

COVER SHEET

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S.E.C. Registration Number

P	H	I	L	I	P	P	I	N	E	B	U	S	I	N	E	S	B	A	N	K	,	I	N	C	.
										a	s	a	v	i	n	g	s	b	a	n	k				

(Company's Full Name)

		3	5	0		R	I	Z	A	L		A	V	E	N	U	E		E	X	T	E	N	S	I	O	N							
						C	O	R	N	E	R		8	T	H		A	V	E	N	U	E		G	R	A	C	E		P	A	R	K	
												C	A	L	O	O	C	A	N															

(Business Address: No. Street City / Town / Province)

Rolando G. Alvendia

Contact Person

363-3333 local 4023

Company Telephone Number

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Month Day
Fiscal Year

SEC FORM 17 - Q

FORM TYPE

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Month Day
Annual Meeting

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Secondary License Type, if Applicable

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Dept. Requiring this Doc.

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Amended Articles Number/Section

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Total No. of Stockholders

Total Amount of Borrowings

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Domestic

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Foreign

To be accomplished by SEC Personnel concerned

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File Number

LCU

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SECURITIES AND EXCHANGE COMMISSION

SEC FORM 17-Q

QUARTERLY REPORT PURSUANT TO SECTION 17 OF THE SECURITIES
REGULATION CODE AND SRC RULE 17(2) (b) THEREUNDER

1. For the quarterly period ended **June 30, 2018**
2. SEC Identification Number **A199701584** 3. BIR Tax Identification No. **000-005-469-606**
4. Exact name of issuer as specified in its charter **Philippine Business Bank, Inc.**
5. **Caloocan** Province, Country or other jurisdiction of incorporation or organization
6. (SEC Use Only) Industry Classification Code:
7. **350 Rizal Avenue corner 8th Avenue Grace Park, Caloocan City** 1400
Address of principal office Postal Code
8. **(02) 363-33-33**
Issuer's telephone number, including area code
9. **NOT APPLICABLE**
Former name, former address, and former fiscal year, if changed since last report.
10. Securities registered pursuant to Sections 8 and 12 of the SRC, or Sec. 4 and 8 of the RSA

Title of Each Class	Number of Shares of Common Stock Outstanding and Amount of Debt Outstanding
Common	643,750,094

11. Are any or all of the securities listed on a Stock Exchange?

Yes [x] No []

The Bank was listed in Philippine Stock Exchange last February 19, 2013

If yes, state the name of such Stock Exchange and the class/es of securities listed therein:

PHILIPPINE STOCK EXCHANGE

COMMON SHARES OF STOCK

12. Indicate by check mark whether the registrant:

1. has filed all reports required to be filed by Section 17 of the Code and SRC Rule 17 thereunder or Sections 11 of the RSA and RSA Rule 11(a)-1 thereunder, and Sections 26 and 141 of the Corporation Code of the Philippines, during the preceding twelve (12) months (or for such shorter period the registrant was required to file such reports)

Yes [] No []

(b) has been subject to such filing requirements for the past ninety (90) days.

Yes [] No []

PART I – FINANCIAL INFORMATION

Item I:

Financial Statements (Attachment 1 - Unaudited Interim Financial Statements)

Item II:

Management's Discussion & Analysis of Financial Condition and Results of Operations

PART II – OTHER INFORMATION

Please refer to the following:

Attachment 2 – Aging of Past Due Loans and Other Receivables

Attachment 3 – Consolidated Financial Ratios

There are no material disclosures that have not been reported under SEC Form 17-C during the period covered by this report.

SIGNATURES

Pursuant to the requirements of the Securities Regulation Code, the issuer has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PHILIPPINE BUSINESS BANK, INC.

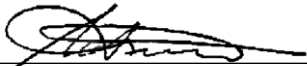
Issuer

By:



FRANCIS T. LEE

Chairman



ROLANDO R. AVANTE

President & CEO

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

The accompanying financial reporting package (FRP) of Philippine Business Bank (“PBB” or the “Bank”) which comprise the Bank’s financial position as of June 30, 2018 and December 31, 2017 and the statements of income, statements of comprehensive income, statements of changes in equity and statements of cash flows for the six-month periods ending June 30, 2018 and June 30, 2017 have been prepared in compliance with Philippine Financial Reporting Standards (PFRS).

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

A. Management’s Discussion and Analysis

	For the six-months ended			
	<u>6/30/2018</u>	<u>6/30/2017</u>	<u>Variance</u>	<u>%</u>
Interest income				
Loans and other receivables	₱ 2,386,488,982	₱ 1,612,728,533	₱ 773,760,449	48.0
Investment and trading securities	65,309,603	103,225,366	(37,915,763)	(36.7)
Securities purchased under reverse repurchase agreements	20,984,705	30,042,525	(9,057,820)	(30.1)
Due from BSP and other banks	6,879,137	22,552,416	(15,673,279)	(69.5)
	<u>2,479,662,427</u>	<u>1,768,548,840</u>	<u>711,113,587</u>	<u>40.2</u>
Interest expense	(682,255,937)	(363,617,967)	(318,637,970)	87.6
Net interest income	1,797,406,490	1,404,930,873	392,475,617	27.9

Interest income on loans and other receivables expanded by 48.0% in the first half of 2018 versus the same period last year due to the increases in loan volumes and yields, bringing the overall interest income to a ₱711.1 billion growth from ₱1.8 billion to ₱2.5 billion.

The 87.6% growth of the Bank’s interest expense was a result of the ₱279.5 million increase in interest expense on deposit liabilities and the ₱39.2 million interest expense on bills payable. Consequently, interest expense stood at ₱682.3 million from ₱363.6 million in the same period last year.

As a result, net interest income ended at ₱1.8 billion for the six months ended June 2018, up 27.9%.

	For the six-months ended			
	<u>6/30/2018</u>	<u>6/30/2017</u>	<u>Variance</u>	<u>%</u>
Core income				
Net interest income	₱ 1,797,406,490	₱ 1,404,930,873	₱ 392,475,617	27.9
Service charges, fees and commissions	65,438,175	49,625,054	15,813,121	31.9
Miscellaneous	93,398,148	95,248,108	(1,849,960)	(1.9)
	<u>1,956,242,813</u>	<u>1,549,804,035</u>	<u>406,438,778</u>	<u>26.2</u>
Non-interest expenses	(1,286,305,023)	(1,127,087,441)	(159,217,582)	14.1
Core income	669,937,790	422,716,594	247,221,196	58.5

Service charges, fees and commissions went up to ₱65.4 million as of June 30, 2018 from ₱49.6 million in the first half of 2017, up 31.9%. On the other hand, miscellaneous income dipped by

1.9% from ₱95.2 million to ₱93.4 million due to the recognition of income from the settlement of PEACe bonds last year.

Operating expenses on the first half of 2018 amounted to ₱1.3 billion, or 14.1% higher than ₱1.1 billion of the same period last year. This is due to the ₱101.3 million increase in taxes and licenses expense incurred during the first half of 2018 as gross receipt tax on interest income grew.

As a result, PBB's core income reached ₱669.9 million as of the second quarter of 2018, 58.5% higher than ₱422.7 million of last year.

	For the six-months ended				Variance	%	
	6/30/2018		6/30/2017				
Core income	₱	669,937,790	₱	422,716,594	₱	247,221,196	58.5
Trading gains (losses)	(	56,797,053)	(	97,703,369)	(	154,500,422)	(158.1)
Pre-tax pre-provision profit		613,140,737		520,419,963		92,720,774	17.8
Loan loss provision	(	110,000,000)	(	80,000,000)	(	30,000,000)	37.5
Profits before tax		503,140,737		440,419,963		62,720,774	14.2
Net income		348,157,556		340,320,214		7,837,342	2.3

Pre-tax pre-provision profit rose by 17.8% from ₱520.4 million to ₱613.1 million despite the ₱56.8 million trading loss incurred in 1H2018.

The Bank set aside ₱110.0 million on provision for impairment losses, higher than last year's ₱80.0 million, as loans and other receivables increased by ₱18.7 billion. As a result, net income as of June 30, 2018 amounted to ₱348.2 million, up 2.3%.

Return on Equity (ROE) and Return on Assets (ROA) stood at 6.7% and 0.8%, respectively.

For the quarters ended June 30, 2018 and March 31, 2018:

	For the quarters ended				Variance	%	
	6/30/2018		3/31/2018				
Interest income							
Loans and other receivables	₱	1,244,310,974	₱	1,136,702,277	₱	107,608,697	9.5
Investment and trading securities		35,077,319		30,232,284		4,845,035	16.0
Securities purchased under reverse repurchase agreements		10,124,889		10,859,816	(	734,927)	(6.8)
Due from BSP and other banks		1,849,929		10,504,939	(	8,655,010)	(82.4)
		1,291,363,111		1,188,299,316		103,063,795	8.7
Interest expense	(	373,023,636)	(	309,232,301)	(	63,791,335)	20.6
Net interest income		918,339,475		879,067,015		39,272,460	4.5

Interest income ended at ₱1.3 billion for the second quarter of 2018, up 8.7% from the first quarter figure of ₱1.2 billion. Interest expense also increased by 20.6% due to the ₱50.5 million and ₱13.3 million increases in interest expense on deposit liabilities and bills payable, respectively.

As a result, net interest income for the second quarter of 2018 ended at ₱918.3 million, 4.5% higher against the ₱879.1 million in the last linked quarter.

	For the quarters ended		Variance	%
	6/30/2018	3/31/2018		
Core income				
Net interest income	₱ 918,339,475	₱ 879,067,015	₱ 39,272,460	4.5
Service charges, fees and commissions	30,173,684	35,264,491	(5,090,807)	(14.4)
Miscellaneous	51,642,742	41,755,406	9,887,336	23.7
	1,000,155,901	956,086,912	44,068,989	4.6
Non-interest expenses	(660,068,082)	(626,236,941)	(33,831,141)	5.4
Core income	340,087,819	329,849,971	10,237,848	3.1

A total of ₱81.8 million in other income was generated in the second quarter of 2018, a 6.2% growth over last linked quarter's ₱77.0 million. Non-interest expenses also went up by 5.4% primarily due to the ₱37.1 million increase in taxes and licenses.

The Bank's core income stood at ₱340.1 million as of the second quarter of 2018 and is 3.1% higher versus the first quarter's figure of ₱329.8 million.

	For the quarters ended		Variance	%
	6/30/2018	3/31/2018		
Core income	₱ 340,087,819	₱ 329,849,971	₱ 10,237,848	3.1
Trading gains (losses)	(26,660,871)	(30,136,182)	3,475,311	(11.5)
Pre-tax pre-provision profit	313,426,948	299,713,789	13,713,159	4.6
Loan loss provision	(75,000,000)	(35,000,000)	(40,000,000)	114.3
Profits before tax	238,426,948	264,713,789	(26,286,841)	(9.9)
Net income	166,902,603	181,254,953	(14,352,350)	(7.9)

Pre-tax pre-provision profit grew to ₱313.4 million, up 4.6% from ₱299.7 million in the first quarter.

Provisions for the quarter ending June 30, 2018 amounted to ₱75.0 million, 114.3% higher than the first quarter's ₱35.0 million as loans continued to grow. As a result, net income was down by ₱14.4 million to ₱166.9 million as of June 2018.

For the quarters ended June 30, 2018 and 2017:

	For the quarters ended			
	6/30/2018	6/30/2017	Variance	%
Interest income				
Loans and other receivables	₱ 1,244,310,974	₱ 830,874,064	₱ 413,436,910	49.8
Investment and trading securities	35,077,319	55,942,753	(20,865,434)	(37.3)
Securities purchased under reverse repurchase agreements	10,124,889	10,264,929	(140,040)	(1.4)
Due from BSP and other banks	1,849,929	13,049,319	(11,199,390)	(85.8)
	1,291,363,111	910,131,065	381,232,046	41.9
Interest expense	(373,023,636)	(187,928,692)	(185,094,944)	98.5
Net interest income	918,339,475	722,202,373	196,137,102	27.2

Overall interest income improved to ₱1.3 billion, up 41.9%, due to the ₱413.4 million increase in interest income on loans and other receivables from ₱830.9 million in the same quarter last year.

Interest expense on deposit liabilities increased by 84.5% for the second quarter of 2018 versus the same period last year as deposit liabilities grew to ₱79.1 billion from ₱61.3 billion year-over-year (YoY). Interest expense on bills payable also stood at ₱26.2 million in the second quarter of 2018. These changes brought the overall interest expense to ₱373.0 million, up 98.5%.

As a result, net interest income improved to ₱918.3 million from ₱722.2 million, a 27.2% increase.

	For the quarters ended			
	6/30/2018	6/30/2017	Variance	%
Core income				
Net interest income	₱ 918,339,475	₱ 722,202,373	₱ 196,137,102	27.2
Service charges, fees and commissions	30,173,684	25,185,603	4,988,081	19.8
Miscellaneous	51,642,742	73,015,823	(21,373,081)	(29.3)
	1,000,155,901	820,403,799	179,752,102	21.9
Non-interest expenses	(660,068,082)	(553,402,517)	(106,665,565)	19.3
Core income	340,087,819	267,001,282	73,086,537	27.4

Service charges, fees and commissions grew by 19.8% for the second quarter of 2018 while miscellaneous income ended at ₱51.6 million, down by 29.3% due to the recognized ₱36.7 million income from PEACe bonds in the second quarter last year. Non-interest expenses was up 19.3% from ₱553.4 million to ₱660.1 million as taxes and licenses expense expanded by ₱72.9 million.

As a result, core income for the quarter ended June 2018 stood at ₱340.1 million, up ₱73.1 million or 27.4% higher than ₱267.0 million figure of the same quarter ended 2017.

	For the quarters ended					
		6/30/2018		6/30/2017	Variance	%
Core income	₱	340,087,819	₱	267,001,282	₱ 73,086,537	27.4
Trading gains (losses)	(	26,660,871)	(	18,841,162	(45,502,033)	(241.5)
Pre-tax pre-provision profit		313,426,948		285,842,444	27,584,504	9.7
Loan loss provision	(	75,000,000)	(	30,000,000)	(45,000,000)	150.0
Profits before tax		238,426,948		255,842,444	(17,415,496)	(6.8)
Net income		166,902,603		180,615,801	(13,713,198)	(7.6)

Pre-tax pre-provision profit for the second quarter of 2018 posted a 9.7% growth over the same quarter last year from ₱285.8 million to ₱313.4 million.

Loan loss reserves stood at ₱75.0 million in the second quarter of 2018, 150.0% higher than the ₱30.0 million figure for the quarter ended June 2017 as loans and other receivables continued to grow. As a result, net income was down by ₱13.7 million, from ₱180.6 million in 2017 to ₱166.9 million in 2018.

