BREAKTHROUGH
ON ALL FRONTS

2007 ANNUAL REPORT

Mission and Vision

We are a leading, dynamic Filipino financial services group with a global presence committed to delivering a whole range of quality products and services that will create value and enrich the lives of our customers, employees, shareholders and communities we serve.

Vision for 2010 and Beyond

To be the most admired financial services organization in the country in terms of:

- **FINANCIAL PERFORMANCE**
  - Rank #1 or #2 in its businesses in terms of return on equity
- **INNOVATIVENESS**
  - In products, services, distribution and the use of cutting-edge technology
- **CUSTOMER PERCEPTION**
  - The preferred financial services provider
  - Customer-centered organization with a passion for service excellence
- **SOCIAL RESPONSIBILITY**
  - The employer of choice, a good corporate citizen and partner in nation-building
- **LONG-TERM VISION**
  - Developing competitive advantage on a sustained basis by anticipating changes in customers' preferences and in the manner of doing business

About the Cover

The theme for this Annual Report, **"Breakthrough on All Fronts,"** effectively summarizes the performance of PNB for the year 2007.

A "breakthrough" denotes a major advance or discovery, an act of breaking through an obstacle. For PNB, it was a year where it broke performance records, made key innovations in process and infrastructure, and transformed into a Bank that is a main force to reckon with in the banking industry.

Your Bank scored major breakthroughs: a five-year high in net income since its turnaround in 2003; an increase in capitalization through a successful follow-on equity offering; becoming a fully private bank; and significant improvements in practically all segments of the Bank's business.

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Consolidated Financial HIGHLIGHTS

(In Thousand Pesos, Except Per Share Amounts)

	December 31	
	2007	2006
Results of Operations		
Gross Income	19,940,996	20,172,979
Total Expenses	18,442,546	19,352,950
Net Income	1,498,450	820,029
Financial Condition		
Total Assets	239,705,040	243,471,065
Loans and Receivables	76,575,031	83,592,219
Total Liabilities	209,475,922	218,714,790
Deposit Liabilities	178,811,969	181,667,692
Total Equity	30,229,118	24,756,275
Per Share[1]/		
Basic / Diluted Earnings Per Share	2.43	1.42
Book Value Per Share	45.48	43.01

1/ attributable to equity holders of the Parent Company

Florencia G. Tarriela
Chairman

Omar Byron T. Mier
Vice Chairman, President and CEO

Message to the SHAREHOLDERS

Philippine National Bank accelerated its growth momentum in 2007 and exceeded targets and expectations, thus achieving significant breakthroughs on all fronts:

- Your Bank's surge in profitability surpassed even the growth rate of the industry.
- The growth was broad-based as improvements were made in practically all the major segments of the Bank's business.
- We increased capital substantially through a follow-on equity offering which was highly successful and considered as the biggest in Philippine banking.
- We brought down our non-performing loans level by 63% over the last two years.
- The Bank prepaid its ₱6.1 billion obligation to the Philippine Deposit Insurance Corporation four years ahead of the loan's due date.
- We implemented initiatives and innovations aimed at further fortifying organizational capability and operational efficiency.

These positive developments and the complete divestment of the government's remaining 12% stake in PNB ushered your Bank's transition into a fully private bank.

Your Bank's performance in 2007 affirmed the wisdom of the three-pronged business objective that we have pursued in the last three years: strengthen core businesses; reduce non-performing assets; and increase profitability.

BREAKTHROUGHS IN FINANCIAL PERFORMANCE

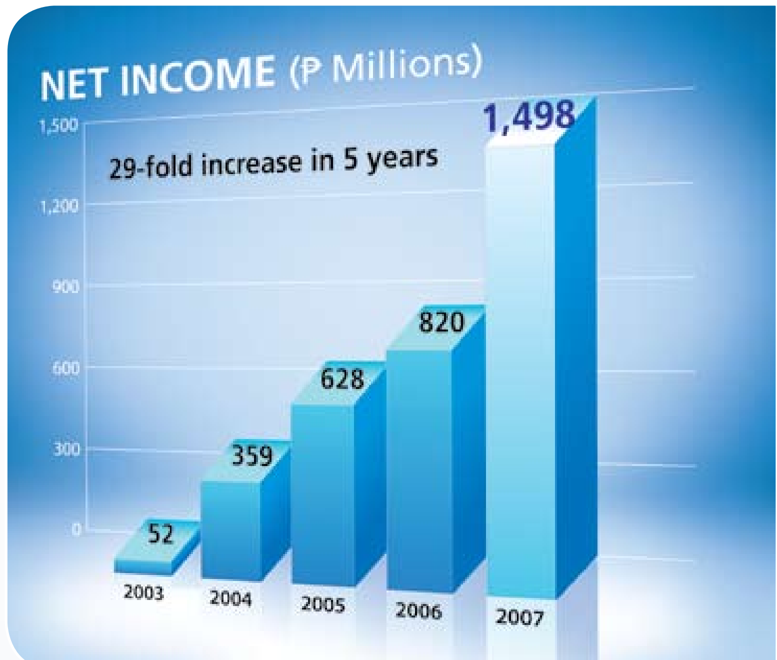
Your Bank's breakthrough performance was exemplified by the ₱1.5 billion net income achieved in 2007, its best performance since its turnaround in 2003. This represents a remarkable 83% growth year-on-year and a 29-fold increase over the last five years. It is noteworthy to mention that had your Bank not set aside a substantial provisioning for probable losses, it could have registered a net income of ₱4.8 billion.

