u>P 3,509,078,698</u></u>	<u><u>P 1,416,395,387</u></u>

Cash consists primarily of funds in the form of Philippine currency notes and coins in the Bank's vault and those in the possession of tellers, including automated teller machines. Other cash items include cash items (other than currency and coins on hand) such as checks drawn on the other banks or other branches that were received after the Bank's clearing cut-off time until the close of the regular banking hours.

Mandatory reserves represent the balance of the deposit account maintained with the BSP to meet reserve requirements and to serve as clearing account for interbank claims.

Due from BSP bears annual effective interest rates ranging from 0.00% to 4.07% in 2012, 0.13% to 0.25% in 2011, and 0.20% to 0.38% for 2010, except for the amounts within the required reserve as determined by the BSP. Total interest income earned amounted to P14.5 million, P16.9 million and P9.4 million in 2012, 2011 and 2010, respectively, and are included as part of Interest Income on Due from BSP and Other Banks in the statements of income.

Under Section 254 of the Manual of Regulations for Banks (MORB), a bank is required to maintain at least 25% of its reserve requirements in the form of deposits with the BSP as among the allowable instruments for reserve cover. Section 254.1 of the MORB further provides that such deposit account with the BSP is not considered as a regular current account as BSP checks for drawings against such deposits shall be limited to (a) settlement of obligations with the BSP, and (b) withdrawals to meet cash requirements.

Starting April 6, 2012, upon effectivity of BSP Circular No. 753 Series of 2012 (the Circular), required reserves of banks shall be kept in the form of deposits placed in the banks' demand deposit accounts with the BSP. As part of the transitory provisions, reserve deposit account that are maintained by banks in the reserve deposit account (RDA) with BSP, which are used in compliance with liquidity reserve requirement as of the effectivity of the Circular was eligible only until the accounts mature. Accordingly, RDA facility was discontinued and BSP will no longer accept new RDA placement from banks. This resulted to the nil balance of RDA as of December 31, 2012. Also, cash in vault presented as part of Cash and other cash items, shall be eligible for compliance with the reserve requirement only until the effectivity of the Circular.

8. DUE FROM OTHER BANKS

The balance of this account represents deposits with the following:

	<u>2012</u>	<u>2011</u>
Local banks	P 796,043,987	P 482,974,569
Foreign banks	<u>204,045,471</u>	<u>147,716,086</u>
	<u>P 1,000,089,458</u>	<u>P 630,690,655</u>

Interest rates on these deposits range from 0.01% to 2.75%, 0.25% to 2.75% and 0.25% to 2.50% per annum in 2012, 2011 and 2010, respectively. Total interest income earned amounted to P8.0 million, P2.4 million and P5.6 million in 2012, 2011 and 2010, respectively, and are included as part of Interest Income on Due from BSP and Other Banks in the statements of income.

The breakdown of due from other banks by currency follows:

	<u>2012</u>	<u>2011</u>
US dollars	P 864,129,447	P 539,250,930
Philippine pesos	<u>135,960,011</u>	<u>91,439,725</u>
	<u>P 1,000,089,458</u>	<u>P 630,690,655</u>

9. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

This account is composed of held-for-trading government securities with fair value amounting P207.7 million as of December 31, 2011 (nil in 2012). Interest rates on these investments range from 5.75% to 8.13%, 6.38% to 8.13%, and 6.25% to 8.75% per annum in 2012, 2011 and 2010, respectively. Total interest income earned amounted to P93.1 million, P19.1 million and P1.1 million in 2012, 2011 and 2010, respectively, and is included as part of Interest Income on Investment and Trading Securities in the statements of income. Related unrealized fair value gains or loss, presented as part of Trading Gains - net in the 2011 statement of income, amounted to a gain of P5.5 million (nil in 2012 and 2010). Realized trading gains, presented as part of Trading Gains - net in the 2012, 2011 and 2010 statements of income, amounted to P91.5 million, P111.8 million, and P21.5 million, respectively.

10. AVAILABLE-FOR-SALE SECURITIES

This account is mainly composed of the following:

	<u>2012</u>	<u>2011</u>
Government securities	P 4,895,202,574	P 4,959,486,972
Other private debt instruments	<u>889,334,015</u>	<u>751,378,548</u>
	<u>P 5,784,536,589</u>	<u>P 5,710,865,520</u>

As to currency, this account consists of the following:

	<u>2012</u>	<u>2011</u>
Philippine pesos	P 4,497,597,109	P 3,844,671,779
Foreign currencies	<u>1,286,939,480</u>	<u>1,866,193,741</u>
	<u>P 5,784,536,589</u>	<u>P 5,710,865,520</u>

Changes in the AFS securities are summarized below.

	<u>2012</u>	<u>2011</u>
Balance at beginning of year	P 5,710,865,521	P 6,623,022,640
Additions	13,528,772,418	10,977,153,805
Disposals	(13,137,527,190)	(12,333,414,967)
Fair value gains	185,130,710	467,638,969
Foreign currency revaluation	(119,891,281)	4,944,443
Amortization of premium	<u>(382,813,589)</u>	<u>(28,479,370)</u>
Balance at end of year	<u>P 5,784,536,589</u>	<u>P 5,710,865,520</u>

The reconciliation of unrealized fair value gains (losses) on AFS securities reported under equity is shown below.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Balance at beginning of year	P 521,895,286	P 59,976,876	(P 6,092,748)
Changes during the year:			
Fair value gains during the year	185,130,710	467,638,969	45,184,502
Amortization of fair value loss (gain)			
on reclassified AFS securities	(206,786)	(287,165)	2,719,038
Realized fair value losses (gains)			
on AFS securities disposed	(384,243,410)	(5,433,394)	18,166,084
during the year - net	<u>(199,319,486)</u>	<u>461,918,410</u>	<u>66,069,624</u>
Balance at end of year	<u>P 322,575,800</u>	<u>P 521,895,286</u>	<u>P 59,976,876</u>

Other private debt instruments including debt securities issued by foreign corporations as of December 31, 2012 and 2011 amounted to P593.2 million and P278.0 million, respectively, while those issued by local corporations amounted to P296.1 million and P473.4 million, respectively. AFS securities earn interest of 4.3% to 9.1%, 5.5% to 11.4% and 6.3% to 12.0% per annum in 2012, 2011 and 2010, respectively. Total interest income earned amounted to P253.9 million, P528.8 million, and P381.9 million in 2012, 2011 and 2010, respectively, and are included as part of Interest Income on Investment and Trading Securities in the statements of income. Fair value gains recycled to profit or loss from equity resulting from the sale of AFS securities amounted to a gain of P384.2 million and P5.4 million in 2012 and 2011 respectively, and a loss of P18.2 million in 2010. These are included as part of Trading Gains - net in the statements of income. Realized trading gains, presented as part of Trading Gains - net in the 2012, 2011 and 2010 statements of income, amounted to P621.5 million, P422.6 million and P540.7 million, respectively.

In 2008, the BSP under Circular No. 628 and pursuant to the amendments to PAS 39 and PFRS 7 allowed the reclassification of financial assets previously classified as AFS securities due to the tainting of HTM investments portfolio back to HTM category for prudential reporting purposes which was also approved by the SEC for financial reporting purposes. Accordingly, the Bank reclassified certain financial assets previously classified as financial assets at FVTPL and AFS securities to HTM investments.

The fair value of AFS securities reclassified amounted to P2,130.8 million including fair value loss of P36.1 million as of the date of reclassification on September 11, 2008. The annual effective interest rates of the reclassified securities ranged from 3.85% to 8.23%.

Presented below is the analysis of the fair value of the remaining financial assets reclassified from AFS securities to HTM investments.