Financial condition as of June 30, 2018 versus December 31, 2017:

Amounts in Thousand Pesos	<u>6/30/2018</u>		<u>12/31/2017</u>		<u>Variance</u>	<u>%</u>
Loans and other receivables	₱	77,497,898	₱	70,552,796	₱ 6,945,102	9.8
Non-performing loans		1,854,076		1,504,510	349,566	23.2
Loan loss reserves		1,628,910		1,456,448	172,462	11.8
Deposits		79,098,773		73,522,017	5,576,756	7.6
Assets		92,921,591		87,263,845	5,657,746	6.5
Equity		10,483,405		10,226,228	257,177	2.5

Loans and other receivables representing 83.4% and 80.8% of the Bank's total assets as of June 2018 and December 2017 increased by ₱6.9 billion from ₱70.6 billion to ₱77.5 billion in the first half of 2018.

The Bank's non-performing loans increased by ₱349.6 million bringing the total NPLs to ₱1.9 billion as of the second quarter of the year.

PBB's loan loss reserves for the first half of 2018 ended at ₱1.6 billion in line with the Bank's loans and other receivables expansion.

Deposit liabilities as of June 30, 2018 stood at ₱79.1 billion, higher by 7.6% from ₱73.5 billion as of year-end 2017 owing to the 8.1% and 7.3% growth in CASA and time deposits.

Total equity stood at ₱10.5 billion, up 2.5% versus ₱10.2 billion capital in year-end 2017. Net book value per share as of June 30, 2018 was at ₱15.3, up by 2.7% from ₱14.9 in December 2017.

B. Key Performance Indicators

Capital Adequacy Ratio, CAR, which is a measure of a bank's financial strength, stood at 14.37% by the end of the second quarter of 2018.

Asset Quality: The Bank's non-performing loans (NPL) ratio increased by 25 basis points to 2.43% as of June 30, 2018 from 2.18% in December 31, 2017.

Profitability: Return on equity (ROE) increased from 6.47% as of December 31, 2017 to 6.72% as of June 30, 2018 while return on assets (ROA) was down by four basis points from 0.81% in year-end 2017 to 0.77% in the first half of 2018. Net interest margin increased from 3.92% to 4.12%, up 20 basis points.

Liquidity: The Bank's loans-to-deposit ratio stood at 97.98% in the first half of 2018.

Cost efficiency: Cost-to-income ratio was up by 198 basis points to 67.72% as of the end of June 2018 from 65.74% in December 31, 2017.

C. Discussions on Key Variable and Other Qualitative and Quantitative Factors

Vertical and Horizontal Analysis

Financial Condition (June 30, 2018 vs. December 31, 2017)

- PBB's assets reached ₱92.9 billion as of June 30, 2018. This is 6.5% higher compared to December 31, 2017's figure of ₱87.3 billion. Significant changes (more than 5%) in assets were registered in the following accounts:
 - a. Cash and other cash items decreased 41.7% from ₱1.0 billion to ₱584.0 million as of the first quarter of 2018
 - b. Due from Bangko Sentral ng Pilipinas other than mandatory reserves were nil as of June 2018 resulting in the 10.6% decrease
 - c. Due from other banks was also down by 38.2% due to the decrease in placements to local banks
 - d. Trading and investment securities has grown by 50.8% from ₱2.4 billion as of year-end 2017 to ₱3.7 billion in the first half of 2018 as the Bank continued to build up its trading portfolio in compliance with the BSP's Minimum Liquidity Ratio (MLR) requirement
 - e. Loans and other receivables increased by 9.8% or ₱6.9 billion higher than ₱70.6 billion as of year-end
 - f. Other resources for the first half of 2018 stood at ₱1.9 billion, up 7.4%

- Total liabilities amounted to ₱82.4 billion as of June 30, 2018 which is 7.0% higher than 2017's figure of ₱77.0 billion. Significant changes (more than 5%) in liabilities were registered in the following accounts:
 - a. Deposit liabilities went up by 7.6% as CASA and time deposits increased by 8.1% and 7.3%, respectively
 - b. Bills payable dropped by 9.8% as borrowings to the BSP have matured as of June 2018
- Total equity for the first half of 2018 stood at ₱10.5 billion, a 2.5% increase versus year-end 2017's ₱10.2 billion. Book value per share as of June 30, 2018 stood at ₱15.3 from ₱14.9 in year-end 2017.

Results of Operations for the second quarter ended June 30, 2018 and June 30, 2017

- Interest income advances to ₱1.3 million as interest on loans and other receivables grew by 49.8%. Interest expenses on deposit liabilities and bills payable both increased by ₱158.9 million and ₱26.2 million, bringing the total interest expense to ₱373.0 million in the second quarter of 2018. As a result, net interest income ended at ₱918.3 million, up 27.2%.
- Service charges, fees and commission grew to ₱30.2 million, or 19.8% higher against ₱25.2 million in the second quarter last year. Miscellaneous income recorded a 29.3% decline due to the one-time gain last year from the recognition of income from the settlement of PEACe bonds amounting to ₱36.7 million.
- Non-interest expenses stood at ₱660.1 million for the second quarter of 2018 against the ₱553.4 million figure of the same period last year. This is mainly due to the ₱72.9 million and ₱15.8 million increase in taxes and licenses and salaries and other employee benefits.
- PBB recorded a ₱340.1 million core income during the second quarter of 2018, a 27.4% increase versus ₱267.0 million figure in the same period of 2017 due to the increase in net interest income, offsetting the 16.7% decrease in other income exclusive of trading gains and 19.3% increase in operating expenses.
- The Bank set aside a portion of its income for its loan loss provisions, increasing impairment losses from ₱30.0 million to ₱75.0 million in the second quarter of the year.
- Net income for the second quarter of 2018 ended at ₱166.9 million, a 7.6% drop.

Significant Elements of Income or Loss

Significant elements of the net income of the Bank for the period ended June 30, 2018 came from its operations. A significant portion came from the core business of interest income on loans and trading gains/losses from the sale of Peso securities.

Known trends, demands, commitments, events or uncertainties

There are no known demands, commitments, events or uncertainties that will have a material impact on the Bank's liquidity within the next twelve (12) months.

Events that will trigger direct or contingent financial obligation

There are no events that will trigger direct or contingent financial obligation that is material to the Bank, including any default or acceleration of an obligation.

Material off-balance sheet transactions, arrangements or obligations

There are no material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the Bank with unsolicited entities or other persons created during the reporting period other than those disclosed in the financial statements.

Significant Elements of Income or Loss

Significant elements of the consolidated net income for the six months period ended June 30, 2018 and 2017 came from its continuing operations.

Seasonal Aspects

There are no seasonal aspects that had a material effect on the Bank's financial position and results of operations.

Attachment 1

PHILIPPINE BUSINESS BANK, INC.

As of June 30, 2018 (Unaudited) and December 31, 2017 (Audited)

And for the Six Months Ended June 30, 2018 and 2017 (Unaudited)

PHILIPPINE BUSINESS BANK, INC. A SAVINGS BANK
 UNAUDITED STATEMENTS OF FINANCIAL POSITION
 JUNE 30, 2018 AND DECEMBER 31, 2017
 (Amounts in Philippine Pesos)

	<u>Unaudited</u> <u>June 30, 2018</u>	<u>Audited</u> <u>December 31, 2017</u>
<u>RESOURCES</u>		
CASH AND OTHER CASH ITEMS	P 584,011,784	P 1,002,240,895
DUE FROM BANGKO SENTRAL NG PILIPINAS	5,878,735,524	6,575,270,040
DUE FROM OTHER BANKS	2,478,250,563	4,012,519,495
TRADING AND INVESTMENT SECURITIES		
At Fair Value Through Profit or Loss	1,468,739,522	-
Available-For-Sale	1,739,926,796	2,438,872,511
Held-To-Maturity	470,082,578	-
LOANS AND OTHER RECEIVABLES - Net	77,497,898,378	70,552,796,381
BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT - Net	482,620,155	486,639,186
INVESTMENT PROPERTIES - Net	418,764,139	423,348,421
OTHER RESOURCES - Net	<u>1,902,561,816</u>	<u>1,772,157,992</u>
TOTAL RESOURCES	<u>P 92,921,591,255</u>	<u>P 87,263,844,921</u>
<u>LIABILITIES AND EQUITY</u>		
DEPOSIT LIABILITIES		
Demand	P 1,275,467,184	P 1,219,946,216
Savings	28,966,763,332	26,761,394,203
Time	<u>48,856,542,612</u>	<u>45,540,676,996</u>
Total Deposit Liabilities	79,098,773,128	73,522,017,415
BILLS PAYABLE	1,743,750,000	1,933,724,724
ACCRUED EXPENSES AND OTHER LIABILITIES	<u>1,595,663,457</u>	<u>1,581,874,771</u>
Total Liabilities	82,438,186,585	77,037,616,910
EQUITY	<u>10,483,404,670</u>	<u>10,226,228,011</u>
TOTAL LIABILITIES AND EQUITY	<u>P 92,921,591,255</u>	<u>P 87,263,844,921</u>

PHILIPPINE BUSINESS BANK, INC. A SAVINGS BANK
UNAUDITED STATEMENTS OF INCOME
FOR SIX MONTHS PERIOD ENDED JUNE 30, 2018 AND JUNE 30, 2017
(Amounts in Philippine Pesos)

	For the quarter ended June 30, 2018	For the quarter ended June 30, 2017	Unaudited For the six months ended June 30, 2018	Unaudited For the six months ended June 30, 2017
INTEREST INCOME				
Loans and other receivables	P 1,244,310,974	P 830,874,064	P 2,386,488,982	P 1,612,728,533
Investment and trading securities	35,077,319	55,942,753	65,309,603	103,225,366
Securities purchased under reverse repurchase agreements	10,124,889	10,264,929	20,984,705	30,042,525
Due from Bangko Sentral ng Pilipinas and other banks	1,849,929	13,049,319	6,879,137	22,552,416
	<u>1,291,363,111</u>	<u>910,131,065</u>	<u>2,479,662,427</u>	<u>1,768,548,840</u>
INTEREST EXPENSE				
Deposit liabilities	346,803,580	187,928,692	643,103,226	363,617,967
Bills payable	26,220,056	-	39,152,711	-
	<u>373,023,636</u>	<u>187,928,692</u>	<u>682,255,937</u>	<u>363,617,967</u>
NET INTEREST INCOME	918,339,475	722,202,373	1,797,406,490	1,404,930,873
IMPAIRMENT LOSSES	<u>75,000,000</u>	<u>30,000,000</u>	<u>110,000,000</u>	<u>80,000,000</u>
NET INTEREST INCOME AFTER IMPAIRMENT LOSSES	<u>843,339,475</u>	<u>692,202,373</u>	<u>1,687,406,490</u>	<u>1,324,930,873</u>
OTHER INCOME				
Trading gains - net	(26,660,871)	18,841,162	(56,797,053)	97,703,369
Service charges, fees and commissions	30,173,684	25,185,603	65,438,175	49,625,054
Miscellaneous	51,642,742	73,015,823	93,398,148	95,248,108
	<u>55,155,555</u>	<u>117,042,588</u>	<u>102,039,270</u>	<u>242,576,531</u>
OTHER EXPENSES				
Salaries and other employee benefits	201,220,760	185,463,094	396,417,499	380,675,275
Taxes and licenses	163,563,684	90,647,737	290,031,266	188,713,234
Management and other professional fees	31,287,759	34,680,160	64,383,656	61,674,861
Depreciation and amortization	48,382,128	42,979,398	94,990,822	86,652,577
Insurance	47,642,697	42,244,905	99,111,154	76,746,235
Representation and entertainment	10,629,166	7,019,364	22,951,808	15,445,398
Miscellaneous	157,341,888	150,367,859	318,418,818	317,179,861
	<u>660,068,082</u>	<u>553,402,517</u>	<u>1,286,305,023</u>	<u>1,127,087,441</u>
PROFIT BEFORE TAX	238,426,948	255,842,444	503,140,737	440,419,963
TAX EXPENSE	<u>71,524,345</u>	<u>75,226,643</u>	<u>154,983,181</u>	<u>100,099,749</u>
NET PROFIT	<u><u>P 166,902,603</u></u>	<u><u>P 180,615,801</u></u>	<u><u>P 348,157,556</u></u>	<u><u>P 340,320,214</u></u>
Earnings Per Share				
Basic			<u>P 0.54</u>	<u>P 0.53</u>
Diluted			<u>P 0.54</u>	<u>P 0.53</u>

PHILIPPINE BUSINESS BANK, INC. A SAVINGS BANK
UNAUDITED STATEMENTS OF COMPREHENSIVE INCOME
FOR SIX MONTHS ENDED JUNE 30, 2018, AND JUNE 30, 2017
(Amounts in Philippine Pesos)

	2018	2017
NET PROFIT	P 348,157,556	P 340,320,214
OTHER COMPREHENSIVE INCOME		
Fair value gain on available-for-sale securities during the year - net	(183,380,583)	54,488,273
Fair value loss (gain) recycled to profit or loss	-	-
Realized fair value (gains) losses of AFS securities disposed during the year - net	57,142,201	(973,452)
Amortization of fair value loss on reclassified securities	2,843,468	-
	(123,394,914)	53,514,821
TOTAL COMPREHENSIVE INCOME	P 224,762,642	P 393,835,035

PHILIPPINE BUSINESS BANK, INC. A SAVINGS BANK
UNAUDITED STATEMENTS OF CHANGES IN EQUITY
FOR SIX MONTHS ENDED JUNE 30, 2018, AND JUNE 30, 2017
(Amounts in Philippine Pesos)

	Capital Stock		Additional Paid-in Capital	Surplus		Unrealized Fair Value Gains (Losses) on Available-for-sale Securities	Accumulated Actuarial Gains (Losses)	Total Equity
	Preferred Stock	Common Stock		Appropriated	Unappropriated			
BALANCE AS OF JANUARY 1, 2018	P 620,000,000	P 6,437,500,940	P 1,998,396,816	P 7,107,770	P 1,241,942,126	(P 52,250,091)	(P 26,469,550)	P 10,226,228,011
Prior period adjustment	-	-	-	-	32,414,017	-	-	32,414,017
Total comprehensive income (loss)	-	-	-	-	348,157,556	(123,394,914)	-	224,762,642
BALANCE AS OF JUNE 30, 2018	P 620,000,000	P 6,437,500,940	P 1,998,396,816	P 7,107,770	P 1,622,513,699	(P 175,645,005)	(P 26,469,550)	P 10,483,404,670
BALANCE AS OF JANUARY 1, 2017	P 620,000,000	P 5,364,584,375	P 1,998,396,816	P 5,989,552	P 1,675,890,814	(P 82,019,677)	(P 12,757,016)	P 9,570,084,864
Prior period adjustment	-	-	-	-	4,057,193	-	(15,829,089)	(P 11,771,896)
Total comprehensive income (loss)	-	-	-	-	340,320,214	96,056,715	-	436,376,929
BALANCE AS OF JUNE 30, 2017	P 620,000,000	P 5,364,584,375	P 1,998,396,816	P 5,989,552	P 2,020,268,221	P 14,037,038	(P 28,586,105)	P 9,994,689,897