Despite the low interest rate scenario that prevailed last year, net interest income rose by 10%. Contributing to this were the significant increases in loans granted to SMEs, LGUs and consumers that have higher margins as these market segments are less sensitive to changes in interest rates. Our traditional stronghold, the LGU market, and our emerging SME market posted growth at 8% and 25%, respectively. We nearly doubled our bookings of motor vehicle and housing loans from ₱845 million to ₱1.5 billion. Moreover, your Bank continued to have one of the lowest cost of funds in the industry of 2.1% as CASA accounts comprised almost half of its total deposits of ₱178.8 billion.

On the other hand, fee-based income generated from deposit-related transactions and the remittance business, coupled with trading gains contributed significantly to the Bank's revenue stream at ₱3.0 billion.

Message to the SHAREHOLDERS

Our initiatives to streamline operations enabled us to achieve a marginal 6% increase in cost and expenses. Consequently, cost-to-income ratio improved to 62.3% from 66.1% the previous year.



FURTHER STRENGTHENING CAPITAL BASE

In compliance with BASEL II requirements and in anticipation of new business growth, your Bank continued to undertake capital raising activity in 2007. PNB's follow-on equity offering in August was highly oversubscribed, infusing fresh capital of ₱5.1 billion. As a result, total capital increased to ₱30.2 billion at year-end, bringing its capital adequacy ratio to 19.0%, far exceeding the minimum 10% ratio required by the Bangko Sentral ng Pilipinas (BSP).

CONTINUED PROGRESS IN IMPROVING ASSET QUALITY

Asset quality improved further with the decline in non-performing loans (NPL) to a more comfortable level of ₱10.3 billion in 2007 from a peak of ₱45.2 billion in 2003. This brought the Bank's NPL ratio to 10.4% as of year-end 2007 from 46.0% five years ago.

We also continued our efforts in disposing acquired assets, resulting in a 9% decrease in total acquired assets in four years. The additional reduction brought down the ratio of acquired assets to total assets from 13% to 10%.

BREAKTHROUGHS IN EXPANDING CORE BUSINESSES

The inherent strength of the PNB franchise lies in the following: extensive and strategically located overseas and domestic branches; a strong brand emanating from its ninety-one year banking history; and a stronghold in the remittance and LGU markets. Your Bank capitalized on these strengths to further improve its core businesses.

Your Bank embarked on efforts to upgrade branch facilities to provide clients with better and more efficient service. PNB completed crafting its Model Branch Program in 2007 and is scheduled for rollout in 2008.

We are happy to inform you that your Bank was granted the authority to accept government deposits on a continuing basis despite having been transformed into a fully private bank. With the improvement in its financial condition, your Bank met the requirements and criteria set by the BSP for granting said authority.

Through these many years, PNB has been at the forefront of serving the evolving needs of Filipino overseas workers, thus maintaining its stature as the bank of the Global Filipino.

Your Bank's breakthrough performance was exemplified by the ₱1.5 billion net income achieved in 2007, its best performance since its turnaround in 2003... a remarkable 83% growth year-on-year, and a 29-fold increase over the last five years.

Your Bank reengineered a number of its remittance products and forged relationships with strategic business partners both local and overseas. PNB now has a network of 3,000 domestic payment outlets, one of the widest in the remittance business. PNB also launched the PNB Cargo Services, Inc. to provide freight forwarding services to Global Filipinos in the United States.

In addition, the Global Filipino Auto Loan Program was offered to complement the growing Own a Philippine Home Loan Program. Both financing programs are open to Filipinos working abroad who may want to invest on real estate properties or provide a motor vehicle for their families back home.

BREAKTHROUGHS IN FORTIFYING INSTITUTIONAL STRENGTHS

2007 was also a year spent in fortifying institutional strengths. We made significant investments in systems and technology. We reorganized and realigned a number of our business units to make them more efficient and effective in responding to the growing needs of our banking public. We likewise stepped up our human resource development programs to empower our people.

Your Bank has started implementing a new generation core banking system: I-flex Solutions' FLEXCUBE—an end-to-end solution designed to automate your Bank's corporate and retail banking businesses. It will enable PNB to enhance service delivery across its multiple channels and branches—both local and overseas; offer a consolidated view of its

Message to the SHAREHOLDERS

A highly oversubscribed follow-on equity offering infused fresh capital of ₱5.1 billion. As a result, total capital stood at ₱30.2 billion at year-end, translating into a capital adequacy ratio of 19.0%, by far exceeding the minimum 10% ratio required by the Bangko Sentral ng Pilipinas.

customers across segments with 24-hour all year round capability; and effectively in-source core overseas technology operations to its global data center in the Philippines.

We restructured some segments of our organization to improve our ability to serve our customers, generate revenues, and tap into new markets. We reorganized geographic groupings as well as the oversight sales and service functions in branch banking to ensure that our branches remain focused on providing our customers with excellent service. We also put in place measures to reinvigorate our consumer lending business and strengthened product management throughout the organization.