	<u>2012</u>	<u>2011</u>
Fair value	P 12,560,943	P 23,889,073
Book value	<u>(12,112,007)</u>	<u>(22,614,861)</u>
Fair value gain recognized in equity of the outstanding reclassified securities	<u>P 448,936</u>	<u>P 1,274,212</u>

The unamortized fair value gains related to debt securities previously reclassified from AFS category to HTM investments amounted to P0.2 million and P0.5 million in 2012 and 2011, respectively. These amounts will be amortized over the remaining life of the reclassified investments or recognized to profit or loss upon sale, whichever comes earlier. Portion of fair value gain in comprehensive income amortized to profit or loss amounted to P0.2 million and P0.3 million for 2012 and 2011, respectively. In 2010, portion of fair value loss in comprehensive income amortized to profit or loss amounted to P2.7 million. There is no impact to total equity had the Bank not made the reclassification in 2008 since the Bank was subsequently tainted on its HTM investments and it reclassified all HTM investments to AFS securities as discussed below.

On September 14, 2009, in light of the improving market conditions, the Bank decided to reclassify the remaining securities reclassified to HTM investments in 2008 as discussed above to AFS securities and subsequently disposed a portion of the same. The carrying value of the HTM investments as of the date of reclassification in 2009 amounted to P2,621.7 million. Of the securities reclassified, P555.1 million was sold during 2009. Due to the Bank's change in intention and inability to hold the HTM investments until their maturity, the Bank is not allowed to classify any of its financial assets to HTM investments until end of 2011.

The fair values of AFS securities have been determined directly by reference to published prices in an active market.

In compliance with current banking regulations relative to the Bank's trust functions, certain AFS securities of the Bank, with face value of P26.3 million for both 2012 and 2011, are deposited with the BSP (see Note 25).

As of December 31, 2011, certain AFS securities, with face value of P958.0 million (nil in 2012) were assigned to another bank for the faithful observance of the Bank's obligation in its undertaking arising from letters of credit extended to its borrowers (see Note 26).

11. LOANS AND OTHER RECEIVABLES

Loans and other receivables consist of the following:

	<u>2012</u>	<u>2011</u>
Receivables from customers:		
Loans and discounts	P 16,289,726,871	P 11,108,879,023
Bills purchased	742,197,945	596,139,950
Customers' liabilities on acceptances, letters of credit and trust receipts	<u>2,650,658,670</u>	<u>1,905,973,799</u>
	19,682,583,486	13,610,992,772
Unearned discount	<u>(50,518,49)</u>	<u>(54,740,908)</u>
	<u>19,632,064,991</u>	<u>13,556,251,864</u>
Other receivables:		
Unquoted debt securities	1,450,850,479	620,409,664
Accrued interest receivable	114,753,768	103,640,510
Sales contracts receivable	94,217,865	44,809,169
Accounts receivable	86,343,332	58,001,421
Deficiency claims receivable - net SPURRA	43,366,498	59,198,952
Others	<u>5,169,902</u>	<u>2,754,000,000</u>
	<u>1,794,701,844</u>	<u>3,640,059,716</u>
	21,426,766,835	17,196,311,580
Allowance for impairment losses	<u>(557,614,114)</u>	<u>(491,656,035)</u>
	<u>P 20,869,152,721</u>	<u>P 16,704,655,545</u>

On various dates in 2002, the Bank purchased P259.0 million face value of the 10-year Poverty Eradication and Alleviation Certificates (PEACe) bonds, in the belief that these were tax-exempt. Said bonds were issued by the Bureau of Treasury (BTr) in 2001 which matured on October 18, 2011. As of December 31, 2012 and 2011, the Accounts receivable includes P36.7 million set up by the Bank for the final tax withheld by the BTr upon maturity of the bonds subject to the issuance of a Supreme Court decision on the matter. Management believes that recoverability of the final tax on PEACe bonds is still probable.

As of December 31, 2012 and 2011, non-performing loans of the Bank amounted to P607.6 million and P488.7 million, respectively, while restructured loans amounted to P133.5 million and P77.8 million, respectively.

A summary of the Bank's maximum exposure to credit risk on loans and other receivables is disclosed in Note 4.03.

The maturity profile of the Bank's loans and discounts follows (amounts in thousands):

	<u>2012</u>	<u>2011</u>
Within one year	P 15,620,655	P 10,626,504
Beyond one year	<u>4,061,928</u>	<u>2,984,489</u>
	<u>P 19,682,583</u>	<u>P 13,610,993</u>

The Bank's concentration of credit as to industry for its loans and discounts portfolio follows (amounts in thousands):

	<u>2012</u>	<u>2011</u>
Wholesale and retail trade	P 7,371,658	P 5,173,022
Manufacturing (various industries)	3,397,525	2,642,610
Real estate, renting and other related activities	2,484,314	1,897,755
Agriculture	495,271	279,852
Others	<u>5,933,815</u>	<u>3,617,754</u>
	<u>P 19,682,583</u>	<u>P 13,610,993</u>

As to security, loans and discounts are classified into the following (amounts in thousands):

	<u>2012</u>	<u>2011</u>
Secured:		
Real estate mortgage	P 5,946,384	P 4,196,180
Deposit hold-out	1,475,719	664,099
Chattel mortgage	1,431,387	958,672
Others	238,238	328,846
Unsecured	<u>10,590,855</u>	<u>7,463,196</u>
	<u>P 19,682,583</u>	<u>P 13,610,993</u>

The changes in the allowance for impairment losses on loans and other receivables are summarized below.

	<u>2012</u>	<u>2011</u>
Balance at beginning of year	P 491,656,035	P 488,658,104
Provision for impairment losses	65,948,079	50,000,000
Recovery	10,000	-
Write-off	-	(47,002,069)
Balance at end of year	<u>P 557,614,114</u>	<u>P 491,656,035</u>

Of the total loans and discounts of the Bank as of December 31, 2012 and 2011, 88.46% and 82.55%, respectively, are subject to periodic interest repricing.

Annual effective interest rates of loans and discounts range from 2.0% to 22.0% in 2012, 3.75% to 22.0% in 2011, and 1.4% to 26.0% in 2010, while the annual effective interest rates of interest-bearing other receivables range from 4.0% to 10.4% and 4.5% to 10.5% in 2012, 2011 and 2010, respectively. Total interest income earned from loans and discounts amounted to P1,203.8 million, P957.4 million, and P1,077.5 million, in 2012, 2011 and 2010, respectively, while total interest income earned from interest-bearing other receivables amounted to P133.6 million, P133.5 million and P34.8 million in 2012, 2011 and 2010, respectively. These are presented as Interest Income on Loans and Other Receivables and SPURRA in the statements of income.

Loans receivables amounting to P0.9 billion and P0.1 billion as of December 31, 2012 and 2011, respectively, are pledged as collaterals to secure borrowings under rediscounting privileges (see Note 16).

Realized trading gains on sale of unquoted debt securities, presented as part of Trading Gains – net in the 2011 and 2010 statements of income, amounted to P55.0 million and P46.0 million, respectively (nil in 2012).

12. BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT

The gross carrying amounts and accumulated depreciation and amortization of bank premises, furniture, fixtures and equipment at the beginning and end of 2012 and 2011 are shown below.