PHILIPPINE BUSINESS BANK, INC. A SAVINGS BANK
UNAUDITED STATEMENTS OF CASH FLOWS
FOR SIX MONTHS ENDED JUNE 30, 2018, AND JUNE 30, 2017
(Amounts in Philippine Pesos)

	<u>2018</u>	<u>2017</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit before tax	P 503,140,736	P 440,419,963
Adjustments for:		
Depreciation and amortization	94,990,822	86,652,577
Impairment losses	110,000,000	80,000,000
	<u>-</u>	<u>-</u>
Operating profit before working capital changes	708,131,558	607,072,540
Decrease (increase) in financial assets at fair value through profit or loss	(1,468,739,522)	3,112,893,923
Increase (decrease) in hold-to-maturity	(470,082,578)	-
Increase in loans and other receivables	(7,055,101,997)	(7,398,146,045)
Decrease (increase) in other resources	(97,403,824)	(99,103,667)
Increase (decrease) in deposit liabilities	5,576,755,713	2,424,851,626
Increase (decrease) in accrued expenses and other liabilities	103,579,398	535,008,942
Increase (decrease) in capital accounts	<u>-</u>	<u>-</u>
Cash generated from (used in) operations	(2,702,861,252)	(817,422,681)
Cash paid for income taxes	(245,359,876)	(90,194,733)
Net Cash From (Used in) Operating Activities	(2,948,221,128)	(907,617,414)
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of available-for-sale (AFS) securities	-	(489,008,225)
Proceeds from sale of AFS securities	575,550,802	16,493,462
Net acquisitions of investment and other properties	4,584,282	(26,157,084)
Net acquisitions of bank premises, furniture, fixtures and equipment	(90,971,791)	(55,555,341)
	<u>-</u>	<u>-</u>
Net Cash From (Used In) Investing Activities	489,163,293	(554,227,188)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net borrowings (payments) of bills payable	(189,974,724)	-
	<u>-</u>	<u>-</u>
Net Cash From (Used in) Financing Activities	(189,974,724)	-
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		
	(2,649,032,559)	(1,461,844,602)
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR		
Cash and other cash items	1,002,240,895	1,098,616,524
Due from Bangko Sentral ng Pilipinas	6,575,270,040	6,225,701,096
Due from other banks	4,012,519,495	1,633,340,396
Securities purchased under reverse repurchase agreements	<u>-</u>	<u>-</u>
	<u>11,590,030,430</u>	<u>8,957,658,016</u>
CASH AND CASH EQUIVALENTS AT END OF THE YEAR		
Cash and other cash items	584,011,784	738,573,216
Due from Bangko Sentral ng Pilipinas	5,878,735,524	5,523,780,537
Due from other banks	2,478,250,563	1,233,459,661
Securities purchased under reverse repurchase agreements	<u>-</u>	<u>-</u>
	<u>P 8,940,997,871</u>	<u>P 7,495,813,414</u>

PHILIPPINE BUSINESS BANK, INC., A SAVINGS BANK
NOTES TO FINANCIAL STATEMENTS
June 30, 2018, AND December 31, 2017
(Amounts in Philippine Pesos or As Otherwise Indicated)

1. CORPORATE MATTERS

1.1 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. The Bank is a publicly listed entity in the Philippine Stock Exchange (PSE). It had its initial public offering (IPO) of shares on February 13, 2013 (see Note 21.1).

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 maintenance of reserve requirements on deposit liabilities and those relating to adoption and use of safe and sound banking practices, among others, as promulgated by the BSP. Its activities are subject to the provisions of the General Banking Law of 2000 [Republic Act (RA) No. 8791] and other relevant laws.

PBB is the first savings bank in the Philippines that obtained the BSP approval to issue foreign letters of credit and pay/accept/negotiate import/export drafts/bills of exchange under RA Nos. 8791 and 7906 and the Manual of Regulations for Banks. It was granted in April 2010.

The Bank operates in the Philippines and as of June 30, 2018 and December 31, 2017, it has 142 branches located nationwide.

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.

1.2 Approval of the Financial Statements

The financial statements of the Bank as of and for the year ended June 30, 2018 (including the comparative financial statements as of December 31, 2017 and for the six months period ended June 30, 2018 and 2017) were authorized for issue by the Bank's Board of Directors (BOD) on July 18, 2018.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

2.1 Basis of Preparation of Financial Statements

(a) Statement of Compliance with Philippine Financial Reporting Standards

The financial statements of the Bank have been prepared in accordance with Philippine Financial Reporting Standards (PFRS). PFRS are adopted by the Financial Reporting Standards Council (FRSC), from the pronouncements issued by the International Accounting Standards Board, and approved by the Philippine Board of Accountancy.

The 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 that follow.

(b) Presentation of Financial Statements

The financial statements are presented in accordance with Philippine Accounting Standard (PAS) 1, Presentation of Financial Statements. The Bank presents a statement of comprehensive income separate from the statement of profit or loss.

The Bank presents a third statement of financial position as at the beginning of the preceding period when it 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. The related notes to the third statement of financial position are not required to be disclosed.

(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 United States (US) dollar, are translated to Philippine peso based on Philippine Dealing System closing rates (PDSCR) at the end of reporting period for the statement of financial position accounts and at the average PDSCR for the period for the profit and loss.

2.2 Adoption of New and Amended PFRS

(a) Effective in 2017 that are Relevant to the Bank

The Bank adopted for the first time the following amendments to PFRS, which are mandatorily effective for annual periods beginning on or after January 1, 2017:

PAS 7 (Amendments)	:	Statement of Cash Flows – Disclosure Initiative
PAS 12 (Amendments)	:	Income Taxes – Recognition of Deferred Tax Assets for Unrealized Losses

Discussed below are the relevant information about these amendments.

- (i) PAS 7 (Amendments), *Statement of Cash Flows – Disclosure Initiative*. The amendments are designed to improve the quality of information provided to users of financial statements about changes in an entity's debt and related cash flows (and non-cash changes). They require an entity to provide disclosures that enable users to evaluate changes in liabilities arising from financing activities. An entity applies its judgment when determining the exact form and content of the disclosures needed to satisfy this requirement. Moreover, they suggest a number of specific disclosures that may be necessary in order to satisfy the above requirement, including: (a) changes in liabilities arising from financing activities caused by changes in financing cash flows, foreign exchange rates or fair values, or obtaining or losing control of subsidiaries or other businesses; and, (b) a reconciliation of the opening and closing balances of liabilities arising from financing activities in the statement of financial position including those changes identified immediately above.

Management has applied these amendments in the current year and has not disclosed comparative figures as allowed by the transitional provisions.

- (ii) PAS 12 (Amendments), *Income Taxes – Recognition of Deferred Tax Assets for Unrealized Losses*. The focus of the amendments is to clarify how to account for deferred tax assets related to debt instruments measured at fair value, particularly where changes in the market interest rate decrease the fair value of a debt instrument below cost. The amendments provide guidance in the following areas where diversity in practice previously existed: (a) existence of a deductible temporary difference; (b) recovering an asset for more than its carrying amount; (c) probable future taxable profit against which deductible temporary differences are assessed for utilization; and, (d) combined versus separate assessment of deferred tax asset recognition for each deductible temporary difference. The amendment had no significant impact on the Bank's financial statements.

(b) *Effective in 2017 that are not Relevant to the Bank*

Annual Improvements to PFRS (2014-2016 Cycle), specifically on PFRS 12, *Disclosure of Interest in Other Entities – Scope Clarification on Disclosure of Summarized Financial Information for Interests Classified as Held for Sale*, are mandatorily effective for annual periods beginning on or after January 1, 2017 but are not relevant to the Bank's financial statements.

(c) *Effective Subsequent to 2017 but not Adopted Early*

There are new PFRS, interpretations and amendments to existing standards effective for annual periods subsequent to 2017, which are adopted by the FRSC. Management will adopt the following relevant pronouncements in accordance with their transitional provisions:

- (i) PAS 40 (Amendment), *Investment Property – Reclassification to and from Investment Property* (effective from January 1, 2018). The amendment states that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use. The amendment provided a non-exhaustive list of examples constituting change in use. Management has assessed that this amendment will have no significant impact on the Bank's financial statements.
- (ii) PFRS 9 (2014), *Financial Instruments* (effective from January 1, 2018). This new standard on financial instruments will replace PAS 39, *Financial Instruments: Classification and Measurement*, and PFRS 9 (2009, 2010 and 2013 versions). This standard contains, among others, the following:
 - three principal classification categories for financial assets based on the business model on how an entity is managing its financial instruments;
 - an expected credit loss (ECL) model in determining impairment of all financial assets that are not measured at fair value through profit or loss (FVTPL), which generally depends on whether there has been a significant increase in credit risk since initial recognition of a financial asset; and,
 - a new model on hedge accounting that provides significant improvements principally by aligning hedge accounting more closely with the risk management activities undertaken by entities when hedging their financial and non-financial risk exposures.

In accordance with the financial asset classification principle of PFRS 9 (2014), a financial asset is classified and measured at amortized cost if the asset is held within a business model whose objective is to hold financial assets in order to collect the contractual cash flows that represent sole payments of principal and interest (SPPI) on the principal outstanding. Moreover, a financial asset is classified and subsequently measured at fair

value through other comprehensive income if it meets the SPPI criterion and is held in a business model whose objective is achieved by both collecting contractual cash flows and selling the financial assets. All other financial assets are measured at FVTPL.

In addition, PFRS 9 (2014) allows entities to make an irrevocable election to present subsequent changes in the fair value of an equity instrument that is not held for trading in other comprehensive income.

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 arrangements, 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 amendment also requires changes in the fair value of an entity's own debt instruments caused by changes in its own credit quality to be recognized in other comprehensive income rather than in profit or loss.

Based on an assessment and comprehensive study of the Bank's financial assets and liabilities as at June 31, 2018, which has been limited to the facts and circumstances existing at that date, management determined the impact of PFRS 9 (2014) on the financial statements as follows:

- Loans and other receivables are composed of receivables from customers and other receivables, which are held to collect contractual cash flows representing SPPI (see Note 14). These financial assets will continue to be measured at amortized cost upon application of PFRS 9 (2014).
- Available-for-sale (AFS) financial securities of the Bank pertain to debt securities which are composed of corporate and government bonds (see Note 12). The Bank's assessment showed that these bonds qualify under the SPPI test and held-to-collect and sell business models. Thus, these bonds will continue to be measured at fair value, with mark-to-market fluctuations recognized in other comprehensive income subject to recycling upon disposal of these securities.
- The financial liabilities of the Bank are measured at amortized cost. Management's assessment showed that the amortized cost classification of the financial liabilities will be retained upon adoption of PFRS 9 (2014).

- In applying the ECL methodology of PFRS 9 (2014), the Bank shall initially use the loan loss provision methodology based on BSP Circular 855 as allowed by the standard and as prescribed by the BSP on October 9, 2014. On the other hand, ECL on government bonds and corporate bonds currently classified as AFS securities shall be measured using the 12-month ECL as these financial assets are assessed to have low credit risk, considering their respective credit ratings.

Management's assessment showed that the application of the ECL model will result in an increase in the required allowance for impairment of certain financial instruments as at the beginning of the next reporting period and in impairment losses in that period as compared with the amount that would have been recognized under the impairment provisions of PAS 39.

- (iii) PFRS 15, *Revenue from Contract with Customers* (effective from January 1, 2018). This standard will replace PAS 18, *Revenue*, and PAS 11, *Construction Contracts*, the related Interpretations on revenue recognition: International Financial Reporting Interpretations Committee (IFRIC) 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreement for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers* and Standing Interpretations Committee 31, *Revenue – Barter Transactions Involving Advertising Services*. This new standard establishes a comprehensive framework for determining when to recognize revenue and how much revenue to recognize. The core principle in the said framework is for an entity to recognize revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Based on an assessment of the Bank's revenue streams as at December 31, 2017, which has been limited to the facts and circumstances existing at that date, management has initially concluded that the adoption of PFRS 15 will have no significant impact on the financial statements. This is because of the fact that as a financial institution, except for certain service charges and fees, its lending activities generate revenues that are substantially from financial instruments which are outside the scope of PFRS 15.

- (iv) IFRIC 22, *Foreign Currency Transactions and Advance Consideration - Interpretation on Foreign Currency Transactions and Advance Consideration* (effective from January 1, 2018). The interpretation provides more detailed guidance on how to account for transactions that include the receipt or payment of advance consideration in a foreign currency. The interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary asset (arising from advance payment) or liability (arising from advance receipt). If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. Management has initially assessed that this amendment has no material impact on the Bank's financial statements.

- (v) PFRS 9 (Amendment), *Financial Instruments – Prepayment Features with Negative Compensation* (effective from January 1, 2019). The amendment clarifies that prepayment features with negative compensation attached to financial instruments may still qualify under the solely payments of principal and interest (SPPI) test. As such, the financial assets containing prepayment features with negative compensation may still be classified at amortized cost or at FVOCI. Management is currently assessing the impact of this new standard in its financial statements.
- (vi) PFRS 16, *Leases* (effective from January 1, 2019). The new standard will eventually replace PAS 17, *Leases*.

For lessees, it requires to account for leases “on-balance sheet” by recognizing a “right of use” asset and a lease liability. The lease liability is initially measured as the present value of future lease payments. For this purpose, lease payments include fixed, non-cancellable payments for lease elements, amounts due under residual value guarantees, certain types of contingent payments and amounts due during optional periods to the extent that extension is reasonably certain. In subsequent periods, the “right-of-use” asset is accounted for similar to a purchased asset subject to depreciation or amortization. The lease liability is accounted for similar to a financial liability which is amortized using the effective interest method.

However, the new standard provides important reliefs or exemptions for short-term leases and leases of low value assets. If these exemptions are used, the accounting is similar to operating lease accounting under PAS 17 where lease payments are recognized as expenses on a straight-line basis over the lease term or another systematic basis (if more representative of the pattern of the lessee’s benefit).

For lessors, lease accounting is similar to PAS 17’s. In particular, the distinction between finance and operating leases is retained. The definitions of each type of lease, and the supporting indicators of a finance lease, are substantially the same as PAS 17’s. The basic accounting mechanics are also similar, but with some different or more explicit guidance in few areas. These include variable payments, sub-leases, lease modifications, the treatment of initial direct costs and lessor disclosures.

Management anticipates that the adoption of this standard will result in an increase in resources and a corresponding increase in obligations based on its analysis of the outstanding lease contract of the Bank as of December 31, 2017.