All our initiatives adhered to the risk management framework that we adopted to identify, measure and manage risks.

We intensified investment in our people through various human resource management and development programs. In 2007, for example, more than 65% of PNB employees underwent various training and development programs to bring competencies at par with business requirements.

We implemented GIFTSWEB, an enhanced due diligence anti-money laundering solution which fulfills the strict and complex regulatory requirements for the detection, monitoring and reporting of suspected money laundering activities.

Our hard work continued to reap rewards. Your Bank was, once again, the recipient of several noteworthy awards and commendations during the year. For the fourth straight year

since 2004, your Bank was accorded the Readers' Digest prestigious Trusted Brand Award in the Gold Category. In the same year, your Bank was likewise honored with the following: Bangko Sentral ng Pilipinas Stakeholders' Award as Outstanding Commercial Bank Reporter on OFW Remittances for the second consecutive year; and Balikat ng Bayan Hall of Fame Award conferred by the Social Security System for winning the Best Paying Bank Award a total of eight times. We are grateful for these endorsements and take pride in the confidence that they provide to our customers and shareholders.

SUSTAINING BREAKTHROUGHS

Moving forward, we shall remain focused on further developing those capabilities that have made us resilient and better equipped to take on the challenges and opportunities of a global business environment that has increasingly become more competitive.

We look forward to the planned merger between PNB and Allied Banking Corporation in the third quarter of 2008. The merger will harness the synergy of the two banks, thus improving the industry ranking of PNB, the surviving bank.

Our aim is not just to be the premier financial institution in the country but more importantly, to better serve our various stakeholders, in particular, our customers who have given us their continued trust and patronage.

As in the past, we dedicate our efforts to our shareholders, our customers, our employees, and our fellow countrymen who provide a wellspring of inspiration and guidance. We shall endeavor to sustain the legacy of our 91-year history and remain as an instrument of the country's economic growth and a conduit for achieving the Filipino people's hopes and aspirations for a better life.

Florencia G. Tarriela
Chairman

Omar Byron T. Mier
Vice Chairman, President and CEO

Operational HIGHLIGHTS

RETAIL BANKING

In 2007, PNB implemented four key initiatives to boost its retail business: enhance customer experience across multi-channel contact points; rationalize geographical presence; introduce products and services to meet evolving market needs; and improve operational efficiency.

A Model Branch Program was launched during the year with the rollout of a modern banking hub in Alabang featuring convenient customer amenities and staffed by seasoned banking professionals. The Model Branch Program aims to provide clients with better and more efficient customer service. A total of 17 branch renovations and 6 branch relocations were also completed to improve customer access and convenience.

Furthermore, 58 new ATMs were deployed in strategic onsite and offsite locations, bringing PNB's total ATM network to 393 by the end of the year. The high online serviceability, security and convenience of the Bank's ATM network earned citations for PNB as the top ranked MegaLink member bank in terms of ATM reply rate and also one of the best performing banks in terms of controllable approval rate and host availability.

The Bank utilized the latest technology to deliver more responsive banking services to its clients, reduce costs, and improve productivity. In 2007, PNB current account depositors started to receive their Statements of Account with scanned images in lieu of the usual computer printed sheets and actual physical checks. This enables clients to enjoy the convenience and benefits of digital technology in organizing their account records and checks, at par with the standards in the USA, South America and United Kingdom.

To ensure optimal efficiency in checks processing, the Bank also launched the Electronic Imaging and Signature Verification System, which integrates processing, imaging and signature verification of clearing checks into one automated system. And for added client security, the Bank completed the ATM Key Encryption Project, thus making its ATMs compliant with international security standards.

CONSUMER FINANCE

The Bank's consumer lending business broke new highs in 2007 as total outstanding consumer loans portfolio rose by 16% from previous year's level. The Consumer Banking Sector capitalized on the favorable interest rates scenario during the year that spurred housing, motor vehicle and personal loan borrowings.

Amidst a constantly changing environment, PNB continues to be a dynamic financial institution that offers a wide array of products and services that meet the diverse and evolving needs of the Consumer Market.

Marketing efforts were stepped up and synergies with key business partners were further strengthened to make consumer loans more accessible to the target markets. Tie-ups with major property developers were expanded. PNB's unique Overseas Philippine Home Loan Program also continued to gain significant inroads particularly in the USA, which now accounts for 71% of this portfolio. The program allows overseas Filipinos to sign up for a loan at PNB's overseas branches to purchase a home in the Philippines.

For auto loans, fleet financing was offered to existing corporate accounts while retail sales were aggressively marketed by the revitalized Regional Consumer Finance Centers. A fully automated motor vehicle loan approval system was likewise put in place during the year to improve customer servicing and support business expansion. The Global Filipino Auto Loan Program, which enables overseas Filipinos to purchase motor vehicles for use of their loved ones in the Philippines, was launched in the first quarter of 2007 initially in Hong Kong and later in Saudi Arabia. The PNB website was also enhanced to enable overseas Filipinos interested to avail of the Bank's Global Filipino Auto Loan Program to do online loan calculation; check on the database of various auto models and prices; and inquire on their loan application status.