	Land	Building	Furniture, Fixtures and Equipment	Transportation Equipment	Leasehold Improvements	Total
December 31, 2012						
Cost	P 77,747,556	P 95,129,253	P 203,109,351	P 90,288,943	P 203,031,977	P 669,307,080
Accumulated depreciation and amortization	-	(26,939,121)	(118,350,928)	(32,754,613)	(92,767,261)	(270,811,923)
Net carrying amount	<u>P 77,747,556</u>	<u>P 68,190,132</u>	<u>P 84,758,423</u>	<u>P 57,534,330</u>	<u>P 110,264,716</u>	<u>P 398,495,157</u>
December 31, 2011						
Cost	P 77,747,556	P 96,962,603	P 168,059,971	P 78,232,912	P 146,190,209	P 567,193,251
Accumulated depreciation and amortization	-	(25,250,296)	(100,557,680)	(31,148,279)	(69,412,884)	(226,369,139)
Net carrying amount	<u>P 77,747,556</u>	<u>P 71,712,307</u>	<u>P 67,502,291</u>	<u>P 47,084,633</u>	<u>P 76,777,325</u>	<u>P 340,824,112</u>
January 1, 2011						
Cost	P 77,747,556	P 96,801,339	P 172,984,840	P 55,345,464	P 123,495,003	P 526,374,202
Accumulated depreciation and amortization	-	(23,229,836)	(103,877,899)	(27,323,335)	(51,572,237)	(206,003,307)
Net carrying amount	<u>P 77,747,556</u>	<u>P 73,571,503</u>	<u>P 69,106,941</u>	<u>P 28,022,129</u>	<u>P 71,922,766</u>	<u>P 320,370,895</u>

A reconciliation of the carrying amounts at the beginning and end of 2012 and 2011 is shown below.

	Land	Building	Furniture, Fixtures and Equipment	Transportation Equipment	Leasehold Improvements	Total
Balance at January 1, 2012, net of accumulated depreciation and amortization	P 77,747,556	P 71,712,307	P 67,502,291	P 47,084,633	P 76,777,325	P 340,824,112
Net additions (disposal)	-	(1,833,351)	40,951,913	26,464,968	57,787,734	123,371,264
Depreciation and amortization charges for the year	-	(1,688,824)	(23,695,781)	(16,015,271)	(24,300,343)	(65,700,219)
Balance at December 31, 2012, net of accumulated depreciation and amortization	<u>P 77,747,556</u>	<u>P 68,190,132</u>	<u>P 84,758,423</u>	<u>P 57,534,330</u>	<u>P 110,264,716</u>	<u>P 398,495,157</u>
Balance at January 1, 2011, net of accumulated depreciation and amortization	P 77,747,556	P 73,571,503	P 69,106,941	P 28,022,129	P 71,922,766	P 320,370,895
Net additions	-	411,103	17,628,695	30,683,631	22,695,205	71,418,634
Depreciation and amortization charges for the year	-	(2,270,299)	(19,233,345)	(11,621,127)	(17,840,646)	(50,965,417)
Balance at December 31, 2011, net of accumulated depreciation and amortization	<u>P 77,747,556</u>	<u>P 71,712,307</u>	<u>P 67,502,291</u>	<u>P 47,084,633</u>	<u>P 76,777,325</u>	<u>P 340,824,112</u>

The BSP requires that investment in bank premises, furniture, fixtures and equipment do not exceed 50% of the Bank's unimpaired capital. As of December 31, 2012 and 2011, the Bank has satisfactorily complied with this requirement.

13. INVESTMENT PROPERTIES

Investment properties include land and buildings held for capital appreciation, except for a certain property which is leased out to a third party. Rental income from investment property amounted to P1.4 million, presented as part of Others under Miscellaneous Income in the 2012 statement of income as disclosed in Note 19.01 (nil in 2011 and 2010). The related real estate taxes on investment properties amounting to P0.1 million for the year ended December 31, 2012 were recognized as a related expense in 2012 (nil in 2011 and 2010).

The gross carrying amounts and accumulated depreciation and impairment of investment properties at the beginning and end of 2012 and 2011 are shown below.

	<u>Land</u>	<u>Buildings and Improvements</u>	<u>Total</u>
December 31, 2012			
Cost	P 460,377,978	P 153,493,072	P 613,871,050
Accumulated depreciation	(-)	(33,866,275)	(33,866,275)
Allowance for impairment	(20,849,654)	(9,917,701)	(30,767,355)
Net carrying amount	<u>P 439,528,324</u>	<u>P 109,709,096</u>	<u>P 549,237,420</u>
December 31, 2011			
Cost	P 355,357,966	P 93,960,707	P 449,318,673
Accumulated depreciation	(-)	(27,627,805)	(27,627,805)
Allowance for impairment	(17,647,692)	(6,650,032)	(24,297,724)
Net carrying amount	<u>P 337,710,274</u>	<u>P 59,682,870</u>	<u>P 397,393,144</u>
January 1, 2011			
Cost	P 248,926,511	P 80,886,548	P 329,813,059
Accumulated depreciation	(-)	(23,366,623)	(23,366,623)
Allowance for impairment	(14,913,782)	(9,003,943)	(23,917,725)
Net carrying amount	<u>P 234,012,729</u>	<u>P 48,515,982</u>	<u>P 282,528,711</u>

A reconciliation of the carrying amounts of investment properties at the beginning and end of 2012 and 2011 is shown below.

	<u>Land</u>	<u>Buildings and Improvements</u>	<u>Total</u>
Balance at January 1, 2012, net of accumulated depreciation and impairment	P 337,710,274	P 59,682,870	P 397,393,144
Additions	218,036,288	65,482,410	283,518,698
Disposals	(113,016,276)	(799,312)	(113,815,588)
Impairment loss for the year	(3,201,962)	(3,267,669)	(6,469,631)
Depreciation for the year	(-)	(11,389,203)	(11,389,203)
Balance at December 31, 2012, net of accumulated depreciation and impairment	<u>P 439,528,324</u>	<u>P 109,709,096</u>	<u>P 549,237,420</u>
Balance at January 1, 2011, net of accumulated depreciation and impairment	P 234,012,729	P 48,515,982	P 282,528,711
Additions	127,494,539	31,763,000	159,257,539
Disposals	(23,796,994)	(9,953,847)	(33,750,841)
Depreciation for the year	(-)	(10,642,265)	(10,642,265)
Balance at December 31, 2011, net of accumulated depreciation and impairment	<u>P 337,710,274</u>	<u>P 59,682,870</u>	<u>P 397,393,144</u>

The fair value of investment properties, based on the latest appraised values at the end of each reporting period, as determined by internal or external appraisers are shown below.

	<u>2012</u>	<u>2011</u>
Land	P 448,131,330	P 369,113,210
Building and improvements	<u>144,192,918</u>	<u>82,345,048</u>
	<u>P 592,324,248</u>	<u>P 451,458,258</u>

Additions to investment properties include gain on foreclosure amounting to P4.5 million, P31.5 million and P9.1 million for the periods ended December 31, 2012, 2011 and 2010, respectively. These are presented as part of Gain on foreclosure under Miscellaneous Income in the statements of income (see Note 19.01).

In 2012 and 2011, gains on sale of investment properties amounted to P11.7 million and P9.8 million, respectively, and are presented as part of Gain on sale of properties under Miscellaneous Income in the statements of income (see Note 19.01). On the other hand, in 2010, loss on sale of investment properties amounting to P12.1 million was recognized and is presented as part of Loss on sale of properties under Miscellaneous Expense in the 2010 statement of income (see Note 19.02).