- (vii) IFRIC 23, *Uncertainty over Income Tax Treatments* (effective from January 1, 2019). The interpretation provides clarification on the determination of taxable profit, tax bases, unused tax losses, unused tax credits, and tax rates when there is uncertainty over income tax treatments. The core principle of the interpretation requires the Bank to consider the probability of the tax treatment being accepted by the taxation authority. When it is probable that the tax treatment will be accepted, the determination of the taxable profit, tax bases, unused tax losses, unused tax credits, and tax rates shall be on the

basis of the accepted tax treatment. Otherwise, the Bank has to use the most likely amount or the expected value, depending on the surrounding circumstances, in determining the tax accounts identified immediately above. Management is currently assessing the impact of this new interpretation in its financial statements.

(viii) Annual Improvements to PFRS 2015-2017 Cycle. Among the improvements, the following amendments are relevant to the Bank but are not expected to have any material impact on the Bank's financial statements as these amendments merely clarify existing requirements:

- PAS 12 (Amendments), *Income taxes – Tax Consequences of Dividends*. The amendments clarify that all income tax consequence of dividend payments should be recognized in profit or loss.
- PAS 23 (Amendments), *Borrowing costs – Eligibility for Capitalization*. The amendments clarify that any specific borrowing which remains outstanding after the related qualifying asset is ready for its intended purpose, such borrowing will then form part of the entity's general borrowings when calculating the capitalization rate for capitalization purposes.

2.3 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 of the acquired entity or net assets. Subsequent to initial recognition, goodwill is tested annually for impairment and carried at cost less any accumulated impairment losses. Impairment losses on goodwill are not reversed (see Note 2.19).

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 profit or loss.

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, *Provision, 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.

2.4 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 8.

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.

2.5 Financial Assets

Financial assets are recognized when the Bank becomes a party to the contractual terms of the financial instrument. For purposes of classifying financial assets, an instrument is considered as an equity instrument if it is non-derivative and meets the definition of an equity for the issuer in accordance with the criteria under PAS 32, *Financial Instruments: Presentation*. All other non-derivative financial instruments are treated as debt instruments.

(a) Classification, Measurement and Reclassification of Financial Assets

Financial assets, other than those designated and effective as hedging instruments, are classified into the following categories: financial assets at 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. Except for derivative financial instruments and financial assets designated at FVTPL, the designation of financial assets is re-evaluated at the end of each reporting period and at which date, a choice of classification or accounting treatment is available, which is subject to compliance with specific provisions of applicable accounting standards.

Regular purchases and sales of financial assets are recognized on their settlement 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 recorded at fair value and the related transaction costs are recognized in profit or loss.

A more detailed description of the four categories of financial assets is as follows:

(i) 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.

(ii) 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, unquoted debt securities, 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 Other Resources (specifically Security deposits, Petty cash fund and Foreign currency notes and coins on hand) 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, foreign currency notes and coins on hand and securities under reverse repurchase agreement (SPURRA) with original maturities of three months or less from placement date.

Loans and receivables are subsequently measured at amortized cost using the effective interest method, less impairment losses, if any.

(iii) 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 were to sell other than an insignificant amount of HTM investments, the whole category would be tainted and reclassified to AFS securities under PFRS, and the Bank will be prohibited from holding investments under the HTM investments category for the next two financial reporting years after the year the tainting occurred. The tainting provision under PFRS 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.

Subsequent to initial recognition, the HTM investments are measured at amortized cost using the effective interest method, less impairment losses, if any.

(iv) AFS Securities

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, corporate bonds and equity securities.

All financial assets within this category are subsequently measured at fair value. Gains and losses from changes in fair value are recognized in other comprehensive income and are reported as part of the Revaluation Reserves account in equity, except for interest and dividend income, impairment losses and foreign exchange differences on monetary assets, which are recognized in profit or loss.

When the financial asset is disposed of or is determined to be impaired, the cumulative fair value gains or losses recognized in other comprehensive income is reclassified from equity to profit or loss and is presented as reclassification adjustment within other comprehensive income even though the financial assets has not been derecognized.

(b) 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.

(i) *Carried at Amortized Cost – Loans and Receivables and HTM Investments*

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and 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 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 because they are 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 profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be objectively related 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 reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date of the impairment is reversed. 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.

(ii) Carried at Fair Value – AFS Financial Assets

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 securities, 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 other comprehensive income as part of equity – is reclassified from other comprehensive income to profit or loss as a reclassification adjustment.

Impairment losses recognized in the statement of profit or loss 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 the impairment loss is reversed through profit or loss.

Reversal of impairment losses is 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.

(iii) Carried at Cost – AFS Financial Assets

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.

(c) Items of Income and Expense Related to Financial Assets

All income and expenses, including impairment losses, relating to financial assets are recognized in the statement of profit or loss.

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.

(d) Derecognition of Financial Assets

The financial assets are derecognized when the contractual rights to receive cash flows from the financial instruments expire, or when the financial assets and all substantial risks and rewards of ownership have been transferred to another party. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

2.6 Derivative Financial Instruments

The Bank uses derivative financial instruments, particularly plain vanilla foreign exchange swaps, to manage its risks associated with fluctuations in foreign currency. Such derivative financial instruments are initially recognized at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive (recognized as part of Miscellaneous under the Other Resources account) and as liabilities (recognized under the Accrued Expenses and Other Liabilities account) when the fair value is negative.

The Bank's derivative instruments provide economic hedges under the Bank's policies but are not designated as accounting hedges. Consequently, any gains or losses arising from changes in fair value are taken directly to profit or loss for the period.

2.7 Offsetting Financial Instruments

Financial assets and financial 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. The right of set-off must be available at the end of the reporting period, that is, it is not contingent on future event. It must also be enforceable in the normal course of business, in the event of default, and in the event of insolvency or bankruptcy; and must be legally enforceable for both entity and all counterparties to the financial instruments.

2.8 Financial Liabilities

Financial liabilities include deposit liabilities, bills payable and accrued expenses and other liabilities (excluding tax-related 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 profit or loss.

Deposit liabilities and bills payable are recognized initially at their fair value, which is the issuance proceeds (fair value of consideration received) net of direct issue costs, and are subsequently measured 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 profit or loss 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 and subsequent 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. The difference between the carrying amount of the financial liability

derecognized and the consideration paid or payable is recognized in profit or loss.

2.9 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 Bank and the asset has a cost or value that can be measured reliably.

2.10 Bank Premises, Furniture, Fixtures and Equipment

Land is stated at cost less impairment losses, if any. 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 2.19).

Fully depreciated and fully amortized assets are retained in the accounts until they are no longer in use and no further charge for depreciation and amortization is made in respect of those assets.

The residual values, estimated useful lives and method of depreciation and amortization 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.

2.11 Investment Properties

Investment properties pertain to land, buildings or condominium units acquired by the Bank, in settlement of loans from defaulting borrowers through foreclosure or dacion in payment. These properties are neither held by the Bank for sale in the next 12 months nor used in the rendering of services or for administrative purposes.

Investment properties are stated at cost, less accumulated depreciation and any impairment losses (see Note 2.19). The cost of an investment property comprises its purchase price and directly attributable costs incurred such as legal fees, transfer taxes and other transaction costs.

Investment properties, except land, are depreciated over a period of five to ten years. Depreciation and impairment loss are recognized in the same manner as in bank premises, furniture, fixtures and equipment.

Transfers from other accounts (such as bank premises, furniture, fixtures and equipment) are made to investment properties when and only when, there is a change in use, evidenced by ending of owner-occupation or holding the property for capital appreciation, while transfers from investment properties are made when, and only when, there is a change in use, evidenced by commencement of owner-occupation.

Direct operating expenses related to investment properties, such as real estate taxes are normally charged against current operations in the period in which these costs are incurred.

Investment properties, including the related accumulated depreciation and any impairment losses, are derecognized upon disposal and no future economic benefit is expected from its disposal. Any gain or loss on the retirement or disposal of investment properties is recognized in profit or loss under the Gain or loss on sale of properties under Miscellaneous Income or Expenses in the statement of profit or loss, in the year of retirement or disposal.

2.12 Intangible Assets

Intangible assets include goodwill, branch licenses and computer software, which are included as part of Other Resources and 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. Capitalized costs are amortized on a straight-line basis over the estimated useful life lives of these intangible assets are considered finite. In addition, intangible assets are subject to impairment testing when indications exist, as described in Note 2.19. 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 2.19). For purposes of impairment testing, goodwill and branch licenses are allocated to cash-generating units and is subsequently carried at cost less any allowance for impairment losses.

When an intangible asset is disposed of, the gain or loss on disposal is determined as the difference between the proceeds and the carrying amount of the asset and is recognized in profit or loss.

2.13 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.

2.14 Equity

Capital stock represents the nominal value of the common and preferred shares that have been issued.

Additional paid-in capital includes any premium received on the issuance of capital stock. Any transaction costs associated with the issuance of shares are deducted from additional paid-in capital.

Appropriated surplus represents the accumulated amount set aside by the Bank for trust business under prevailing regulations, requiring the Bank to carry to surplus 10% of its net profits accruing from trust business until the surplus amounts to 20% of its authorized capital stock. The reserve shall not be paid out in dividends, but losses accruing in the course of the trust business may be charged against this reserve.

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

Revaluation reserves comprise of the remeasurements of post-employment defined benefit plan and unrealized fair value gains (losses) on mark-to-market valuation of AFS securities, net of amortization of fair value gains or losses on reclassified financial assets.

2.15 Related Party Transactions and Relationships

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) the Bank's funded retirement plan.

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

2.16 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 costs and expenses incurred and to be incurred can be measured reliably. Cost and expenses are recognized in profit or loss upon utilization of the assets or services or at the date these are incurred. In addition, the following specific recognition criteria must also be met before revenue is recognized:

(a) *Interest Income and Expense*

Interest income and expense are recognized in the statement of profit or loss 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.

(b) *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.

(c) *Trading Gains or Losses*

Trading gains or losses 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 or losses also include result from the mark-to-market valuation of the securities classified as financial assets at FVTPL at the valuation date and gain or loss from foreign exchange trading.

(d) *Gain on Sale of Properties*

Gain on sale of properties, which arises from the disposals of real properties, are recognized when the related risks and rewards of ownership of the assets have already been transferred to the buyer.

2.17 Leases – 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 lease. Operating lease payments (net of any incentive received from the lessor) are recognized as an expense in profit or loss on a straight-line basis over the lease term. Associated costs, such as repairs and maintenance and insurance, are expensed as incurred.

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.

2.18 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. 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 profit or loss.

Changes in the fair value of monetary financial assets denominated in foreign currency classified as AFS securities are analyzed between translation differences resulting from changes in the amortized cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortized cost are recognized in profit or loss, and other changes in the carrying amount are recognized in other comprehensive income.

2.19 Impairment of Non-financial Assets

The Bank's premises, furniture, fixtures and equipment, investment properties, goodwill, branch licenses, computer software, other properties held-for-sale (classified as part of Miscellaneous under Other Resources) and other non-financial assets are subject to impairment testing. Intangible assets with an indefinite useful life, such as goodwill and branch licenses (see Note 2.12) 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.

For purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). As a result, assets are tested for impairment either individually or at the cash-generating unit level.

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. Discount factors are determined individually for each cash-generating unit and reflect management's assessment of respective risk profiles, such as market and asset-specific risk factors. 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. An impairment loss is reversed if the cash generating units' recoverable amount exceeds its carrying amount.

2.20 Employee Benefits

The Bank provides post-employment benefits to employees through a defined benefit plan and defined contribution plan, and other employee benefits which are recognized as follows:

(a) Post-employment 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 at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates based on zero coupon government bonds as published by Philippine Dealing & Exchange Corp. (PDEX) 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.

Remeasurements, comprising of actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions and the return on plan assets (excluding amount included in net interest) are reflected immediately in the statement of financial position with a charge or credit recognized in other comprehensive income in the period in which they arise. Net interest is calculated by applying the discount rate at the beginning of the period, taking account of any changes in the net defined benefit liability or asset during the period as a result of contributions and benefit payments. Net interest is reported as part of Interest Expense account in the statement of profit or loss.

Past-service costs are recognized immediately in profit or loss in the period of a plan amendment or curtailment.

(b) *Post-employment 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 at the earlier of when it can no longer withdraw the offer of such benefits and when it recognizes costs for a restructuring that is within the scope of PAS 37 and involves the payment of termination benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the end of the reporting period are discounted to their 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.

2.21 Borrowing Costs

Borrowing costs are recognized as expenses in the period in which they are incurred, except to the extent that they are capitalized. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (i.e., an asset that takes a substantial period of time to get ready for its intended use or sale) are capitalized as part of cost of such asset. The capitalization of borrowing costs commences when expenditures for the asset and borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalization ceases when substantially all such activities are complete.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization.

2.22 Income Taxes

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

Current 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 profit or loss.

Deferred tax is accounted for, using the liability method, on temporary differences at the end of each 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 deductible temporary differences 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 such deferred tax assets to be recovered.

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 provided such tax rates have been enacted or substantively enacted at the end of the reporting period.

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.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Most changes in deferred tax assets or liabilities are recognized as a component of tax expense in profit or loss, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity, respectively.

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

2.23 Earnings Per Share

Basic earnings per share (EPS) is determined by dividing net profit attributable to common shares 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, if any.

The diluted EPS is 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 Securities and Exchange Commission. Convertible preferred shares are deemed to have been converted to common shares at the issuance of preferred shares. As of June 30 2018 and December 31, 2017, the Bank has no convertible preferred shares (see Note 22.1).

2.24 Trust and Fiduciary 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.

2.25 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 preparation of the Bank's financial statements in accordance with PFRS requires 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.

3.1 Critical Management Judgments in Applying Accounting Policies

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

(a) Classification of Financial Assets at HTM Investments

In classifying non-derivative financial assets with fixed or determinable payments and fixed maturity, such as bonds, as HTM investments, the Bank evaluates its intention and ability to hold such investments up to maturity. This classification requires significant judgment. In making this judgment, the Bank evaluates its intention and ability to hold such investments up to maturity.

If the Bank fails to keep these investments at maturity other than for the allowed specific circumstances as allowed under the standards, 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. See related disclosure in Note 13.

(b) Impairment of AFS Securities

The determination when an investment is other-than-temporarily impaired 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 flows.

Based on the recent evaluation of information and circumstances affecting the Bank's AFS securities, management has assessed that none of the Bank's securities are impaired as of June 30, 2018 and December 31, 2017. Future changes in those information and circumstance might significantly affect the carrying amount of the assets.

(c) *Distinction Between Investment Properties or Other Properties Held for Sale 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 properties but also to other assets used in the production or supply process.

The Bank classifies its acquired properties (foreclosed properties) as Bank Premises, Furniture, Fixtures and Equipment if used in operations, as other properties held for sale presented as part of Miscellaneous under Other Resources if the Bank expects that the properties, which are other than land and building, will be recovered through sale rather than use, and as Investment Properties if the Bank intends to hold the properties, which could be land and/or building, to earn rental or for capital appreciation in accordance with PAS 39.