INTERNATIONAL BANKING

Despite stiff competition posed by traditional and non-traditional market players, PNB strengthened its franchise in the remittance business by being one

Operational HIGHLIGHTS

of the only two local remittance service providers that can guarantee that funds sent for payout are available within seconds. PNB cornered 18% of the total remittances coursed through the banking system in 2007. This affirms PNB's strong foothold in the remittance business and its commitment in providing Global Filipinos with the most convenient, affordable, secure and speedy remittance service wherever they may be.

PNB is proud to have launched four new remittance services in 2007 to further expand an already impressive suite of products and services. Dedicated OFW lanes were set up in branches with high volume of remittance clients to ensure quick servicing of payout transactions. PNB Remittance Centers, Inc. (PNB RCI) in Los Angeles started offering web-based remittance that allows clients to simply sign up and send money from their US bank accounts via the Internet. The Dollar door-to-door service was also introduced in all overseas offices as a safe way of sending dollars to the Philippines. Towards the end of the year, the Bank ventured into cargo business in the US West Coast through PNB Cargo Services, Inc., a wholly-owned subsidiary. This business is capitalizing on overseas Filipinos' tradition of sending gifts to their families in the Philippines. The service was initially offered in California and will be later expanded to cover other areas in the United States.

PNB's Global Filipino Card (GFC), a reloadable pre-paid card which allows remittance beneficiaries to access their funds through any ATM in the Philippines, was enhanced with the addition of a membership benefit. GFC clients in California enjoy, for a modest fee, membership perks like Accident Insurance Coverage of US$ 5,000; discounts on remittance fee for repeat transactions, cargo services, phone cards purchased from PNB RCI and Philippine real estate tax payments.

The Bank continued to accelerate the expansion of its remittance network through strategic alliances with firms both here and abroad. Among the Bank's new local partners are Cebuana Lhuillier, Globe Telecom's G-Exchange Inc., which operates the GCash outlets, Philippine Rural Banking Corporation and Prime Asia Pawnshop. Through these outlets, OFW beneficiaries can claim their remittances seven days a week, even beyond banking hours, right in their communities. Overseas, the Bank partnered with P2P Paytrends Corporation of Canada to tap its 500 agents.

In 2007, PNB also bolstered its presence in Europe with the opening of the Paris Branch of PNB Europe Plc. This major milestone was followed by the opening of three branches of PNB subsidiaries in Miami, HongKong and Barcelona. With a total of 105 overseas offices and 672 correspondent banks as of year-end 2007, the Bank's global presence remains unmatched by any local bank.

Operational HIGHLIGHTS

CORPORATE BANKING

PNB's corporate loan portfolio grew by 11% as the Bank's Business Development Sector (BDS) embarked on an aggressive marketing and credit risk management strategy that emphasized generating new partnerships, strengthening existing relationships with corporate and government clients and improving lending infrastructure and delivery systems.

During the year, the Bank also focused its efforts in fortifying its presence in the small-and-medium enterprise (SME) market. Loans to SMEs grew by 25%, accounting for almost 25% of the sector's loan portfolio in 2007. The Bank's commercial lending centers strategically located in the major cities nationwide were instrumental in mobilizing funding for SMEs.

Meanwhile, loans to the government sector expanded by 8% despite the statutory 90-day freeze on public works during an election year. PNB's BDS and Treasury Group collaborated to introduce bond underwriting as an alternative financing for local government units (LGUs). By year-end, the Bank facilitated the issuance of ₱500 million LGU bonds.

Lending to large private corporations expanded by 4%, comprising 45% of total corporate loans. A major milestone for corporate lending was PNB's participation as one of the co-lenders in the landmark US$ 380 million financing for the privatization of the Magat Hydropower Plant. The Magat loan syndication achieved several firsts: the first power sector privatization in Asia with significant foreign participation (International Finance Corp. and Nordic Investment Bank); the first financing in the Philippines in which lenders assumed electricity market risk; and the first major financing that included a significant amount of long-tenor Philippine peso financing. The deal bagged four citations from prestigious international finance magazines that conduct research and analysis on project financing developments around the world, to wit: Best Project Finance and Best Privatization given by The Asset Magazine (Triple A House and Deal Awards 2007); Asia Pacific Power Deal of the Year given by the Project Finance International; and the Best Vanilla Deal in Southeast Asia awarded by Alpha Southeast Asia Magazine.

PNB's various business banking services helped in strengthening and expanding relationships with institutional clients. The Bank's comprehensive collection platform provides payment convenience to customers of PNB clients using the Bank's multi-channel capabilities—branch counters, ATM, Internet banking, phone and mobile banking while other business banking solutions like the Paywise and CashMover address their disbursement requirements. The Corporate e-Pay solution was enhanced to provide greater efficiency and speed in the settlement of financial obligations between suppliers and customers. Moreover, the Bank's Corporate Internet Banking facility was introduced to allow corporate clients to conveniently manage their day-to-day banking transactions online.