14. OTHER RESOURCES

This account consists of the following as of December 31:

	<u>Note</u>	<u>2012</u>	<u>2011</u>
Due from head office or branches		P 342,707,056	P 140,369,137
Branch licenses		246,500,000	20,000,000
Deferred tax assets - net	22	192,465,883	159,606,709
Goodwill		49,878,393	49,878,393
Foreign currency notes and coins on hand		33,269,353	18,339,274
Computer software - net		20,662,395	21,393,222
Security deposits		19,045,693	10,027,324
Deferred charges		17,643,424	17,643,424
Prepaid expenses		15,446,701	2,339,797
Creditable withholding tax		14,834,740	-
Stationery and supplies		13,839,505	6,446,612
Miscellaneous		<u>38,025,018</u>	<u>47,850,965</u>
		1,004,318,161	493,894,857
Allowance for impairment		<u>(17,643,424)</u>	<u>(17,643,424)</u>
		<u>P 986,674,737</u>	<u>P 476,251,433</u>

14.01 Branch Licenses

Branch licenses as of December 31, 2011 pertain to the Bank's acquisition of the four licenses from Prime Savings Bank, Inc. for a total consideration of P20 million.

In November 2011, the Monetary Board of BSP approved the request of the Bank to establish fifteen branches in selected restricted cities in Metro Manila for a total consideration of P226.5 million which was paid by the Bank to the BSP in January 2012.

14.02 Goodwill

Goodwill represents the excess of the cost of acquisition over the fair value of the net assets of Kabalikat Rural Bank, Inc. (KRBI) at the date of merger in 2010.

On April 22, 2008, the Bank entered into a Purchase Agreement (the Agreement) with the stockholders of KRBI wherein the Bank purchased all of KRBI's shares of stock, properties, resources and goodwill for a consideration amounting to P16.0 million.

Subsequently, on May 21, 2008, the Bank and KRBI entered into a Plan of Merger which became effective on March 3, 2010, the date of the approval by the SEC of the Articles of Merger under the Plan of Merger, which were previously approved by the BSP.

Under the merger, the entire resources and liabilities of KRBI were transferred to and absorbed by PBB. In applying the acquisition method, the financial statement items of PBB and KRBI were combined at the acquisition date, March 3, 2010.

The total fair values of the resources and liabilities of KRBI that were absorbed by PBB on March 3, 2010 were P25,252,181 and P59,130,574, respectively, with fair value of the net liabilities of KRBI amounting to P33,878,393. The total consideration for KRBI amounted to P49,878,393, representing the initial cash payment of P16,000,000 and the net liabilities of P33,878,393 assumed by the Bank. As such, the Bank recognized goodwill amounting to P49,878,393 representing the excess of purchase price over the fair value of KRBI's net assets.

14.03 Others

Deferred charges amounting to P17.6 million as of December 31, 2012 and 2011 pertain to prepaid final taxes from prior years that are fully provided with allowance since the Bank has assessed that these prepaid taxes are no longer recoverable.

Other properties held for sale (included under Miscellaneous) are presented net of accumulated depreciation of P3.2 million and P3.1 million for 2012 and 2011, respectively. Depreciation expense recognized in 2012, 2011 and 2010 amounted to P0.5 million, P1.6 million and P1.1 million, respectively, and are presented as part of Depreciation and Amortization in the statements of income. Additions to other properties held for sale in 2012 and 2011, as a result of foreclosure, amounted to P2.7 million and P6.0 million, respectively. The Bank recognized losses on foreclosure of other properties held for sale amounting to P3.5 million and gains on foreclosure of other properties held for sale amounting to P0.6 million in 2012 and 2011, respectively (nil in 2010). These are presented as part of Gain on foreclosure under Miscellaneous Income in 2012 and 2011 statements of income (see Notes 19.01).

In 2012, gains on sale of other properties held for sale amounted to P0.5 million and are presented as part of Gain on sale of properties - net in the 2012 statement of income (see Note 19.01). In 2011 and 2010, losses and gains on sale of other properties held for sale amounted to P0.6 million and P0.3 million, respectively. These are presented as net to Gain on sale of properties in 2011 and Loss on sale of properties in the 2010 statements of income (see Notes 19.01 and 19.02).

15. DEPOSIT LIABILITIES

The maturity profile of the Bank's deposit liabilities follows:

	<u>2012</u>	<u>2011</u>
Within one year	P 26,127,182,946	P 20,935,723,448
Beyond one year	321,703,792	259,264,669
	<u>P 26,448,886,738</u>	<u>P 21,194,988,117</u>

The classification of the Bank's deposit liabilities as to currency follows:

	<u>2012</u>	<u>2011</u>
Philippine pesos	P 24,317,283,308	P 18,894,928,262
Foreign currencies	2,131,603,430	2,300,059,855
	<u>P 26,448,886,738</u>	<u>P 21,194,988,117</u>

Interest rates on deposit liabilities range from 0.25% to 4.75% per annum in 2012, 0.25% to 5.0% per annum in 2011, and 0.25% to 4.5% in 2010.

As mentioned in Note 21, the Bank has deposit liabilities from DOSRI as of December 31, 2012 and 2011.

16. BILLS PAYABLE

This account consists of the following (including the related accrued interest):

	<u>2012</u>	<u>2011</u>
BSP	P 711,165,218	P 29,197,284
Other bank	<u>54,324,299</u>	<u>92,285,315</u>
	<u>P 765,489,517</u>	<u>P 121,482,599</u>

The maturity profile of bills payable follows:

	<u>2012</u>	<u>2011</u>
Within one year	P 712,623,267	P 37,102,210
Beyond one year	<u>52,866,250</u>	<u>84,380,389</u>
	<u>P 765,489,517</u>	<u>P 121,482,599</u>

Bills payable are denominated in Philippine pesos with annual interest rates ranging from 3.75% to 5.35%, 4.0% to 5.35%, and 4.0% to 4.75% in 2012, 2011 and 2010, respectively. Total interest expense incurred amounted to P25.9 million, P36.2 million and P48.6 million in 2012, 2011 and 2010, respectively, and these are presented as Interest Expense on Bills Payable in the statements of income. Bills payable are collateralized by certain loans from customers (see Note 11).

17. ACCRUED EXPENSES AND OTHER LIABILITIES

The breakdown of this account follows:

	<u>Notes</u>	<u>2012</u>	<u>2011</u>
Bills purchased		P 731,630,900	P 585,572,905
Outstanding acceptances		444,449,958	28,138,722
Accounts payable		143,442,056	90,733,003
Accrued expenses	28.01	66,445,781	85,486,530
Manager's checks		62,760,689	93,368,852
Post-employment benefit obligation	20.02	17,808,558	6,791,741
Others		<u>13,999,073</u>	<u>5,520,580</u>
		<u>P 1,480,537,015</u>	<u>P 895,612,333</u>

Bills purchased pertain to availments of the bills purchase line which are settled on the third day from the transaction date.

Outstanding acceptances pertain to the liabilities recognized by the Bank in its undertaking arising from letters of credit extended to its borrowers.

Accounts payable include amounts which the Bank owes to its suppliers and advance payments received from its customers.

Accrued expenses include accruals on employee benefits, utilities, janitorial and security services fees and others.

18. EQUITY

18.01 Capital Stock

Capital stock as of December 31 consists of:

	Number of Shares		Amount	
	2012	2011	2012	2011
Preferred shares – P10 par value in 2012 and P100 par value in 2011				
Authorized – 130,000,000 shares in 2012 and 13,000,000 shares in 2011				
Issued and subscribed				
Balance at beginning of year	6,200,000	6,200,000	P 620,000,000	P 620,000,000
Change in par value	55,800,000	-	-	-
Balance at end of year	62,000,000	6,200,000	620,000,000	620,000,000
Subscriptions receivable				
Balance at beginning of year			(375,000,000)	(375,000,000)
Collections during the year			375,000,000	-
Balance at end of year			-	(375,000,000)
			<u>P 620,000,000</u>	<u>P 245,000,000</u>
Common shares – P10 par value in 2012 and P100 par value in 2011				
Authorized – 870,000,000 shares in 2012 and 17,000,000 shares in 2011				
Issued and subscribed	4,200,000	4,200,000	P 420,000,000	P 420,000,000
Stock dividends	20,000,000	-	2,000,000,000	-
Change in par value	217,800,000	-	-	-
	<u>242,000,000</u>	<u>4,200,000</u>	<u>P2,420,000,000</u>	<u>P 420,000,000</u>

The Bank's preferred shares are nonvoting, nonconvertible, and are redeemable at the option of the Bank. These shares are entitled to non-cumulative dividend of 8% per annum. The dividends for preferred shares are declared upon the sole discretion of the Bank's BOD.