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) *Determination of Branch Licenses Having Indefinite Useful Lives*

The Bank's branch licenses were regarded as having an indefinite useful lives considering there is no foreseeable limit to the period over which such assets are expected to generate net cash inflows for the Bank. The assessment of having indefinite useful lives is reviewed periodically and is updated whether events and circumstances such as the period of control over these assets and legal or similar limits on the use of these assets continue to support such assessment.

(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.

As of June 30, 2018 and December 31, 2017, the Bank has determined that all its leases are operating leases (see Note 26).

(f) *Recognition of Provisions and Contingencies*

Judgment is exercised by management to distinguish the difference between provisions and contingencies. Policies on recognition of provisions and contingencies are discussed in Note 2.13 and relevant disclosures are presented in Note 26.

In dealing with the Bank's various legal proceedings, its estimate of the probable costs that may arise from claims and contingencies has been developed in consultation and coordination with the Bank's internal and outside counsels acting in defense for the Bank's legal cases and are based upon the analysis of probable results.

Although the Bank does not believe that its dealing on these proceedings will have material adverse effect on the Bank's financial position, it is possible that future results of operations could be materially affected by changes in the estimates or in the effectiveness of the strategies conducted relating to those proceedings.

3.2 Key Sources of Estimation Uncertainty

Discussed in below and in the succeeding pages 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 reporting period.

(a) *Estimation of Impairment of Financial Assets (AFS Securities and Loans and Other Receivables)*

The Bank reviews its AFS securities and loans and other receivable 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.

Moreover, the Bank holds debt securities measured at fair value classified as AFS securities as of June 30, 2018 and December 31, 2017. The determination when an investment is other-than-temporarily impaired requires significant judgment. In making this judgment whether the Bank has an investment classified as AFS is other-than-temporarily impaired, 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 flows.

In determining whether the loans and receivables have any evidence of impairment, the Bank gathers information that include observable data which indicates 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, including, but not limited to, the length of the Bank's relationship with the customers, the customers' current credit

status, average age of accounts, collection experience and historical loss experience.

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 loans and other receivables and the analysis of the related allowance for impairment on such financial assets are shown in Note 14. There are no impairment losses recognized on AFS securities and HTM investments in 2018, 2017 and 2016.

(b) Fair Value Measurement 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 end of the reporting period.

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 11 and 12, respectively.

(c) Estimation of Useful Lives of Bank Premises, Furniture, Fixtures and Equipment, Investment Properties and Other Resources (i.e. Computer Software)

The Bank estimates the useful lives of bank premises, furniture, fixtures and equipment, investment properties, except land, and other resources (i.e. computer software) 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, investment properties and computer software 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.

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.

(d) *Determination of 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 management has assessed to be fully recoverable, as of June 30, 2018 and December 31, 2017 is disclosed in Notes 15.

(e) *Determination of Fair Value of Investment Properties*

The Bank's investment properties are composed of parcels of land and buildings and improvements which are held for capital appreciation, and are measured using cost model. The estimated fair value of investment properties disclosed in Note 7.4 is determined on the basis of the appraisals conducted by professional appraiser applying the relevant valuation methodologies as discussed therein.

At initial recognition, the Bank determines the fair value of the acquired properties based on 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. For investment properties with appraisal conducted prior to the end of the current reporting period, management determines whether there are significant circumstances during the intervening period that may require adjustments or changes in the disclosure of fair value of those properties.

A significant change in key inputs and sources of information used in the determination of the fair value disclosed for those assets may result in adjustment in the carrying amount of the assets reported in the financial statements if their fair value will indicate evidence of impairment.

The Bank's methodology in determining the fair value of acquired properties are further discussed in Note 7.

(f) *Estimation of Impairment of Non-financial Assets*

Except for intangible assets with indefinite useful lives (i.e. goodwill and branch licenses), which are annually tested for impairment, 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 2.19. 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 are discussed in Notes 15. There are no impairment losses recognized in goodwill, 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 and include, among others, discount rates, expected rate of salary increases and employee turnover. A significant change in any of these actuarial assumptions may generally affect the recognized expense and the carrying amount of the post-employment benefit obligation in the next reporting period.

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 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.

The ability to manage risks effectively is vital for the Bank to sustain its growth and continue to create value for its shareholders.

4.1 Risk Management

The Bank continually advances on its risk management techniques and integrate this into the overall strategic business objectives to support the growth objectives of the Bank.

The Bank has automated the front-office, back office, and middle office operations as far as market risk is concerned. This includes the integration of pre-deal limit checking, on-demand position monitoring, automated limit reporting and breach approval, and automated value-at-risk (VaR) calculations. In addition to the automation, the Bank continues to review its limits system to ensure that it only enters into transactions allowed under its existing policies and that adequate capital is available to cover market risk exposures.

On the credit side, the Bank has instituted improvements on its credit policies, which includes review and approval of large exposure and credit concentration within proper authority. The Bank also reviews plans and progress on the resolution of problem loan accounts. Credit process streamlining has also been initiated to ensure that commensurate controls are in place while the Bank continues to device ways to improve on its credit process.

As for operational risk, the Bank has completed the bankwide operational risk and control self-assessment in support of the enterprise risk management framework of the Bank. With this, there is also an enterprise-wide training on risk awareness to ensure appreciation and measurement of key risks of each unique business and support units and how these relate to the over-all objective and strategies of the Bank. In addition, information security policies were further strengthened, implemented, and

disseminated across all units of the Bank.

4.2 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, subject to prudent limits and stringent controls as established in its risk management framework and governance structure. The Bank has an integrated process of planning, organizing, leading, and controlling its activities in order to minimize the effects of risk on its capital and earnings. The Bank's BOD formulates the corporate risk policy, sets risk tolerances and appetite and provide risk oversight function through the Risk Oversight Committee (ROC), which in turn supervises the Chief Risk Officer and Head of the Enterprise Risk Management Group (ERMG) in the development and implementation of risk policies, processes and guidelines. The framework covers operational, market and liquidity, credit and counterparty, and other downside risks within the context of the supervisory risk guidelines of the BSP and aligned best practices on risk management.

4.3 Credit Risk

Credit risk pertains to the risk to income or capital due to failure by borrowers or counterparties to pay 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. ERMG, as guided by the ROC, performs an independent portfolio oversight of credit risks and reports regularly to the BOD and the ROC.

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.

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 maximum credit risk exposure of financial assets is the carrying amount of the financial assets as shown in the statements of financial position or in the detailed analysis provided in the notes to the financial statements and as summarized below (amounts in thousands).

	Notes	2018	2017
Due from BSP	9	P 5,878,735	P 6,575,270
Due from other banks	10	2,478,251	4,012,519
Financial assets at FVTPL	11	1,468,739	-
AFS securities	12	1,739,927	2,438,873
HTM investments	13	470,083	-
Loans and other receivables – net	14	77,497,898	70,552,796
Other resources	15	93,011	29,782
		P 89,626,644	P 83,609,240

The credit risk quality of the Bank's financial assets is further described below and in the succeeding pages:

(i) *Cash and Cash Equivalents*

The credit risk for cash and cash equivalents is considered negligible, since the counterparties are reputable banks with high quality external credit ratings. Included in the cash and cash equivalents with credit risk are Due from BSP, Due from Other Banks, and SPURRA under Loans and Other Receivables. Due from Other Banks are insured by the Philippine Deposit Insurance Corporation up to a maximum coverage of P500,000 for every depositor per banking institution.

(ii) *Financial Assets at FVTPL and AFS Securities*

The Bank continuously monitors defaults of counterparties, identified either individually or by group, and incorporates this information into its credit risk controls. Moreover, these investments are mainly composed of government bonds whose credit risk is secured by the Philippine Government and certain corporate debt securities issued by publicly-known local companies with no observed history of credit default. Accordingly, all debt instruments held by the Bank are considered as either high grade or standard grade that is neither past due nor specifically impaired.

(iii) *Loans and Other Receivables*

The Bank regularly reviews and monitors defaults of borrowers identified either individually or by group, and incorporates this information into its credit risk evaluation. Where available at a reasonable cost, external credit ratings and/or reports on customers are obtained and used. In addition, for a significant proportion of loans, post-dated checks are received to mitigate credit risk.

The Bank's financial assets that are past due but unimpaired pertains only to certain loans and other receivable items.

In addition to default and concentration risk arising from lending activities, the Bank has an incremental issuer credit risk exposure emanating from trading and investment securities and due from other banks amounting to P3,678.7 million and P2,478.3 million, respectively, as of June 30, 2018; and from trading and investment securities,

due from other banks and derivative financial assets, which is included in the Other Resources account, amounting to P2,438.9 million, P4,012.5 million, respectively, as of December 31, 2017. These are, however, neither past due nor impaired.

The balance of the Due from BSP account represents the aggregate balance of noninterest-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 on this account.

The carrying amounts of loans and other receivables are partially secured by collateral mainly consisting of real estate and chattel mortgages, and hold-out deposits.

The Bank's financial assets that are past due but unimpaired pertains only to certain loans and other receivable items.

4.4 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 resources and liabilities, embedded optionality in the loans and deposits due to pre-terminations, and potential cash run offs arising from changes in the 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.

(a) 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 assets and financial liabilities as to foreign currency (translated into Philippine pesos) and Philippine peso-denominated balances as of June 30, 2018 and December 31, 2017 follow (amounts in thousands):

	2018		
	Foreign Currency	Philippine Peso	Total
<i>Financial Assets:</i>			
Cash and other cash items	P -	P 584,012	P 584,012
Due from BSP	-	5,878,735	5,878,735
Due from other banks	1,855,070	623,181	2,478,251
At fair value through profit	1,197,573	271,167	1,468,740
AFS securities	1,739,927	-	1,739,927
Held-to-maturity	-	470,083	470,083
Loans and other receivables - net	913,988	76,583,910	77,497,898
Other resources	55,566	37,445	93,011
	P 5,762,124	P 84,448,533	P 90,210,657
<i>Financial Liabilities:</i>			
Deposit liabilities	P 5,605,747	P 73,493,026	P79,098,773
Bills payable	-	1,743,750	1,743,750
Accrued expenses and other liabilities	-	1,479,560	1,479,560
	P 5,605,747	P 76,716,336	P82,322,083
	2017		
	Foreign Currency	Philippine Peso	Total
<i>Financial Assets:</i>			
Cash and other cash items	P -	P 1,002,241	P 1,002,241
Due from BSP	-	6,575,270	6,575,270
Due from other banks	3,122,080	890,439	4,012,519
AFS securities	2,073,756	365,116	2,438,872
Loans and other receivables - net	444,176	70,108,620	70,552,796
Other resources	54,223	36,055	90,278
	P 5,694,235	P 78,977,741	P 84,671,976
<i>Financial Liabilities:</i>			
Deposit liabilities	P 5,463,248	P 68,058,769	P 73,522,017
Bills payable	-	1,933,725	1,933,725
Accrued expenses and other liabilities	-	1,403,001	1,403,001

(b) *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 Earnings at Risk (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 resources 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.

(c) *Price Risk*

In measuring the magnitude of exposures related to the Bank's trading portfolio arising from holding of 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 PDEX 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 ten 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: (i) VaR limit on a per instrument and portfolio; (ii) loss limit on per investment portfolio, (iii) off-market rate limits on per instrument type; and, (iv) 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.

(d) *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 Maximum Cumulative Outflow (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 ROC prior to the confirmation by the BOD.

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. This limit is reviewed every year. Compliance to MCO Limits is monitored and reported to the BOD and senior management. In case of breach in the MCO Limit, the Risk Management Center elevates the concern to the BOD through the ROC for corrective action.

Additional measures to mitigate liquidity risks include reporting of funding concentration, short-term liquidity reporting, available funding sources, and liquid assets analysis.

More frequent analysis of projected funding source and requirements as well as pricing strategies is discussed thoroughly during the weekly ALCO meetings.

4.5 Operational Risk

Operational risks are risks arising from the potential inadequate information systems and systems, operations or transactional problems (relating to service or product delivery), breaches in internal controls, fraud, or unforeseen catastrophes that may result in unexpected loss. Operational risks include the risk of loss arising from various types of human or technical error, settlement or payments failures, business interruption, administrative and legal risks, and the risk arising from systems not performing adequately.

The ROC of the Bank assists management in meeting its responsibility to understand and manage operational risk exposures.

The ROC applies a number of techniques to efficiently manage operational risks. Among these are enumerated below.

- Each major business line has an embedded operational risk management officer who acts as a point person for the implementation of various operational risk tools. The operational risk officers attend annual risk briefings conducted by the ROC to keep them up-to-date with different operational risk issues, challenges and initiatives.
- With ROC's bottom up self-assessment process, which is conducted at least annually, areas with high risk potential are highlighted and reported, and control measures are identified. The results of said self-assessment exercise also serve as one of the inputs in identifying specific key risk indicators (KRIs).
- KRIs are used to monitor the operational risk profile of the Bank and of each business unit, and alert the management of impending problems in a timely fashion.
- Internal loss information is collected, reported and utilized to model operational risk.
- The ROC reviews product and operating manuals, policies, procedures and circulars, thus allowing the embedding of desired operational risk management practices in all business units.

(a) *Reputational Risk*

Reputation risk is the risk to earnings or capital arising from negative public opinion. This affects the Bank's ability to establish new relationships or services, or to continue servicing existing relationships. This risk can expose the Bank to litigation, financial loss, or damage to its reputation. Reputation risk arises whenever technology-based banking products, services, delivery channels or processes may generate adverse public opinion such that it seriously affects the Bank's earnings or impairs its capital. This risk is present in activities such as asset management and regulatory compliance.

The Bank adopted a reputation risk monitoring and reporting framework to manage public perception.

(b) *Legal Risk and Regulatory Risk Management*

Changes in laws and regulations and fiscal policies could adversely affect the Bank's operations and financial reporting. In addition, the Bank faces legal risks in enforcing its rights under its loan agreements, such as foreclosing of collateral. Legal risk is higher in new areas of business where the law remains untested by the courts. The Bank uses a legal review process as the primary control mechanism for legal risk. Such a legal review aims to verify and validate the existence, genuineness and due execution of legal documents, and verify the capacity and authority of counterparties and customers to enter into transactions. In addition, the Bank seeks to minimize its legal risk by using stringent legal documentation, imposing certain requirements designed to ensure that transactions are properly authorized, and consulting internal and external legal advisors.

Regulatory risk refers to the potential for the Bank to suffer financial loss due to changes in the laws or monetary, tax or other governmental regulations of the country. The Bank's Compliance Program, the design and implementation of which is overseen and coordinated by the Compliance Officer, is the primary control process for regulatory risk issues. The Compliance Office is committed to safeguard the integrity of the Bank by maintaining a high level of regulatory compliance. It is responsible for communicating and disseminating new rules and regulations to all units, assessing and addressing identified compliance issues, performing periodic compliance testing on branches and head office units, and reporting compliance findings to the Audit Committee and the BOD.