In 2007, the BDS underwent reorganization to enable it to focus on market and business development. In particular, the credit evaluation function was spun off to a separate unit. Continuous improvements in credit processing and documentation were also undertaken to make sure that BDS is in a better position to meet market demands.

Through its broad range of corporate banking products and services, PNB caters to the needs of SMEs, LGUs and large private corporations, the country's economic prime movers.

TREASURY

The year 2007 was a very challenging year for the Bank's treasury business. The turmoil in the global financial markets triggered by the sub-prime crisis in the United States in the middle of the year put upward pressure on prices of U.S. dollar-denominated instruments issued by financial institutions. Amidst this scenario, trading activity appropriately took defensive strategies to address the high volatility of the overseas credit default swap markets. This was exacerbated on the domestic front by a shortfall in government's tax collection efforts, which pushed domestic interest rates higher for most part of the year. Nonetheless, PNB managed to post a net trading and investment gain of ₱1.1 billion and a foreign exchange gain of almost ₱900 million.

Low-risk structured products were utilized to enhance the yield of the Bank's investments. Moreover, in its continuing bid to tap into other income

streams and expand trading opportunities, an Equity Trading Division was formed in the fourth quarter of 2007. Throughout the year, Treasury continued to beef up its personnel complement and enhanced the skills of its staff through continuous training. In line with developments in the regulatory environment, Treasury, in collaboration with the Risk Management Group, strengthened its risk management tools by reviewing, updating and expanding its set of risk limits.

ASSET MANAGEMENT

PNB's asset disposal program went on high gear in 2007. The upswing in the real estate market coupled with the implementation of new programs and strategies; and the re-engineering of the Bank's Asset Management Sector enabled PNB to dispose ₱1.4 billion worth of acquired assets.

A Joint Auction Agreement with Allied Banking Corporation was forged to take advantage of synergies in marketing, advertising and logistical support. As a result, eleven joint auctions in various parts of the country were conducted during the year and actively participated in by branches of both banks. The Bank likewise inked its first joint venture deal with Eton Properties Philippines Inc., the real estate flagship of the LT Group of Companies. PNB looks forward to closing more joint ventures with strategic partners to generate better value and returns for the Bank's ROPAs.

Operational HIGHLIGHTS

program, the ROPA Administration System (RAS), a fully automated, end-to-end and centralized inventory and data processing platform, was rolled out. RAS provides real-time account history and important information on the Bank's acquired assets portfolio.

REMEDIAL MANAGEMENT

The Bank's Remedial Management Sector focused its energies in 2007 on aggressive collection efforts, restructuring and foreclosures of non-performing loans unlike in the previous two years when the bulk of the reductions were done through Special Purpose Vehicle (SPV) sales. Consequently, NPLs were further reduced to ₱10.3 billion.

The Bank also completed in the first quarter of 2007 the sale of the second pool of non-performing assets amounting to ₱7.6 billion which were part of the total portfolio sold through an SPV scheme in late 2006.

Meanwhile, the Bank launched the Pabahay Bonanza 2008, a one-year sales campaign to fast track the disposal of low-ticket items whose appraised values are below ₱1.0 million each. The streamlined processing and approval of these assets will relieve the Bank of substantial administrative and handling costs.

To effectively and efficiently dispose of the Bank's acquired assets in the provinces, the Regional Desk Group of the Asset Management Sector was also re-engineered. Furthermore, to strengthen the management of the Bank's asset disposal

TRUST BANKING

The Bank's total Trust Assets rose by 59% by end-2007 due largely to the higher volume of Investment Management Accounts (IMA), which were mostly invested in the higher-yielding Special Deposit Accounts (SDA) facility of the Bangko Sentral ng Pilipinas.

During the year, two of the Bank's seven Unit Investment Trust Funds (UITFs) were cited as among the best managed funds by Lipper Philippines, a Reuters company that specializes in fund evaluation. It rated the PNB PHISIX UITF as the best equity fund in 2007 with its 7.07% return, net of taxes, or a gross yield of 8.84% per annum. It also acknowledged the PNB Dollar Profit UITF as the third highest yielding among all medium-term dollar bond funds with its 4.93% return, net of taxes, or a gross yield of 6.16% per annum. These fund's excellent rate of return reflected the Bank's adoption of prudent investment strategies derived from rigorous fundamental and strategic research and analysis.

Corporate Social RESPONSIBILITY

EMPOWERING OUR COMMUNITIES FOR A STRONGER NATION

Even as the Bank relentlessly pursued its business objectives, it accelerated its corporate social responsibility programs by mobilizing resources to empower the less privileged sectors of society. Over the past years, your Bank has been focusing on two major initiatives: Education and community development. These advocacies have received a groundswell of support from many dedicated Philnabankers who willingly contributed their time, energies, and own money to make a difference in the lives of others.