In a joint special meeting held on July 27, 2007, the Bank's BOD and stockholders approved the increase of the Bank's authorized capital stock from P1 billion, divided into seven million common shares and three million preferred shares to P3 billion, divided into 17 million common shares and 13 million preferred shares, both with par value of P100 per share. In connection with this, on June 19, 2009, the Bank received cash infusion amounting to P125 million from three subscribers representing 25% of the total subscription price of P500.0 million representing five million preferred shares to be taken out from the increase in authorized capital stock. The Bank's application for increase in authorized capital stock was approved by the SEC on September 17, 2009. As of December 31, 2011, the balance of subscriptions receivable that relates to the five million subscribed preferred shares amounted to P375.0 million (nil in 2012). The subscriptions receivable pertaining to the said preferred shares were collected from the subscribers in cash on September 6, 2012.

On July 16, 2012, the BOD and the stockholders representing at least two-thirds of the issued and outstanding capital stock approved the following amendments, among others, to the articles of incorporation of the Bank: (i) increase in the authorized capital stock to P10 billion divided into 870 million common shares with par value of P10 per share and 130 million preferred shares with par value of P10 per share from P3 billion authorized capital stock divided into 17 million common shares with par value of P100 per share and 13 million preferred shares with par value of P100 per share, and; (ii) change in the features of preferred shares from redeemable and non-convertible to redeemable and convertible to common shares at par value at the option of the Bank. On November 27, 2012, the BOD approved to revoke the July 16, 2012 approval to change the features of preferred shares to redeemable and convertible to common at par value. The amended articles of incorporation (excluding the change of the features of preferred shares to redeemable and convertible to common shares) were approved by the BSP and SEC on October 16, 2012 and November 16, 2012, respectively.

Also on July 16, 2012, the stockholders representing at least two-thirds of the issued and outstanding capital stock, approved the declaration of cash dividends amounting to P100.35 million for all issued and outstanding preferred shares and stock dividends totaling 20 million common shares amounting to P2 billion for all issued and outstanding common shares to stockholders on record for the year ended December 31, 2011. The dividend distribution was approved by the BSP on October 17, 2012.

As of December 31, 2012, the Bank has eight stockholders owning 100 or more common shares each of the Bank's capital stock.

18.02 Appropriated Surplus

On August 16, 2003, the BOD approved the establishment of a sinking fund for the exclusive purpose of the redemption of redeemable preferred shares should the Bank opt to redeem the shares. As of December 31, 2012 and 2011, the sinking fund for the redemption of redeemable preferred shares is yet to be established.

In 2012 and 2011, additional appropriations of surplus amounting to P0.6 million and P0.3 million (nil in 2010), respectively, pertain to the portion of the Bank's income from trust operations set-up in compliance with BSP regulations (see Note 25).

18.03 Restatement of Prior Years Financial Statements

Certain statement of comprehensive income accounts in 2011 and 2010 were restated to conform with the 2012 financial statements presentation. These pertain to the reclassification of Interest Income on Investment and Trading Securities to Interest Income on Loans and Other Receivables in the statements of income of both years.

The effect of the reclassification on certain statement of income accounts for the years ended December 31, 2011 and 2010 are presented below.

	<u>Notes</u>	<u>As Previously Reported</u>	<u>Prior Period Reclassification</u>	<u>As Restated</u>
December 31, 2011				
Reclassification of interest income on:				
Investment and trading securities	9, 10	P 615,377,020	(P 67,564,038)	P 547,812,982
Loans and other receivables	11	963,876,515	67,564,038	1,031,440,553
December 31, 2010				
Reclassification of interest income on:				
Investment and trading securities	9, 10	382,954,936	(151,474,926)	231,480,010
Loans and other receivables	11	930,705,018	151,474,926	1,082,179,944

The reclassification did not result in any adjustment to the 2011 and 2010 statements of financial position, comprehensive income, changes in equity and cash flows.

The reclassification has no effect on the earnings per share for the years ended December 31, 2011 and 2010.

19. MISCELLANEOUS INCOME AND EXPENSES

19.01 Miscellaneous Income

This account is composed of the following:

	<u>Notes</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>
Gain on sale of properties – net	13, 14	P 12,226,663	P 9,199,762	P -
Trust fees	25	5,959,343	4,102,522	6,103,861
Gain on foreclosure - net	13, 14	1,018,455	32,028,960	9,096,006
Income from write-off of long outstanding payable		-	11,499,716	14,511,557
Reversal of various accruals		-	15,780,874	12,399,686
Foreign exchange gain – net		-	442,526	-
Consultancy fee		52,353,685	-	-
Others		<u>32,657,922</u>	<u>29,473,098</u>	<u>16,699,070</u>
		<u>P 104,216,068</u>	<u>P 102,527,458</u>	<u>P 58,810,180</u>

Consultancy fee pertains to a one-time fee received by the Bank for acting as a financial advisor for the settlement of a third party's obligation to another counterparty.

Others include, among others, commitment, processing and handling fees in relation to services rendered by the Bank.

19.02 Miscellaneous Expenses

This account is composed of the following:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Litigation on asset acquired	P 26,475,997	P 27,891,414	P 4,773,524
Communication	13,987,594	11,683,582	10,969,537
Advertising and publicity	12,076,687	3,582,540	12,234,623
Foreign currency loss - net	11,041,216	-	975,553
Banking fees	8,663,057	6,752,348	8,884,096
Amortization of software licenses	6,956,079	5,824,407	497,957
Membership dues	1,305,265	1,272,487	1,621,750
Information technology	626,073	-	-
Donations and contributions	202,503	2,081,174	2,009,720
Loss on sale of properties - net	-	-	11,838,992
Others	<u>290,632,912</u>	<u>233,478,678</u>	<u>173,712,922</u>
	<u>P 371,967,383</u>	<u>P 292,566,630</u>	<u>P 227,518,674</u>

Others include, among others, occupancy, transportation and travel, supplies, brokerage fees, commissions, appraisal and processing fees incurred by the Bank.

20. EMPLOYEE BENEFITS

20.01 Salaries and Other Employee Benefits

Expenses recognized for salaries and other employee benefits are broken down below.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Salaries and wages	P 185,125,618	P 145,979,695	P 120,531,440
Bonuses	59,666,530	46,904,563	38,341,736
Post-employment			
defined benefit plan	12,262,810	6,701,781	6,906,959
Social security costs	10,722,110	8,937,407	7,667,071
Short-term medical benefits	246,589	607,817	301,675
Other short-term benefits	<u>54,501,366</u>	<u>46,249,395</u>	<u>38,037,125</u>
	<u>P 322,525,023</u>	<u>P 255,380,658</u>	<u>P 211,786,006</u>

20.02 Post-employment Benefit

The Bank maintains a partially funded, tax-qualified, noncontributory retirement plan that is being administered by a trustee covering all regular full-time employees. Actuarial valuations are made annually to update the retirement benefit costs and the amount of contributions.