4.6 Anti-Money Laundering Controls

The Anti-Money Laundering Act (AMLA) or RA No. 9160 was passed in September 2001 and was amended by RA No. 9194, RA No. 10167, and RA No. 10365 in March 2003, June 2012 and February 2013, respectively. Under the AMLA, as amended, the Bank is required to submit “Covered Transaction Reports” to the Anti-Money Laundering Council (AMLC) involving single transactions in cash or other equivalent monetary instruments in excess of P0.5 million within one banking day. The Bank is also required to submit “Suspicious Transaction Reports” to the AMLC in the event that circumstances exist and there are reasonable grounds to believe that the transaction is suspicious. Furthermore, terrorist financing was criminalized in RA No. 10168. In addition, the AMLA requires that the Bank safe keeps, as long as the account exists, all the Know Your Customer (KYC) documents involving its clients, including documents that establish and record the true and full identity of its clients. Likewise, transactional documents must be maintained and stored for five years from the date of the transaction. In cases involving closed accounts, the KYC documents must be kept for five years after their closure. Meanwhile, all records of accounts with court cases must be safe kept until there is a final resolution.

On January 27, 2011, BSP Circular No. 706 was implemented superseding all policies on AMLA. The Circular requires the Bank to adopt a comprehensive and risk-based Money Laundering and Terrorist Financing Prevention Program (MLPP) designed according to the covered institution’s corporate structure and risk profile.

In an effort to further prevent money laundering activities, the Bank revised its KYC policies and guidelines in order to comply with the aforementioned Circular. Under the guidelines, each business unit is required to validate the true identity of a customer based on official or other reliable identifying documents or records before an account may be opened. Likewise, the Bank is required to risk profile its clients to Low, Normal or High with its corresponding due diligence of Reduced, Average or Enhanced, in compliance with the risk-based approach mandated by the Circular. Decisions to enter into a business relationship with a high risk customer requires senior management approval, and in some cases such as a politically exposed person or a private individual holding a prominent position, Credit and Collection Department Group Head approval is necessary.

The Bank’s procedures for compliance with the AMLA are set out in its MLPP. The Bank’s Compliance Officer, through the Anti-Money Laundering Department (AMLDD), monitors AMLA compliance and conducts regular compliance testing of business units.

The AMLDD requires all banking units to submit to the Compliance Office certificates of compliance with the Anti-Money Laundering Rules and Regulations on a quarterly basis.

The Compliance Officer regularly reports to the Audit Committee and to the BOD results of their monitoring of AMLA compliance.

5. CAPITAL MANAGEMENT AND REGULATORY CAPITAL

The Bank's lead regulator, the BSP, sets and monitors capital requirements for the Bank. In implementing current capital requirements, the BSP requires the Bank to maintain a prescribed ratio of qualifying capital to risk-weighted assets. PBB, being a stand-alone thrift bank, is required under BSP regulations to comply with Basel 1.5. Under this regulation, the qualifying capital account of the Bank should not be less than an amount equal to 10% of its risk weighted assets.

The qualifying capital of the Bank for purposes of determining the capital-to-risk assets ratio consists of Tier 1 capital plus Tier 2 capital elements net of the required deductions from capital such as:

- (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 net of deferred tax liability;
- (d) goodwill;
- (e) sinking fund for redemption of redeemable preferred shares; and,
- (f) other regulatory deductions.

Risk weighted assets is the sum of the Bank's credit risk weighted assets, operational risk weighted assets, and market risk weighted assets. The latter was due to the Bank's authority to engage in derivatives as end-user under a Type 3 Limited End-User Authority. Risk weighted assets are computed using the standardized approach for credit and market risks while basic indicator approach with modification was used for operational risk.

The following are the risk-based capital adequacy of the Bank as of June 30, 2018, December 31, 2017 and 2016 (amounts in millions):

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Net Tier 1 Capital	P 10,167	P 9,809	P 9,241
Tier 2 Capital	703	678	470
Total Qualifying Capital	P 10,870	P 10,487	P 9,711
Risk Weighted Assets			
Credit Risk Weighted Assets	P 70,303	P 68,887	P 48,738
Operational Risk Weighted Assets	4,370	3,941	3,930
Market Risk Weighted Assets	996	2,092	4,477
Total Risk-Weighted Assets	P 75,669	P 74,920	P 57,145

	2018	2017	2016
Capital ratios:			
Total qualifying capital expressed as percentage of total risk-weighted assets	14.4%	14.0%	17.0%
Net Tier 1 capital expressed as percentage of total risk-weighted assets	13.4%	13.1%	16.2%

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 equivalent to 50% of the following:

1. Investments in equity of unconsolidated subsidiary banks and other financial allied undertakings, but excluding insurance companies;
2. Investments in debt capital instruments of unconsolidated subsidiary banks;
3. Investments in equity of subsidiary insurance companies and non-financial allied undertakings;
4. Reciprocal investments in equity of other banks/enterprises; and,
5. 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.

As of June 30, 2018 and December 31, 2017, the Bank has no exposure in item (a) to item (e) above. There were no material changes in the Bank's management of capital during the current year.

As of June 30, 2018 and December 31, 2017, the Bank has satisfactorily complied with the capital-to-risk assets ratio.

Under existing BSP regulations, the determination of the Bank's compliance with regulatory requirements and ratios is based on the amount of the Bank's "unimpaired capital" (regular net worth) reported to the BSP, determined on the basis of regulatory accounting policies, which differ from PFRS in some aspects (mainly in the recognition of deferred tax assets). Thrift banks with head office in the National Capital Region and have more than 50 branches are required to comply with the minimum capital requirement of P2.0 billion. The Bank has complied with the minimum capital requirement at the end of each reporting period.

6. CATEGORIES AND OFFSETTING OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

6.1 Carrying Amounts and Fair Values by Category

The following table summarizes the carrying values and fair values of those financial assets and financial liabilities in the statements of financial position:

	<u>Notes</u>	<u>Carrying Values</u>	<u>Fair Values</u>
June 30, 2018:			
<i>Financial Assets</i>			
Loans and receivables:			
Cash and other cash items	9	P 584,011,784	P 584,011,784
Due from BSP	9	5,878,735,524	5,878,735,524
Due from other banks	10	2,478,250,563	2,478,250,563
Loans and other receivables	14	77,497,898,378	77,497,898,378
Other resources	15	93,011,454	93,011,454
AFS securities	12	1,739,926,796	1,739,926,796
		<u>P88,271,834,499</u>	<u>P88,271,834,499</u>
<i>Financial Liabilities</i>			
At amortized cost:			
Deposit liabilities	19	P79,098,773,128	P79,098,773,128
Bills payable	20	1,743,750,000	1,743,750,000
Accrued expenses and other liabilities	21	1,479,559,693	1,479,559,693
		<u>P82,322,082,821</u>	<u>P82,322,082,821</u>

December 31, 2017:

Financial Assets

Loans and receivables:

Cash and other cash items	9	P 1,002,240,895	P 1,002,240,895
Due from BSP	9	6,575,270,040	6,575,270,040
Due from other banks	10	4,012,519,495	4,012,519,495
Loans and other receivables	14	70,552,796,381	60,760,296,589
Other resources	15	90,278,157	90,278,157
AFS securities	12	2,438,872,511	2,438,872,511
		<u>P84,671,977,479</u>	<u>P74,879,477,687</u>

Financial Liabilities

At amortized cost:

Deposit liabilities	19	P73,522,017,415	P73,465,834,285
Bills payable	20	1,933,724,724	1,933,724,724
Accrued expenses and other liabilities	21	1,403,000,937	1,403,000,937
		<u>P76,858,743,076</u>	<u>P76,802,559,946</u>

The Bank considers that the carrying amounts of foregoing other financial assets and financial liabilities which are measured at amortized cost, approximate the fair values either because those instruments are short-term in nature or the effect of discounting for those with maturities of more than one year is not material. The fair value information disclosed for the Bank's debt securities are determined based on the procedures and methodologies discussed in Note 7.2.

6.2 Offsetting of Financial Assets and Financial Liabilities

The following financial assets of the Bank with net amounts presented in the statements of financial position as of June 30, 2018 and December 31, 2017 are subject to offsetting, enforceable master netting arrangements and similar agreements (amounts in millions):

	<u>Financial assets</u>	<u>Financial liabilities available for set-off</u>	<u>Collateral received</u>	<u>Net Amount</u>
June 30, 2018				
Loans and receivables				
Receivable from customers	P 2,902	P -	P 2,902	P -
Bills payable	485	485	-	-
Total	<u>P 3,387</u>	<u>P 485</u>	<u>P 2,902</u>	<u>P -</u>

December 31, 2017				
Loans and receivables				
Receivable from customers	P 2,902	P -	P 2,902	P -
Bills payable	<u>933</u>	<u>933</u>	<u>-</u>	<u>-</u>
Total	<u>P 3,835</u>	<u>P 933</u>	<u>P 2,902</u>	<u>P -</u>

The following financial liabilities with net amounts presented in the statements of financial position of the Bank are subject to offsetting, enforceable master netting arrangements and similar agreements (amounts in millions):

	<u>Financial liabilities</u>	<u>Financial assets available for set-off</u>	<u>Collateral given</u>	<u>Net Amount</u>
June 30, 2018				
Deposits liabilities	P 2,902	P 2,902	P -	P -
Bills payable	<u>2,336</u>	<u>2,336</u>	<u>-</u>	<u>-</u>
Total	<u>P 5,238</u>	<u>P 5,238</u>	<u>P -</u>	<u>P -</u>
December 31, 2017				
Deposits liabilities	P 2,902	P 2,902	P -	P -
Bills payable	<u>1,934</u>	<u>1,934</u>	<u>-</u>	<u>-</u>
Total	<u>P 4,836</u>	<u>P 4,836</u>	<u>P -</u>	<u>P -</u>

For financial assets and financial liabilities subject to enforceable master netting agreements or similar arrangements above, each agreement between the Bank and counterparties allows for net settlement of the relevant financial assets and financial liabilities when both elect to settle on a net basis. In the absence of such an election, financial assets and financial liabilities will be settled on a gross basis; however, each party to the master netting agreement or similar agreement will have the option to settle all such amounts on a net basis in the event of default of the other party.

7. FAIR VALUE MEASUREMENT AND DISCLOSURES

7.1 *Fair Value Hierarchy*

In accordance with PFRS 13, Fair Value Measurement, the fair value of financial assets and financial liabilities and non-financial assets which are measured at fair value on a recurring or non-recurring basis and those assets and liabilities not measured at fair value but for which fair value is disclosed in accordance with other relevant PFRS, are categorized into three levels based on the significance of inputs used to measure the fair value. The fair value hierarchy has the following levels:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that an entity can access at the measurement date;
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset 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.

For purposes of determining the market value at Level 1, a market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

For investments which do not have quoted market price, the fair value is determined by using generally acceptable pricing models and valuation techniques or by reference to the current market of another instrument which is substantially the same after taking into account the related credit risk of counterparties, or is calculated based on the expected cash flows of the underlying net asset base of the instrument.

When the Bank uses valuation technique, it maximizes the use of observable market data where it is available and relies as little as possible on entity specific estimates. If all significant inputs required to determine the fair value of an instrument are observable, the instrument is included in Level 2. Otherwise, it is included in Level 3.

7.2 Financial Instruments Measured at Fair Value

The table shows the fair value hierarchy of the Bank's classes of financial assets and financial liabilities measured at fair value in the statements of financial position on a recurring basis as of December 31, 2017 and 2016 (amounts in millions).

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<u>December 31, 2017</u>				
AFS securities				
Government debt securities	P 1,490	P 77	-	P 1,567
Corporate debt securities	872	-	-	872
	<u>P 2,362</u>	<u>P 77</u>	<u>-</u>	<u>P 2,439</u>
 <u>December 31, 2016</u>				
Financial assets at FVTPL				
Government bonds	<u>P 1,043</u>	<u>P 2,231</u>	<u>-</u>	<u>P 3,274</u>
AFS securities				
Government debt securities	1,381	88	-	1,469
Corporate debt securities	2,341	-	-	2,341
Equity securities	-	-	2	2
	<u>3,722</u>	<u>88</u>	<u>2</u>	<u>3,812</u>
Derivative financial assets	<u>-</u>	<u>1</u>	<u>-</u>	<u>1</u>
	<u>P 4,765</u>	<u>P 2,320</u>	<u>P 2</u>	<u>P 7,087</u>

As of December 31, 2016 (nil as of December 31, 2017), the Bank had an outstanding derivative financial assets presented as part of Miscellaneous under Other Resources account in the statement of financial position (see Note 15). The Bank has no outstanding derivative liabilities as of March 31, 2018 and December 31, 2017. Derivative financial assets are categorized within Level 2, and are determined through valuation techniques using the net present value computation.

The fair value of the debt securities of the Bank determined as follows:

- (a) For peso-denominated government debt securities issued by the Philippine government, fair value is determined to be the reference price per PDEX which is computed based on the weighted average of done or executed deals (Level 1), or the simple average of all firm bids per benchmark tenor or interpolated yields (Level 2). This is consistent with BSP Circular No. 813, issued by the BSP pursuant to Monetary Board Resolution No. 1504 dated September 13, 2013.
- (b) For other quoted debt securities under Level 1, fair value is determined to be the current mid-price, which is computed as the average of ask and bid prices as appearing on Bloomberg.

There were neither transfers between Levels 1 and 2 nor changes in Level 3 instruments in both years.

7.3 *Financial Instruments Measured at Amortized Cost for which Fair Value is Disclosed*

The fair values of financial assets and financial liabilities not presented at fair value in the statements of financial position are determined as follows:

(a) 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.

(b) 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.

(c) Other Financial Assets

Other financial assets pertain to foreign currency notes and coins, security deposits and petty cash fund which are included in the Other Resources account. Due to their short duration, the carrying amounts of these items in the statements of financial position are considered to be reasonable approximation of their fair values.

(d) 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.

(e) Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities classified as financial liabilities are recognized initially at their fair value and subsequently measured at amounts to which they are to be paid. Due to their short-duration, management ascertained that the fair values of these short-term liabilities approximate their carrying values.

7.4 Fair Value Measurement of Investment Properties Carried at Cost

The total estimated fair values of the Bank's investment properties, categorized under Level 3 of the fair value hierarchy, amounted to P554.6 million and P617.3 million as of December 31, 2017 and 2016, respectively.

The fair value of the investment properties of the Bank was determined on the basis of a valuation carried out on the acquisition dates by either an independent or internal appraiser having appropriate qualifications and recent experience in the valuation of properties in the relevant locations. To some extent, the valuation process was conducted by the appraisers in discussion with the management of the Bank with respect to determination of the inputs such as size, age, and condition of the land and buildings and the comparable prices in the corresponding property location. In estimating the fair value of the properties, management takes into account the market participant's ability to generate economic benefits by using the assets in highest and best use. Based on management's assessment, the best use of the investment properties indicated above is their current use which is generate positive future cash flows through sale.