Nurturing Young Minds

PNB was an active partner of the Tan Yan Kee Foundation (TYKF), the social development arm of the Lucio Tan Group of Companies, in its Story Book Drive Project dubbed as *"Sa Pagbasa, May Pag-Asa."* The project aimed to spark public school pupils' interest in reading as an important step towards their holistic development. A total of 18,000 storybooks were collected from many committed Philnabankers, exceeding the target of 15,000 storybooks. TYKF matched the contribution of PNB employees, bringing the total storybooks to 36,000, which benefited 72 public elementary schools all over the country. Each school received 500 books. Your Bank also supported the Department of Education's *Brigada Eskwela* program when it adopted the Calumpang Elementary School in Binangonan, Rizal. A 24-man PNB volunteer team, led by Asset Management Sector Head Christian Jerome O. Dobles, worked for three days to refurbish the school with a fresh coat of paint. Last but not least, the Bank brought Christmas cheer to the orphaned children of Asilo de San Vicente de Paul with its food donation for their holiday festivities. The bonding with the children proved an enriching experience for the PNB volunteer employees that participated in the activity.

Building Communities

PNB has also joined forces with *Gawad Kalinga* (GK). This multi-sectoral social development movement envisions transforming poverty-stricken areas into model communities where Filipinos could live in dignity and peace. To meaningfully celebrate the Bank's 91st anniversary last July 22, an army of volunteer Philnabankers willingly toted shovels, rollers and brushes in the searing sun to help complete the GK Sunshineville Village in BF Resort, Las Piñas. The Bank's involvement in the GK movement was further strengthened with the donation in December 2007 of a valuable real estate property in Lubao, Pampanga as the future site of a PNB-GK Village. Fund raising efforts are ongoing in the PNB community to build at least 10 homes by next year.

PNB looks forward to the coming years with more meaningful programs and projects where it could share its blessings as a way of paying forward, particularly, the underprivileged communities, whose children deserve safer haven and educational opportunities to ensure their better future and ultimately a stronger nation for all.

Corporate GOVERNANCE

CORPORATE GOVERNANCE

The Bank adheres to the principles of good governance as culled from leading best practices internationally and on a national level. It subscribes to the philosophy of integrity, accountability and transparency in its manner of doing business, fair dealing with its clients, investors, staff, stockholders and its various publics, professionalism in managing the company and its subsidiaries and respect for the laws and regulations of the countries affecting its business. Internally, it follows a philosophy of rational checks and balances as well as a structured approach to its operating processes.

The Bank has promulgated a Revised Manual on Corporate Governance which provides for the appointment of a senior officer to ensure compliance with the provisions of the Manual. The Directors, Board Advisor and some Executive Officers of the Bank have taken a course on Corporate Governance to be able to understand and implement the principles thereof in a consistent and satisfactory manner.

Measures to Fully Comply with Corporate Governance

Under the Manual, compliance with the principles of good corporate governance principally starts with the Board of Directors. It is the Board's responsibility to foster the long-term success of the corporation and secure its sustained competitiveness in accordance with its fiduciary responsibility. In order to have a central focus for the Bank's activities, the Board has appropriately established the company's Mission and Vision Statements.

To have a structure for compliance, the Manual established and defined the responsibilities and functions of the Board and the various Committees necessary for good governance, i.e., the Corporate Governance Committee, the Board Audit and Compliance Committee, the Risk Management Committee and the roles of the External and Internal Auditors and the Corporate Secretary. The Manual also established an evaluation system by which the Directors and the Executive Officers can rate the Bank periodically against certain leading practices and principles on good corporate governance. Last but not least, the Manual made provisions for the protection of Investors' Rights including Minority Interests.

Evaluation System

The captioned system consists of a personal assessment process by the Bank's Directors of themselves, as members of various Board Committees and of the Board of Directors. The recently Revised Board Evaluation Sheets are based on the Corporate Governance Scorecard for Publicly-Listed Companies (CG-Sc) circulated by the Securities and Exchange Commission (SEC) and the self-assessment form adopted by PNB in compliance with the requirements of the Bangko Sentral ng Pilipinas (BSP). These were combined together into a concise form which substantially complies with the requirements of both the SEC and the BSP. The Directors' evaluation of the Board Committees have to be reviewed and evaluated by the respective Committees en banc. After that the Director's self-assessment of themselves, the Board Committees' en banc evaluation of the Directors' assessment of each Committee, and the Directors' evaluation of the Board of Directors will undergo a proper review and evaluation by the Corporate Governance Committee before final submission to the Board of Directors. Thereafter, the Compliance Officer will compile and tabulate all the evaluation results and issue a certification to the SEC on January 30th of each year on the extent and quality of compliance with the Bank's Corporate Governance Manual based on the results of the Board's self-assessment/evaluation.

No Material Deviations

Because of the heightened sense of accountability among the staff and an enhanced culture of compliance within the whole Bank, there have been no material deviations noted by the Compliance Officer.

Plans To Improve Corporate Governance

The Manual was updated on July 28, 2006, September 28, 2007, November 23, 2007, February 22, 2008 and April 25, 2008. Apart from these updates, there are no other plans to change the Manual for the moment.

Disclosure on Risk MANAGEMENT

OVERVIEW OF THE RISK MANAGEMENT PROCESS

PNB firmly believes that risk management is not merely for regulatory compliance but a strategic discipline, which builds competitive advantage and ultimately long-term shareholder value. Therefore, risk management is a top-level priority overseen by the Risk Management Committee (RMC), a Board level committee. The RMC is vested with the authority to approve the Bank's risk management process, framework, policies, risk appetite and risk management infrastructure. The Risk Management Group (RMG), which is headed by a Chief Risk Officer, supervises the risk management activities at the operational level.