The amounts of post-employment benefit obligation recognized and included as part of Accrued Expenses and Other Liabilities account in the statements of financial position are determined as follows (see Note 17):

	<u>2012</u>	<u>2011</u>
Present value of the DBO	P 89,870,700	P 65,437,303
Fair value of plan assets	(49,629,617)	(44,927,195)
Deficiency of plan assets	40,241,083	20,510,108
Unrecognized actuarial losses	(22,432,525)	(13,718,367)
	<u>P 17,808,558</u>	<u>P 6,791,741</u>

The movements in the present value of the DBO recognized in the books follow:

	<u>2012</u>	<u>2011</u>
Balance at beginning of year	P 65,437,303	P 37,394,689
Current service and interest cost	14,745,430	9,522,320
Benefits paid	(506,680)	(4,456,465)
Actuarial losses	10,194,647	22,976,759
Balance at end of year	<u>P 89,870,700</u>	<u>P 65,437,303</u>

As at December 31, the composition of plan assets is presented below.

	<u>2012</u>	<u>2011</u>
Due from BSP	P 4,010,443	P -
Deposits in own bank	6,857,113	6,317,681
AFS securities – government securities	13,136,519	38,561,168
HTM investments - government securities	24,177,592	-
Others	1,447,950	48,346
	<u>P 49,629,617</u>	<u>P 44,927,195</u>

The movements in the fair value of plan assets are presented below.

	<u>2012</u>	<u>2011</u>
Balance at beginning of year	P 44,927,195	P 34,893,924
Expected return on plan assets	2,745,524	2,791,514
Actuarial gains	1,217,585	4,755,263
Contributions paid into the plan	1,245,993	6,942,959
Benefits paid	(506,680)	(4,456,465)
Balance at end of year	<u>P 49,629,617</u>	<u>P 44,927,195</u>

The amounts of post-employment benefits recognized in the statements of income follow:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Current service cost	P 10,531,180	P 6,584,400	P 5,609,263
Interest cost	4,214,250	2,937,920	2,330,958
Expected return on plan assets	(2,745,524)	(2,791,514)	(954,040)
Net actuarial losses (gains) recognized during the year	<u>262,904</u>	<u>(29,025)</u>	<u>(79,222)</u>
	<u>P 12,262,810</u>	<u>P 6,701,781</u>	<u>P 6,906,959</u>

The movements in the balance of post-employment benefit obligation are as follows:

	<u>2012</u>	<u>2011</u>
Balance at beginning of year	P 6,791,741	P 7,032,919
Expense recognized	12,262,810	6,701,781
Contributions paid into the plan	<u>(1,245,993)</u>	<u>(6,942,959)</u>
Balance at end of year	<u>P 17,808,558</u>	<u>P 6,791,741</u>

The Bank plans to contribute P1,133,819 to the post-employment benefit plan in 2013.

In determining the amounts of post-employment benefit obligation, the following actuarial assumptions were used:

	<u>2012</u>	<u>2011</u>
Discount rates	5.89%	6.44%
Expected rate of return on plan assets	8.00%	8.00%
Expected rate of salary increases	5.00%	5.00%

Presented below is the historical information related to the present value of the DBO, fair value of plan assets and deficit in the plan (in thousands) arising on plan assets and liabilities.

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Present value of the obligation	P 89,871	P 65,437	P 37,395	P 29,137	P 28,060
Fair value of the plan assets	<u>49,630</u>	<u>44,927</u>	<u>34,894</u>	<u>11,926</u>	<u>11,775</u>
Deficit in the plan	<u>P 40,241</u>	<u>P 20,510</u>	<u>P 2,501</u>	<u>P 17,211</u>	<u>P 16,285</u>

21. RELATED PARTY TRANSACTIONS

The Bank's related parties include entities under common ownership, key management and others as described below.

The following are the Bank's transactions with related parties:

Related Party Category	Notes	2012		2011	
		Amount of Transaction	Outstanding Balance	Amount of Transaction	Outstanding Balance
Entities under common ownership					
Deposit liabilities	21.01	P 2,516,345,619	P 5,661,977,764	P 458,814,915	P 3,145,632,145
Loans	21.02	547,053,786	782,053,786	235,523,669	235,523,669
Interest income on loans	21.02	11,920,599	2,046,583	1,768,926	1,613,931
Retirement fund	21.03	739,313	17,808,558	2,486,494	6,791,741
Key management and others					
Compensation	21.04	67,106,365	-	51,211,281	-
Loans	21.02	5,421,877	18,787,338	49,777,378	24,209,215
Interest income on loans	21.02	1,327,033	92,608	1,312,333	81,968
Sale of investment properties	21.02	300,000	-	250,000	-

21.01 DOSRI Deposits

The total balance of DOSRI deposits are inclusive of the corresponding related accrued interest included in the financial statements as of December 31, 2012 and 2011.

21.02 DOSRI Loans

- a. The Bank has loan transactions with its officers and employees. The General Banking Act of the BSP provides that in aggregate, loans to DOSRI generally should not exceed the Bank's total equity or 15% of the Bank's total loan portfolio, whichever is lower. In addition, the amount of individual loans to DOSRI, of which 70% must be secured, should not exceed the amount of their deposits and the book value of their investments in the Bank. As of December 31, 2012 and 2011, the Bank has satisfactorily complied with the BSP requirement on DOSRI limits.

Relative to the DOSRI loans, the following additional information is also presented:

	2012	2011
Total outstanding DOSRI loans	P 800,841,124	P 259,732,884
% to total loan portfolio	4.1%	1.2%
% of unsecured DOSRI loans to total DOSRI loans	1.0%	3.4%

The Bank has no past due DOSRI loans as of December 31, 2012 and 2011. As of December 31, 2012, the Bank has an approved line of credit to certain related parties totaling P218.0 million of which P207.8 million was used to guarantee the obligation of the respective related parties to other creditors up to the extent of the unused line of credit.

The Bank has no unsecured loan that is subject to 30% aggregate DOSRI ceiling. Unsecured DOSRI loans to the officers of the Bank, which are subject to the 5% ceiling for loans under fringe benefits program under MORB, amounted to P18.1 million and P24.2 million, as of December 31, 2012 and 2011, respectively.

- b. The BOD approved the sale of investment properties on May 21, 2012 for an amount equal to its carrying value of P0.3 million, and on June 2, 2011 with a carrying value of P0.4 million for P0.3 million. There are no outstanding receivables from these DOSRI sale transactions as of December 31, 2012 and 2011.

21.03 Transactions with Retirement Fund

The Bank's retirement fund has no transactions direct and indirect with the Bank or its employees as of December 31, 2012, except for the contributions and benefits paid out of the plan to the Bank's employees as disclosed in Note 20.02.