The fair value of these investment properties were determined based on the following approaches:

(a) Fair Value Measurement for Land

The Level 3 fair value of land was derived using observable recent prices of the reference properties adjusted for differences in key attributes such as property size, zoning, and accessibility. The most significant input into this valuation approach is the price per square foot; hence, the higher the price per square foot, the higher the fair value. On the other hand, if fair value of the land was derived using the market comparable approach that reflects the recent transaction prices for similar properties in nearby locations, fair value is included in Level 2. Under this approach, when sales prices of comparable land in close proximity are used in the valuation of the subject property, minor adjustments on the price is made to consider peculiarities of the property with that of the benchmark property.

(b) Fair Value Measure for Building and Improvements

The Level 3 fair value of the buildings and improvements under Investment Properties account was determined using the replacement cost approach that reflects the cost to a market participant to construct an asset of comparable usage, constructions standards, design and lay-out, adjusted for obsolescence. The more significant inputs used in the valuation include direct and indirect costs of construction such as but not limited to, labor and contractor's profit, materials and equipment, surveying and permit costs, electricity and utility costs, architectural and engineering fees, insurance and legal fees. These inputs were derived from various suppliers and contractor's quotes, price catalogues, and construction price indices. Under this approach, higher estimated costs used in the valuation will result in higher fair value of the properties. There has been no change to the valuation techniques used by the Bank during the year for its non-financial assets. Also, there were no transfers into or out of Level 3 fair value hierarchy in 2017 and 2016.

8. 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) *Corporate 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 trading and investment 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.

9. CASH AND DUE FROM BSP

This account is composed of the following:

	<u>2018</u>	<u>2017</u>
Cash and other cash items	P 584,011,784	P 1,002,240,895
Due from BSP		
Mandatory reserves	5,878,735,524	5,475,270,040
Other than mandatory reserves	-	1,100,000,000
	<u>5,878,735,524</u>	<u>6,575,270,040</u>
	P 6,462,747,305	P 7,577,510,935

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 (see Note 17)] 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 other than mandatory reserves bears annual effective interest rates ranging from 0.0% to 2.5% in 2018, 2017 and 2016. The total interest income earned in 2018, 2017 and 2016 amounted to P4.7 million, P18.8 million and P27.5 million, respectively, and are included as part of Interest Income on Due from BSP and Other Banks in the statements of profit or loss.

10. DUE FROM OTHER BANKS

The balance of this account represents deposits with the following:

	<u>2018</u>		<u>2017</u>
Local banks	P 1,604,733,530	P	3,538,289,535
Foreign banks	873,517,033		474,229,960
	<u>P 2,478,250,563</u>	P	<u>4,012,519,495</u>

Interest rates on these deposits range from 0.25% to 1.75% per annum in 2018, 2017 and 2016. The total interest income earned in 2018, 2017 and 2016 amounted to P2.2 million, P3.7 million and P6.4 million, respectively, and are included as part of Interest Income on Due from BSP and Other Banks in the statements of profit or loss.

The breakdown of due from other banks by currency follows:

	<u>2018</u>		<u>2017</u>
US dollars	P 1,855,069,718	P	3,122,079,557
Philippine peso	623,180,845		890,439,938
	<u>P 2,478,250,563</u>	P	<u>4,012,519,495</u>

11. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

This account is composed of held-for-trading government securities with fair value amounting to P1,468.7 million as of June 30, 2018, nil as of December 31, 2017, and P3,274.2 million as of December 31, 2016. Because of better earning opportunities in other form of investments, management decided to dispose of this financial instrument in 2017; hence, the nil balance as at December 31, 2017. Interest rates on these investments range from 3.0% to 7.50% in 2018, and 3.5% to 8.0% in 2016. The total interest income earned in 2018, 2017 and 2016 amounted to P26.0 million, P15.1 million and P5.1 million, respectively, and are included as part of Interest Income on Trading and Investment Securities in the statements of profit or loss.

The related net unrealized fair value losses, presented as part of Trading Gains in the statements of profit or loss, amounted to (P39.7) million in 2018, (P.5) million in 2017 and nil in 2016. Net realized trading gains amounting to (P17.1) million, P98.2 million and P101.8 million in 2018, 2017 and 2016, respectively, for held-for-trading government securities, are presented as part of Trading Gains in the statements of profit or loss.

12. AVAILABLE-FOR-SALE SECURITIES

This account is composed of the following:

	<u>2018</u>		<u>2017</u>
Government debt securities	P 1,472,968,098	P	1,566,860,912
Corporate bonds – quoted	266,958,699		872,011,599
Equity securities – unquoted	<u>-</u>		<u>-</u>
	<u>P 1,739,926,797</u>	P	<u>2,438,872,511</u>

As to currency, this account consists of the following:

	<u>2018</u>		<u>2017</u>
Foreign currencies	P 1,739,926,797	P	2,073,756,448
Philippine pesos	<u>-</u>		<u>365,116,063</u>
	<u>P 1,739,926,797</u>	P	<u>2,438,872,511</u>

Changes in the AFS securities are summarized below.

	<u>Notes</u>	<u>2018</u>	<u>2017</u>
Balance at beginning of year		P 2,438,872,511	P 3,811,726,524
Additions		-	3,352,273,750
Disposals		-	(4,767,354,091)
Fair value gains		(183,380,583)	59,748,950
Foreign currency revaluation		(105,955,260)	(8,938,655)
Amortization of discount (premium)		572,929,392	(8,583,967)
Acquired through business acquisition		-	-
Reclassification from HTM investments	13	(982,539,263)	-
Reclassification from Loans and Other Receivables	14	<u>-</u>	<u>-</u>
Balance at end of year		<u>P 1,739,926,797</u>	<u>P 2,438,872,511</u>

AFS securities earn annual interest ranging from 3.7% per annum, 0.0% to 8.125%, and from 3.5% to 8.1% in 2018, 2017, and 2016 respectively. The total interest income earned in 2018, 2017, and 2016 amounted to P30.1 million, P88.1 million, and P53.2 million, respectively, and are included as part of Interest Income on Trading and Investment Securities in the statements of profit or loss.

The fair values of AFS securities have been determined directly by reference to published prices in an active market except for the unquoted equity securities of the Bank.

In compliance with current banking regulations relative to the Bank's trust functions, certain AFS securities of the Bank, with a face value of P35.0 million and P55.0 million as of June 30, 2018 and December 31, 2017 and 2016, respectively, are deposited with the BSP.

13. HELD-TO-MATURITY INVESTMENTS

In 2016, in anticipation of its planned disposal, the Bank reclassified its entire HTM investments with a carrying value of P6,085.7 million, which consist of local and foreign government securities, and recognized fair value gain amounting to P850.5 million upon reclassification, to AFS securities (see Note 12). The same were subsequently disposed of within the same year.

This account is composed of the following:

Corporate bonds	P	287,929,248
Government securities		182,153,331
Equity securities		-
Balance at end of year	P	470,082,579

The effective interest rates on these investments ranges from 0.00% to 8.125% in 2018, and 5.3% to 8.1% per annum in 2016 and 2015. The total interest income earned from these investments amounted to P9.3 million and P73.7 million in 2018 and 2016, respectively, and is shown as part of Interest Income on Trading and Investment Securities in the statements of profit or loss.

On May 29, 2014, the Bank reclassified certain government debt securities from AFS securities to HTM investments with a market value of P5,623.6 million at the date of reclassification. The annual effective interest rates of the reclassified securities ranges from 5.3% to 8.1%. The unrealized fair value loss on the reclassified securities amounting to P511.6 million was retained in other comprehensive income and were amortized over the remaining life of the HTM investments and was consequently recognized to profit or loss upon sale. The amortization of unrealized fair value loss amounted to P6.5 million and P11.1 million in 2016 and 2015, respectively, and was presented as part of Trading Gains in the statements of profit or loss. The book value and unamortized fair value losses related to these debt securities as of December 31, 2015 amount to P5,581.6 million and P498.9 million, respectively (see Note 12). There was no reclassification of AFS to HTM in 2016 and 2015.

14. LOANS AND OTHER RECEIVABLES

This account consists of the following:

	<u>2018</u>	<u>2017</u>
Receivables from customers:		
Loans and discounts	P 72,801,651,391	P 66,993,743,115
Unearned discount	(167,274,829)	(120,049,688)
	<u>72,634,376,562</u>	<u>66,873,693,427</u>
Bills purchased	307,248,465	366,130,161
Customers' liabilities on acceptances, letters of credit and trust receipts	3,420,086,419	3,577,720,164
	<u>76,361,711,446</u>	<u>70,817,543,752</u>
Other receivables:		
SPURRA	800,000,000	826,072,472
Accrued interest receivable	237,731,256	207,680,908
Deficiency claims receivable	51,169,833	55,056,218
Accounts receivable	28,540,176	41,032,917
Sales contracts receivable	37,655,705	35,934,861
Interbank call loans receivable	1,610,000,000	-
Unquoted debt securities	-	25,923,421
	<u>2,765,096,970</u>	<u>1,191,700,797</u>
	79,126,808,416	72,009,244,549
Allowance for impairment	(1,628,910,038)	(1,456,448,168)
	<u>P 77,497,898,378</u>	<u>P 70,552,796,381</u>

In 2016, the Bank reclassified to AFS securities certain corporate debt securities previously included as part of Unquoted debt securities above amounting to P698.2 million (see Note 12). There was no similar transaction in 2017.

SPURRA are secured by certain treasury bills of the BSP. SPURRA represent loans and receivables from BSP as of June 30, 2018 and December 31, 2017 arise from overnight lending from excess liquidity.

As of December 31, 2016, Accounts receivable includes P36.7 million set up by the Bank for the final tax withheld by the Bureau of Treasury (BTr) subject to the resolution of a case filed with the Supreme Court (SC) on the matter. On various dates in 2002, the Bank purchased P259.0 million face value of the 10-year Poverty Eradication and Alleviation Certificates (PEACe) bonds, which were issued by the BTr in 2001, with the understanding that these were tax-exempt. However, when the bonds matured on October 18, 2011, the BTr withheld final tax on them; hence, a petition for the release of the amount withheld was made by the Bank together with other banks. On January 13, 2015, the SC nullified the 2011 Rulings of the Bureau of Internal Revenue (BIR) classifying all bonds as deposit substitutes and ordered the BTr to return to the petitioning banks the 20% final withholding taxes that it withheld on the PEACe Bonds. On August 16, 2016, the SC ordered the BTr to immediately release and pay the bondholders the amount representing the 20% final withholding tax on the PEACe bonds, plus the corresponding legal interest

of 6% per annum from October 19, 2011 until full payment. On April 11, 2017, BTr released to the Bank the whole amount withheld, plus P8.1 million legal interest which is presented as part of Interest Income on Loans and Other receivable in the 2017 statement of profit or loss.

Non-performing loans of the Bank amount to P1,854.1 million and P1,504.5 million as of June 30, 2018 and December 31, 2017, respectively, while restructured loans amount to P38.7 million and P40.6 million, respectively.

A summary of the Bank's maximum exposure to credit risk on loans and other receivables is disclosed in Note 4.3.

An analysis of the maturity profile of the Bank's receivables from customers, gross of allowance, follows (amounts in thousands):

	<u>2018</u>	<u>2017</u>
Within one year	P 38,160,637	P 38,358,514
Beyond one year	38,368,349	32,579,079
	<u>P 76,528,986</u>	<u>P 70,937,593</u>

The Bank's concentration of credit as to industry for its receivables from customers portfolio, gross of allowance, follows (amounts in thousands):

	<u>2018</u>	<u>2017</u>
Wholesale and retail trade	P 27,542,436	P 25,028,390
Construction	20,092,454	19,435,728
Manufacturing	7,075,566	7,659,280
Administrative and support services	8,274,016	7,155,130
Transportation and storage	6,983,706	5,916,230
Electricity, gas, steam and air-conditioning supply	5,113,851	4,697,583
Agriculture, fishery and forestry	1,231,124	861,697
Mining and quarrying	204,077	171,610
Activities of private household as employers and undifferentiated goods and services and producing activities of households for own use	11,756	11,945
	<u>P 76,528,986</u>	<u>P 70,937,593</u>

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

	Note	2018	2017
Secured:			
Real estate mortgage		P 32,873,880	P 28,816,083
Chattel mortgage		6,323,491	4,860,906
Deposit hold-out	6.2	2,534,394	2,901,898
Others		1,258,474	782,717
Unsecured		33,538,747	33,575,989
		P 76,528,986	P 70,937,593

Reversal of allowance for impairment pertains to the recovery of the accounts receivables, which has been fully provided with allowance, set-up for the amount improperly withheld on the PEACe bonds.

Of the total loans and discounts of the Bank as of June 30, 2018 and December 31, 2017 81.0% and 81.0%, respectively, are subject to periodic interest repricing.

Loans receivables pledged as collaterals to secure borrowings under rediscounting privileges amount to P932.5 million as of December 31, 2017 (nil as of June 30, 2018).

15. OTHER RESOURCES

This account consists of the following as of June 30, 2018 and December 31, 2017:

	Notes	2018	2017
Other investments	15.1	P 575,030,000	P 575,030,000
Deferred tax assets – net		518,843,663	493,343,661
Branch licenses	16	250,480,060	250,380,060
Goodwill	17	121,890,408	121,890,408
Due from head office or branches		16,047,678	70,311,672
Foreign currency notes and coins on hand		62,877,702	60,144,407
Computer software – net		68,681,741	45,868,442
Prepaid expenses		129,844,238	30,175,044
Security deposits		29,782,252	29,782,252
Stationery and supplies		16,257,519	14,905,921
Deferred charges		15,289,308	13,383,687
Sundry debits		1,020,816	3,819,865
Retirement benefit asset		1,202,348	1,202,348
Miscellaneous		110,352,507	76,958,649
		1,917,600,240	1,787,196,416
Allowance for impairment		(15,038,424)	(15,038,424)
		P 1,902,561,816	P 1,772,157,992

15.1 Other Investments

(a) Acquisition of Shares of Insular Savers Bank, Inc.

In July 2015, the Bank's BOD approved the acquisition of all outstanding shares of Insular Savers Bank, Inc. (ISBI), which is still subject to BSP's approval as at December 31, 2017, with an agreed initial purchase price of P518.2 million. Of this purchase price, the Bank directly paid P101.2 million to the shareholders of ISBI and deposited P417.0 million with the designated escrow agent. In 2016, the agreed purchase price was increased by P82.5 million but was subsequently reduced by P25.7 million in 2017 because of the revaluation of ISBI which brings the agreed purchase price to P575.0 million as at December 31, 2017 from P549.3 million as at December 31, 2016. As of December 31, 2016 and 2015, the Bank has already released from the escrow fund P252.9 million and P105.1 million, respectively, as payment for the ISBI shares. The unpaid balance of the purchase price (i.e., net of amounts released from the escrow fund and direct payment made) is presented as part of Accounts payable under Accrued Expenses and Other Liabilities in the statements of financial position (see Note 21). Because of the pending BSP approval, the total acquisition price is temporarily lodged as part of Other investments under Other Resources.