The Bank's Enterprise Risk Management (ERM) framework has the following objectives: institutionalize the risk management process; define and disseminate the Bank's risk philosophy and objectives; develop the risk management infrastructure; identify, measure, analyze, and manage risks inherent to all the Bank's activities; and assist the risk taking business and operating units in understanding and measuring risk/return profiles. This framework revolves around eight (8) risk management approaches: internal environment scanning, objective setting, event identification, risk assessment, risk response, control activities, information and communication, and monitoring

Under the ERM, the key risks that the Bank faces such as credit risks, market risk, liquidity risk, interest rate risk, operational risk, technology risk, strategic and business risks, compliance risk, and legal risk are not only monitored under their separate and distinct components, but also monitored across the interrelated components.

CREDIT RISK

The Bank prudently manages its credit risk at the strategic level, portfolio level down to the individual credit or transaction. The Board is involved in this aspect through the oversight function of the RMC. Senior management plays an active role in managing credit based on the core principles of sound credit supervision. Additionally, credit risk management infrastructures are implemented across the organization. These include: continuing review of credit risk policies, systems and procedures; rationalization of the credit risk functional organization; continuing review of the internal credit limit structure; adoption of updated systems and technology; centralized Management Information System (MIS); granularized Credit Risk Rating System; and periodic review of the adequacy of loan loss reserves.

MARKET RISK

Market, Balance Sheet and Liquidity risks, on the other hand, are managed using a framework of policies, control procedures and limits. This framework is supported through active Board and Senior Management oversight. The limits are reviewed annually by the Treasury Sector (the risk taking unit) in coordination with RMG and approved by the Bank's Assets & Liabilities Committee (ALCO), the RMC and the Board of Directors. The Board, through the RMC, and senior management are kept abreast of market risks through periodic reporting of the RMG. Internal Audit also provides for additional oversight inspection on the consistency of the engaged activity and reporting. The following are the regular monitors:

- Market Risk—this is dimensioned and controlled in both the trading book and balance sheet. In the trading book, it is controlled by a daily analysis of the Value-at-Risk (VAR) of trading instruments under normal market conditions. The volatilities used are those for a rolling one-year period, updated quarterly. To complement the VAR measure, stress tests are performed wherein the trading portfolios are valued under extreme market and stop loss limits.
- Interest Rate risk in the Banking Book—impact of changes in interest rates are assessed over a one-year period using Earnings-at-Risk (EAR), which arrays assets and liabilities according to their repricing profile and tempered by approved assumptions.
- Liquidity Risk—this is monitored and controlled primarily via a gap analysis of maturities of relevant assets and liabilities reflected in the MCO report as well as an analysis of liquid assets. Further, an internal liquidity ratio has been set to determine sufficiency of liquid assets over deposit liabilities. Also a concentration risk in funding is tracked by the Large Funders Report.

OPERATIONAL RISK

The management of operational risk is focused on the protection of the Bank's capital and earnings through the utilization of operational risk management tools. PNB is embarking on the implementation of Basel II compliant operational risk controls. While the Bank opted to compute capital charge for Operational Risk using the simple Basic Indicator Approach, a more structured framework is now in place covering risk identification, analysis, monitoring and mitigation. This means adopting the best practices principles for operational risk management imposed by Basel II.

INFORMATION SECURITY AND TECHNOLOGY RISK

Information Security and Technology Risk is a shared responsibility of everyone in the Bank. The Board plays an important role through its review and approval of new technology projects and oversight functions. Senior management also embraces the day-to-day monitoring of said projects.

Internal controls and monitoring efforts for managing this type of risk include, among others, the following:

- Creation of an independent Information Security & Technology Risk Unit under the umbrella of RMG
- Adoption and customization of the technology risk management framework and the conduct of information security assessment
- Inventory, review or updating of all existing systems to determine its efficiency and applicability
- Documentation of policies and procedures on information security and technology process
- Continuous training of existing manpower to keep abreast with technology development and continuous screening of qualified applicants to maintain sufficient number of workforce
- Defining and testing the Business Contingency Plan, including system software back-ups, to ensure continuity of operations in the event of disruptions
- Conduct of vulnerability assessment and penetration testing to identify gaps/vulnerability and implement remedial measures
- Monitoring/review of all outsourcing activities
- Consistent monitoring of systems to address downtime and causes of failure

BASEL II IMPLEMENTATION

The Bank's Basel II compliance roadmap is in place. A Basel II team is now fully engaged to follow through with both current and future requirements that regulators and global standards require. The Bank is compliant with BSP's requirement on the quarterly reporting of the bank's Capital Adequacy Ratio.

For Credit Risk management, the Bank has clearly defined measurement areas of monitoring to comply to both BSP and internal requirements. These are regularly reported to the RMC by the Compliance Division and the RMG.

Mandatory compliance requirements cover loans, investments, reserves, foreign currency, and MOU limits, among others. Internal compliance requirements, on the other hand, include Single Borrower's Limit, DOSRI ceilings per BSP guidelines, target industry limits, limits on Financial Institutions, country risk limit, and treasury risk limit.