21.04 Key Management Personnel Compensation

Salaries and short-term benefits received by key management personnel are summarized below.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Salaries and wages	P 45,629,360	P 35,588,847	P 16,335,245
Bonuses	11,610,623	8,871,712	4,060,107
Other short-term benefits	6,292,113	4,855,279	383,132
Post-employment defined benefit	2,551,469	1,343,903	749,675
Social security costs	<u>1,022,800</u>	<u>551,540</u>	<u>1,458,910</u>
	<u>P 67,106,365</u>	<u>P 51,211,281</u>	<u>P 22,987,069</u>

22. TAXES

The components of tax expense for the years ended December 31, 2012, 2011 and 2010 follow:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Current tax expense:			
Final tax on income at 20%, 10% and 7.5%	P 73,261,960	P 100,614,810	P 56,559,818
Minimum corporate income tax (MCIT) at 2%	15,172,799	6,374,842	11,394,468
Regular corporate income tax (RCIT) at 30%	<u>856,207</u>	<u>5,467,061</u>	<u>999,877</u>
	<u>P 89,290,966</u>	<u>P 112,456,713</u>	<u>P 68,954,163</u>
Deferred tax income relating to origination and reversal of temporary differences	<u>(32,859,173)</u>	<u>(12,895,338)</u>	<u>(66,209,946)</u>
Tax expense reported in the statements of income	<u>P 56,431,793</u>	<u>P 99,561,375</u>	<u>P 2,744,217</u>

A reconciliation of tax on pretax profit computed at the applicable statutory rates to tax expense reported in the statements of income follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Tax on pretax profit at 30%	P 213,215,144	P 253,960,649	P 205,806,388
Adjustment for income subjected to lower tax rates	<u>(23,283,941)</u>	<u>(62,119,270)</u>	<u>(49,762,803)</u>
Tax effects of:			
Non-taxable income	<u>(227,439,423)</u>	<u>(208,034,794)</u>	<u>(194,432,063)</u>
Non-deductible expenses	<u>93,940,013</u>	<u>115,754,790</u>	<u>41,132,695</u>
Tax expense reported in the statements of income	<u>P 56,431,793</u>	<u>P 99,561,375</u>	<u>P 2,744,217</u>

As of December 31, 2012 and 2011, the Bank has unrecognized deferred tax assets amounting to P11.9 million which pertain to certain allowance for impairment losses absorbed from KRBI upon merger amounting to P39.6 million.

The Bank is subject to MCIT computed at 2% of gross income as defined under the tax regulations or RCIT, whichever is higher. The breakdown of the Bank's MCIT which can be applied against RCIT follows:

<u>Year</u>	<u>Original Amount</u>	<u>Applied in Current Year</u>	<u>Remaining Balance</u>	<u>Valid Until</u>
2012	P 15,172,799	P -	P 15,172,799	2015
2011	6,374,842	-	6,374,842	2014
2010	11,394,468	-	11,394,468	2013
	<u>P 32,942,109</u>	<u>P -</u>	<u>P 32,942,109</u>	

For the years ended December 31, 2012 and 2011, the Bank opted to claim itemized deductions.

The net deferred tax assets as of December 31, 2012 and 2011 (included as part of Other Resources account – see Note 14) relate to the following:

	<u>Statements of Financial Position</u>		<u>Statements of Income</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Deferred tax assets:				
Allowance for impairment	P 169,910,136	P 148,184,823	(P 21,725,313)	(P 899,379)
Excess MCIT over RCIT	32,942,109	17,769,310	(15,172,799)	(6,374,842)
Accumulated depreciation of investment properties and other properties held for sale	11,109,045	9,206,233	(1,902,812)	(1,749,092)
Post-employment benefit obligation	5,342,567	2,037,522	(3,305,045)	72,354
Unamortized past service cost	3,558,456	4,065,270	506,814	399,246
Accrued bonus and leave conversion	2,481,373	13,078,830	10,597,457	(13,078,830)
Provision for contingencies	-	-	-	1,029,510
Deferred tax liabilities:				
Gain on initial exchange of investment properties	(29,702,243)	(34,735,279)	(5,033,035)	7,705,695
Excess payment over accrual of expenses	(3,175,560)	-	3,175,560	-
Net Deferred Tax Assets	<u>P 192,465,883</u>	<u>P 159,606,709</u>		
Deferred Tax Income			<u>(P 32,859,173)</u>	<u>(P 12,895,338)</u>

23. EVENTS AFTER THE END OF THE REPORTING PERIOD

The PSE and the Philippine SEC approved the Bank's application for the listing of its common stock on January 9, 2013 and on February 5, 2013, respectively. The approval covered the initial public offering (IPO) of 101,333,400 million unissued common shares of the Bank at P31.50 offer price per share and the listing of those shares on PSE's main board on February 19, 2013.

24. COMMITMENTS AND CONTINGENT LIABILITIES

The following are the significant commitments and contingencies involving the Bank:

- a. The Bank leases the premises occupied by its branch offices for periods ranging from 5 to 20 years, renewable upon mutual agreement between the Bank and the lessors. Rent expense amounted to P60.1 million, P47.0 million and P40.7 million in 2012, 2011 and 2010, respectively, and are included as part of Others under Miscellaneous Expenses in the statements of income.

As of December 31, 2012 and 2011, future minimum rental payments required by the lease contracts are as follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Within one year	P 54,608,414	P 40,311,242	P 37,069,702
After one year but not more than five years	133,513,317	128,913,938	105,385,295
More than five years	<u>26,165,256</u>	<u>24,880,204</u>	<u>31,279,490</u>
	<u>P 214,286,987</u>	<u>P 194,105,384</u>	<u>P 173,734,487</u>

- b. In the normal course of the Bank's operations, the Bank has various outstanding commitments and contingent liabilities such as guarantees, commitments to extend credit, etc., which are not reflected in the financial statements.
- c. The Bank recognizes in its books any losses and liabilities incurred in the course of its operations as soon as these become determinable and quantifiable.

The following is a summary of the Bank's commitments and contingent accounts as of December 31:

	<u>2012</u>	<u>2011</u>
Investment management accounts	P 1,462,371,014	P 1,841,713,573
Outstanding letters of credit	364,819,500	968,787,354
Trust and other fiduciary accounts	102,541,928	80,231,813
Unit investment trust fund	14,851,696	11,551,210
Outward bills for collection	5,059,810	24,905,629
Late deposits/payments received	2,188,903	9,853,633
Items held for safekeeping	19,367	20,805
Items held as collateral	6,627	5,816
Other contingent accounts	<u>394,551,132</u>	<u>190,415,055</u>
	<u>P 2,346,409,977</u>	<u>P 3,127,484,888</u>

As of December 31, 2012, the Bank's management believes that losses, if any, from the above commitments and contingencies will not have a material effect on the Bank's financial statements.

25. TRUST OPERATIONS

The following securities and other properties held by the Bank in fiduciary or agency capacity (for a fee) for its customers are not included in the statements of financial position since these are not properties of the Bank:

	<u>2012</u>	<u>2011</u>
Due from BSP	P 192,000,000	P 704,405,700
Due from banks	29,425,392	43,711,321
Loans and other receivables	541,888,348	559,205,790
Investment securities	<u>816,450,898</u>	<u>626,173,785</u>
	<u>P 1,579,764,638</u>	<u>P 1,933,496,596</u>

In compliance with the requirements of the General Banking Act relative to the Bank's trust functions:

- (a) Government bonds owned by the Bank with face value of P26.3 million as of December 31, 2012 and 2011, respectively, are deposited with the BSP (see Note 10); and,
- (b) 10% of the trust income is transferred to appropriated surplus. This transfer is required until the surplus reserve for trust function is equivalent to 20% of the Bank's authorized capital stock. As of December 31, 2012 and 2011, the reserve for trust functions amounted to P0.6 million and P0.3 million, respectively, and is presented as Appropriated Surplus in the Bank's statements of changes in equity.

Income from trust operations, shown as part of Miscellaneous Income, amounted to P6.0 million, P4.1 million and P6.1 million for the years ended December 31, 2012, 2011 and 2010, respectively, in the statements of income (see Note 19.01).