(b) Purchase of Assets and Assumption of Liabilities of Bataan Savings and Loan Bank, Inc.

In July 2015, the Bank entered into a Sale and Purchase Agreement with Bataan Savings and Loan Bank, Inc. (BLSB), whereby the Bank shall acquire all the assets of BLSB and assume the payment of all its obligation. The agreed purchase price was P68.8 million which has been fully paid by the Bank in 2015. As of December 31, 2016, the transaction is still subject to BSP approval and, as such, the purchase price was temporarily lodged as part of Other investments under Other Resources in the 2016 statement of financial position. On July 12, 2017, the BSP approved the acquisition. Upon BSP's approval of the transaction, the Bank recognized the following assets and liabilities of BLSB at their approximate fair values (amount in thousands) resulting in the recognition of P12.5 million goodwill:

Recognized amounts of identifiable	
assets acquired and liabilities assumed:	
Cash and cash equivalents	P 215,165
Trading and investment securities	1,243
Loans and other receivables	7,014
Bank premises, furniture, fixtures and equipment	991
Other resources	136
Total assets	<u>224,549</u>
Deposit liabilities	P 166,726
Other liabilities	1,488
Total liabilities	<u>168,214</u>
Net asset position	56,335
Cash consideration given	68,833
Goodwill (see Note 17.3)	<u>P 12,498</u>

Management's assessment showed that because the net assets are composed of short-term financial instruments and those that are non-financial instruments are not material, the carrying value of the assets and liabilities at the time of consummation of the acquisition is an approximation of their fair value.

(c) *Purchase of Assets and Assumption of Liabilities of Rural Bank of Kawit (RBK)*

In September 2014, as part of the Bank's expansion strategy, the BOD approved the acquisition of all the assets and assumption of all the obligation of RBK in exchange for P15.0 million. The approval of the BSP was not obtained until 2016; hence, the acquisition price was temporarily lodged as part of Other investments under Other Resources. Upon approval by the BSP on February 1, 2016, the Bank recognized the following assets and liabilities of RBK at their fair values (amounts in thousands), resulting in the recognition of P59.9 million goodwill.

Recognized amounts of identifiable		
assets acquired and liabilities assumed:		
Cash and cash equivalents	P	29,323
Trading and investment securities		6,602
Loans and other receivables		94,332
Bank premises, furniture, fixtures and equipment		5,616
Investment properties		15,840
Other resources		3,025
Total assets		<u>154,738</u>
Deposit liabilities	P	155,913
Other liabilities		43,339
Total liabilities		<u>199,252</u>
Net liability position		44,514
Cash consideration given		<u>15,000</u>
Goodwill (see Note 17.3)	P	<u>59,514</u>

15.2 Branch Licenses

In 2016, the Bank have opened various branches in the CAMANAVA, Vis-Min Area and Central Luzon area which total cost of branch licenses amounted to P1.7 million.

On February 27, 2014, the Bank received an approval from the BSP regarding its application for new licenses. This is in line with the Bank's branch expansion program for which it has allocated a portion of its IPO proceeds to cover the cost of new licenses in the following areas plus processing fees which amounted to a total of P2.2 million: CAMANAVA, Vis-Min Area, Central Luzon and Southern Luzon.

In November 2011, the Monetary Board of BSP approved the request of the Bank to establish 15 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.

In December 2011, the Bank acquired four licenses from Prime Savings Bank, Inc. for a total consideration of P20.0 million.

15.3 Goodwill

Goodwill arose from the following acquisitions:

	Note	2018	2017
RBK	17	P 59,513,648	P 59,513,648
Kabalikat Rural Bank, Inc. (KRBI)		49,878,393	49,878,393
BLSB	17	12,498,367	12,498,367
		P 121,890,408	P 121,890,408

KRBI, which is located in Sta. Maria Bulacan, Philippines, was acquired in 2010.

The Bank acquired the foregoing smaller banks with the objective of availing the branch incentives under the Strengthening Program for Rural Bank Plus; and, its expected future economic benefits and synergies that will result from incorporating the operations of these acquired rural banks with that of the Bank which expands its presence in the small and medium enterprise market. Accordingly, the Bank acquired them at a premium resulting in the recognition of goodwill.

As indicated in Notes 2.19 and 3.2(f), goodwill is tested for impairment annually. In 2017 and 2016, using interest rates of 4.7% and 4.5%, respectively, management estimates the expected future cash flows from each branches where the goodwill arises from and the Bank has assessed that the carrying amount of the goodwill is recoverable. Accordingly, no impairment loss is required to be recognized in the statements of profit or loss in both years.

15.4 Others

Deferred charges amounting to P13.4 million as of June 30, 2018 and December 31, 2017 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.

16. DEPOSIT LIABILITIES

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

	<u>2018</u>	<u>2017</u>
Within one year	P 76,055,293,743	P 71,593,063,292
Beyond one year	3,043,479,385	1,928,954,123
	<u>P 79,098,773,128</u>	<u>P 73,522,017,415</u>

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

	<u>2018</u>	<u>2017</u>
Philippine peso	P 73,493,026,387	P 68,058,769,464
Foreign currencies	5,605,746,741	5,463,247,951
	<u>P 79,098,773,128</u>	<u>P 73,522,017,415</u>

Annual interest rates on deposit liabilities range from 0.3% to 2.9% in 2018 and 2017, and 2016.

Deposit liabilities as of June 30, 2018 and December 31, 2017 include those that are from DOSRI as of June 30, 2018 and December 31, 2017.

Under existing BSP regulations, the Bank is subject to reserve requirement equivalent to 8.0% of non-FCDU deposit liabilities. On April 6, 2012, the BSP issued an amendment to the existing provisions as to the eligibility of cash and deposit accounts with BSP as forms of reserve requirements. As indicated in the recent amendment, cash and other cash items are no longer considered as eligible reserves. The Bank's available reserves as of June 30, 2018 and December 31, 2017 amount to P5,878.7 million and P5,475.3 million, respectively, and is in compliance with these regulations with the BSP requirement.

17. BILLS PAYABLE

The bills payable are denominated in Philippine pesos and have maturities of less than one year. The Bank has no outstanding bills payable as of December 31, 2016 because the carryover balance of bills payable as at December 31, 2015 was settled in 2016.

This account is composed of the following:

	<u>2018</u>		<u>2017</u>
Interbank	P 1,743,750,000	P	1,000,000,000
Other - BSP	-		933,724,724
	P 1,743,750,000	P	1,933,724,724

As of June 30, 2018 and December 31, 2017, bills payable are secured with certain Bank's loans and receivables.

18. ACCRUED EXPENSES AND OTHER LIABILITIES

The breakdown of this account follows:

	<u>Notes</u>	<u>2018</u>		<u>2017</u>
Accounts payable		P 438,430,486	P	452,617,596
Bills purchased		296,681,421		355,563,117
Manager's checks		169,438,283		242,451,472
Accrued expenses		498,778,554		239,720,661
Income tax payable		81,426,974		138,803,669
Withholding taxes payable		34,676,790		40,070,165
Outstanding acceptances		28,663,521		22,183,416
Due to BSP		5,648,676		18,023,886
Dividends payable	23	-		-
Others		41,918,752		72,440,789
		P 1,595,663,457	P	1,581,874,771

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

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

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

19. EQUITY

19.1 Capital Stock

Capital stock consists of:

	<u>Number of Shares</u>		<u>Amount</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Preferred shares – P10 par value				
Authorized – 130,000,000 shares				
Issued and outstanding	62,000,000	62,000,000	P620,000,000	P620,000,000
Common shares – P10 par value				
Authorized – 870,000,000 shares				
Issued and outstanding				
Balance at beginning of year	643,750,094	536,458,437	P6,437,500,940	P5,364,584,370
Stock dividends (see Note 21.2)	-	107,291,657		1,072,916,570
Balance at end of year	643,750,094	643,750,094	P6,437,500,940	P6,437,500,940

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 8.0% per annum.

On February 17, 2016, the BOD approved the redemption of all the issued and outstanding preferred shares of the Bank at par value of P620.0 million through staggered redemption. However, as at December 31, 2017 and 2016, none of the preferred shares have been redeemed yet and the Bank is now considering conversion of the preferred shares to common shares instead. Both options require regulatory approvals.

On January 9, 2013, the PSE approved the Bank's application for the listing of its common shares. The approval covered the IPO of 101,333,400 unissued common shares of the Bank at P31.50 per share and the listing of those shares in the PSE's main board on February 19, 2013, its day of listing. The Bank offered its 101,333,400 unissued common to the public at the approved P31.50 per share resulting in the recognition of additional paid-in capital of P1,998.4 million, net of transactions costs (see Note 21.4).

As of December 31, 2017 and 2016, the Bank has 71 and 65 holders, respectively, of its listed common stock. The Bank has 643,750,094 and 536,458,437 common shares traded in the PSE as of December 31, 2017 and 2016 and its share price closed as of June 30, 2018 and December 31, 2017 at P11.90 and P14.36 as at the same date, respectively.

19.2 Dividends

On March 15, 2017, the BOD approved the declaration of 20% stock dividend on common shares totaling 107.3 million or P1,072.9 million to stockholders of record as of August 4, 2017 and paid on August 18, 2017. The dividend distribution was approved by the stockholders on May 26, 2017.

On December 29, 2016, the Bank's BOD approved the declaration of cash dividends on preferred shares amounting to P79.2 million which is presented as Dividends payable under the Accrued Expenses and Other Liabilities account in the 2016 statement of financial position (see Note 20). This dividend payable has been fully paid during 2017.

On April 15, 2015, the BOD approved the declaration of stock dividend on common shares totaling 107.3 million or P1.1 billion to stockholders of record as of September 15, 2015 and paid on October 8, 2015. The dividend distribution was approved by the stockholders and the BSP on May 29, 2015 and July 23, 2015, respectively.

19.3 Appropriated Surplus

In 2017, 2016 and 2015, additional appropriations of surplus amounting to P1.1 million, P1.2 million and P1.4 million, respectively, representing portion of the Bank's income from trust operations were made in compliance with BSP regulations (see Note 27).

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, 2017 and 2016, the sinking fund for the redemption of redeemable preferred shares is yet to be established.

19.4 Paid-in Capital from IPO

As mentioned in Note 21.1, the Bank's common shares were listed at the PSE in February 2013. The total proceeds received from the IPO amounted to P3,191.9 million which exceeded par value by P1,998.4 million, net of share issuance cost of P180.2 million. The excess over par value is presented as Additional Paid-in Capital in the statements of financial position.

20. 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. The rent expense amounting to P138.1 million, P130.8 million and P115.1 million in 2017, 2016 and 2015, respectively, are included as part of Occupancy under Other Expenses in the statements of profit or loss.
- (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 June 30, 2018 and December 31, 2017:

	<u>2018</u>	<u>2017</u>
Investment management accounts	P 2,451,916,353	P 2,352,423,750
Trust and other fiduciary accounts	819,916,962	753,922,571
Outstanding letters of credit	962,403,293	626,860,238
Unit investment trust fund	29,578,488	31,562,003
Late payment/deposits received	7,324,943	14,996,909
Outward bills for collection	33,104,199	4,358,349
Items held for safekeeping	115,995	93,083
Items held as collateral	11,202	11,066
Other contingent accounts	338,306,867	239,479,318

As of June 30, 2018 and December 31, 2017, 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.

- (d) There are other commitments, guarantees and contingent liabilities that arise in the normal course of the Bank's operations that are not reflected in the financial statements. As of June 30, 2018 and December 31, 2017, management is of the opinion that losses, if any, from these items will not have a material effect on the Bank's financial statements.

21. EARNINGS PER SHARE

Basic and diluted earnings per share are computed as follows:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Net profit	P 348,157,556	P 340,320,214	P 340,004,471
Dividends on preferred shares	<u>-</u>	<u>-</u>	<u>(79,200,000)</u>
Net profit attributable to common shareholders	348,157,556	340,320,214	260,804,471
Divided by the weighted average number of outstanding common shares	<u>643,750,094</u>	<u>643,750,094</u>	<u>643,750,094</u>
Basic earnings per share	<u>P 0.54</u>	<u>P 0.53</u>	<u>P 0.41</u>

The 2016 earnings per share of the Bank was restated to account for the stock dividends declared in 2017 which is considered as a bonus issue under PAS 33, Earnings per Share. PAS 33 requires stock dividends issued to be recognized at the beginning of the earliest period presented for earnings per share computation.

As of June 30, 2018 and December 31, 2017 the Bank has no outstanding potentially dilutive securities; hence, basic earnings per share is equal to diluted earnings per share.

SCHEDULE OF AGING OF LOANS RECEIVABLES
(PSE Requirement per Circular No. 2164-99)
As of June 30, 2018

Current Accounts (by maturity)	
Up to 12 months	45,362,836,211
Over 1 year to 3 years	4,747,016,838
Over 3 years to 5 years	8,822,117,297
Over 5 years	18,859,717,124
Past due and items in litigations	1,502,395,775
Loans Receivables (gross)	79,294,083,245
Less:	
Unearned and other deferred income	167,274,829
Allowance for credit losses	1,628,910,038
Loans Receivables (Net)	77,497,898,378

FINANCIAL SOUNDNESS INDICATORS
(As Required by SRC Rule)

	June 30, 2018	December 31, 2017
Current Ratio ⁽¹⁾	41.73%	50.14%
Solvency Ratio ⁽²⁾	1.13%	1.13%
Debt-to-equity ⁽³⁾	7.86%	7.53%
Asset-to-equity ⁽⁴⁾	8.86%	8.53%
Interest rate coverage ratio ⁽⁵⁾	173.75%	208.49%
Return on Equity ⁽⁶⁾	6.72%	6.47%
Return on Assets ⁽⁷⁾	0.77%	0.81%
Net Interest Margin ^{(8) (9)}	4.12%	3.92%
Cost-to-Income Ratio ⁽¹⁰⁾	67.72%	65.74%

Notes:

- (1) Current assets divided by current liabilities
- (2) Total assets divided by total liabilities
- (3) Total liabilities divided by total equity
- (4) Total assets divided by total equity
- (5) Income before interest and taxes divided by interest expense
- (6) Net income divided by average total equity for the periods indicated (annualized)
- (7) Net income divided by average total assets for the periods indicated (annualized)
- (8) Net interest income divided by average interest-earning assets (incl. interbank loans, trading and investment securities and loans)
- (9) Starting April 2012, the BSP stopped paying interest on reserves on customer deposits of banks. The Q1 2013 computation considered the Bank's deposit with BSP as non-earning. In Q1 2012 and previous to that, it is considered part of earning assets. NIM in Q1 2012 would have been 7.3% if this was to be calculated on same basis as that of Q1 2013
- (10) Other expenses (excl. provision for impairment and credit losses) divided by the sum of interest and other income for the periods indicated