26. SELECTED FINANCIAL PERFORMANCE INDICATORS

a. The following are some of the financial performance indicators of the Bank:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Return on average capital			
$\frac{\text{Net profit}}{\text{Average total capital accounts}}$	16.2%	24.3%	32.7%
Return on average resources			
$\frac{\text{Net profit}}{\text{Average total resources}}$	2.2%	3.1%	3.5%
Net interest margin			
$\frac{\text{Net interest income}}{\text{Average interest earning resources}}$	3.9%	4.6%	4.8%
Capital to risk assets ratio			
$\frac{\text{Total capital}}{\text{Risk resources}}$	18.86%	26.5%	22.8%
Liquidity ratio			
$\frac{\text{Current assets}}{\text{Current liabilities}}$	1.2	1.1	0.9
Debt-to-equity ratio			
$\frac{\text{Liabilities}}{\text{Equity}}$	6.5	6.0	8.0
Asset-to-equity ratio			
$\frac{\text{Asset}}{\text{Equity}}$	7.5	7.0	9.0
Interest rate coverage ratio			
$\frac{\text{Earnings before interests and taxes}}{\text{Interest expense}}$	2.1	2.5	2.5

b. Secured Liabilities and Resources Pledged as Security

As of December 31, 2012 and 2011, bills payable are the only secured liabilities (see Note 16). Additionally, certain AFS securities as of December 31, 2011 (nil in 2012) were assigned to another bank for the faithful observance of the Bank's obligation in its undertaking arising from letters of credit extended to its borrowers (see Note 10).

27. EARNINGS PER SHARE

27.01 Basic Earnings Per Share

Basic earnings per share are computed as follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Net profit	P 654,285,353	P 746,974,122	P 683,277,077
Dividends on preferred shares	<u>(100,350,000)</u>	<u>-</u>	<u>-</u>
Net profit attributable to common shareholders	553,935,353	746,974,122	683,277,077
Divided by the weighted average number of outstanding common shares	<u>242,000,000</u>	<u>242,000,000</u>	<u>242,000,000</u>
Basic earnings per share	<u>P 2.29</u>	<u>P 3.09</u>	<u>P 2.82</u>

27.02 Diluted Earnings Per Share

Diluted earnings per share are computed as follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Net profit	P 654,285,353	P 746,974,122	P 683,277,077
Dividends on preferred shares	<u>(100,350,000)</u>	<u>-</u>	<u>-</u>
Net profit attributable to common shareholders	553,935,353	746,974,122	683,277,077
Divided by the weighted average number of outstanding common shares	<u>242,000,000</u>	<u>242,000,000</u>	<u>242,000,000</u>
Diluted earnings per share	<u>P 2.29</u>	<u>P 3.09</u>	<u>P 2.82</u>

The 2011 and 2010 earnings per share of the Bank were restated to account for the stock dividends declared and change in par value in 2012. These are considered as a bonus issue and stock split, respectively, under PAS 33, Earnings per Share, which require stock dividends issued and change in par value to be recognized as if it occurred at the beginning of 2010, the earliest period presented for earnings per share computation.

28. SUPPLEMENTARY INFORMATION REQUIRED BY THE BUREAU OF INTERNAL REVENUE

Presented below is the supplementary information which is required by the Bureau of Internal Revenue (BIR) under its existing revenue regulations to be disclosed as part of the notes to financial statements. This supplementary information is not a required disclosure under FRSP for banks.

28.01 Requirements Under Revenue Regulation (RR) 15-2010

The information on taxes, duties and license fees paid or accrued during the taxable year under RR 15-2010 follows:

(a) Gross Receipts Tax (GRT)

In lieu of the value-added tax, the Bank is subject to the GRT, pursuant to Sections 121 and 122 of the Tax Code which is imposed on banks, non-banks financial intermediaries and finance companies.

In 2012, the Bank reported total GRT amounting to P128,824,679 shown under Taxes and Licenses account [see Note 28.01 (c)]. GRT paid during the year amounted to P115,892,235, exclusive of December 2011 GRT paid during 2012. Total GRT payable as of December 31, 2012 amounted to P12,932,444, included as part of Accrued expenses under Accrued Expenses and Other Liabilities account in the 2012 statement of financial position (see Note 17).

GRT is levied on the Bank's lending income, which includes interest, commission and discounts arising from instruments with maturity of five years or less and other income. The tax is computed at the prescribed rates of either 7%, 5% or 1% of the related income.

(b) Documentary Stamp Tax (DST)

The Bank is enrolled under the Electronic Documentary Stamp Tax (e-DST) System starting July 2010. In 2012, DST remittance thru e-DST amounted to P138,543,031, while DST on deposits for remittance amounts to P2,411,374. In general, the Bank's DST transactions arise from the execution of debt instruments, lease contracts and deposit liabilities.

DST on loan documents and letters of credit in 2012 amounting to P84,381,576 were charged to borrowers and these were properly remitted by the Bank.

(c) Taxes and Licenses

The details of Taxes and Licenses account for the year ended December 31, 2012 follow:

	<u>Note</u>		
Gross receipts tax	28.01 (a)	P	128,824,679
Documentary stamp tax			56,572,829
Business tax			5,803,689
Real property tax			531,549
Miscellaneous			<u>31,405,127</u>
		<u>P</u>	<u>223,137,873</u>

Taxes and licenses allocated to tax exempt income and income subject to final tax and special rate totaling P36,269,137 were excluded from the itemized deductions for purposes of income tax computation [see Note 28.02(d)].

(d) Withholding Taxes

The details of total withholding taxes for the year ended December 31, 2012 are shown below.

Final	P	125,903,678
Compensation and benefits		37,091,374
Expanded		<u>20,470,577</u>
	<u>P</u>	<u>183,465,629</u>

(e) *Deficiency Tax Assessments and Tax Cases*

As of December 31, 2012, the Bank did not have any final deficiency tax assessments from the BIR nor does it have tax cases outstanding or pending in courts or bodies outside the BIR in any of the open years.

(f) *Other Required Tax Information*

The Bank did not have any transaction in 2012 which is subject to excise tax, customs duties and tariff fees.

28.02 Requirements Under RR 19-2011

RR 19-2011 requires schedules of taxable revenues and other non-operating income, costs of sales and services, itemized deductions and other significant tax information, to be disclosed in the notes to financial statements.

The Bank's Regular Banking Unit (RBU) is taxed separately from FCDU. The amounts of taxable revenues and income, and deductible costs and expenses of RBU of the Bank are presented below. The amounts of taxable revenues and income, and deductible costs and expenses of the FCDU are presented in the notes to the separate financial statements of the FCDU for which corresponding income tax return is separately filed with the BIR.

The amounts of taxable revenues and income, and deductible costs and expenses presented below are based on relevant tax regulations issued by the BIR, hence, may not be the same as the amounts reflected in the 2012 statement of income, which are based on FRSP for banks.

(a) *Taxable Revenues*

The Bank's taxable revenues for the year ended December 31, 2012 at the regular tax rate pertain to interest income amounting to P1,287,513,534.

(b) *Deductible Costs of Services*

Deductible costs of services for the year ended December 31, 2012 at the regular tax rate comprise the following:

Interest expense	P	485,781,068
Salaries and wages		159,259,949
Insurance		40,356,821
Supervision/examination fees		<u>7,288,880</u>
	P	<u>692,686,718</u>

(c) *Taxable Non-operating and Other Income*

The details of taxable non-operating and other income in 2012 which are subject to regular tax rate are shown below.

Bank commissions and service charges	P	65,389,444
Trading gains		77,987
Others		<u>120,990,926</u>
	P	<u>186,458,357</u>

(d) *Itemized Deductions*

The amounts of itemized deductions for the year ended December 31, 2012 subject to regular tax rate follow:

Taxes and licenses	P	176,454,415
Management and other professional fees		129,432,615
Employee benefits		114,581,910
Depreciation and amortization		53,733,811
Representation and entertainment		15,436,586
Insurance		12,158,710
Advertising and publicity		8,860,448
Miscellaneous		<u>269,116,997</u>
	P	<u>779,775,492</u>