Under the Market Risk management process, the Bank has approved limits on its trading portfolio as well as on its investment portfolio. This is done for both local and foreign currency trading portfolios. Market limits are reviewed on an annual basis and appropriately adjusted to reflect the Bank's direction in trading risks, and asset-liability mix targets.

Under the Liquidity Risk/Interest Rate Risk management process, the Bank's current monitoring tools are as follows: Maximum Cumulative Outflow, Stress Testing, Liquid Assets Array, Liquidity Ratios and Earnings at Risk Limit.

The Bank has adopted the following principles on best practices for operational risk management imposed by Basel II:

- Oversight of the Board of Directors through the RMC
- Accountability and direct involvement of the Management in managing Operational Risk
- Well-defined risk management policies contained in the Operational Risk Management Manual
- Designation of Risk Overseer in each business line and operating unit
- Independent risk management function, compliance function and audit function
- Shared risk management responsibility across the organization from top level to the lowest staff in the organization

To cover operational risks, the Bank maintains the following management tools and processes:

- Business Contingency Plan
- Back-Up and Recovery Program
- Risk and Control Self-Assessment
- Operational risk mapping to Eight Business Lines
- Product/Project Management Business Model

The Bank's risk management process is continuously being reviewed and strengthened as part of an intrinsic discipline to achieve a high quality portfolio of risk assets and to make the institution fully in step with Basel II implementation.

Board of DIRECTORS

Members of the Board from left to right:
Omar Byron T. Mier - *Vice Chairman, President & CEO*
Florencia G. Tarriela - *Chairman*
Washington Z. Sycip - *Director*
Domingo T. Chua - *Director*
Eric O. Recto - *Director*
Lucio C. Tan - *Director*

Board of DIRECTORS

Members of the Board from left to right:
Macario U. Te - *Director*
Jose Ngaw - *Board Advisor*
Feliciano L. Miranda, Jr. - *Director*
Florido P. Casuela - *Director*
Carmen G. Huang - *Director*
Lucio K. Tan, Jr. - *Director*
Renato J. Fernandez - *Corporate Secretary*

Senior Management TEAM

Front row, from left to right:
EVP Carmen G. Huang - *Chief Financial Officer & Chief of Staff to the President*
EVP Ma. Elena B. Piccio - *Head, Business Development Sector*

Second row, from left to right:
EVP Renato A. Castillo - *Chief Credit Officer & Head Remedial Management Sector*
EVP Anthony Q. Chua - *Head, Global Operations Sector*
EVP Cynthia V. Javier - *Chief Technology Officer & Head Global Technology Sector*
FSVP Ma. Elena S. Sarmiento - *Trust Officer & Head, Trust Banking Group*

Third row, from left to right:
FSVP Ramon L. Lim - *Head, Treasury Sector*
FSVP Rafael Z. Sison, Jr. - *Head, Retail Banking Sector*
FSVP Jovencio B. Hernandez - *Head, Consumer Banking Sector*

Senior Management TEAM

Front row, from left to right:
SVP Carmela A. Pama - *Chief Risk Officer & Head, Risk Management Group*
FSVP Cris S. Cabalatungan - *Head, Internal Audit Group*

Second row, from left to right:
SVP Christian Jerome O. Dobles - *Head, Asset Management Sector*
SVP Maria Paz D. Lim - *Treasurer*
FSVP Isabelita Manalastas-Watanabe - *Head, International Banking & Overseas Remittance Sector (Europe, Israel & African Continent)*
FSVP Edgardo T. Nallas - *Head, Human Resource Group*

Third row, from left to right:
FSVP Alvin C. Go - *Chief Legal Counsel & Head, Legal Group*
Rommel R. Garcia - *President, PNB Remittance Center Inc. & Sector Head, North American Region*

Products and SERVICES

DEPOSITS AND RELATED SERVICES

Peso Accounts
- Regular Passbook Savings Account
- Superteller Savings Account
- PNB Prime Savings Account
- OFW Savings Account
- SSS Savings Account
- GSIS Savings Account
- PNB Direct Deposit Account
- Regular Checking Account
- Budget Checking Account
- PNBig Checking Account
- Priority One Checking Account
- *e*Xecutive Checking Account
- COMBO Account
- Regular Time Deposit
- PNBig Savings Account
- Peso Wealth Multiplier Account

Foreign Currency Accounts
- Dollar Accounts
  - U.S. Dollar Savings Account
  - Greencheck (Interest-bearing U.S. Dollar Checking Account)
  - Greenmarket (U.S. Dollar Time Deposit)
  - PNB $ M.I.N.T. Account
- Euro Accounts
  - Euro Savings Account
  - Euro Time Deposit Account

Business Banking Services
- Collections
  - *e*-Collect
  - Cash Mover
  - Government Services
    - Bureau of Internal Revenue
    - Social Security System
    - Bureau of Customs
    - Philhealth
    - National Home Mortgage Finance Corp.

Disbursements
- Paywise (Payroll Services)
- Executive Check Writer System
- Corporate *e*Pay
- PNB *e*-Tax Payment Facility

e-Banking Services
- Personal Internet Banking
- Corporate Internet Banking
- Phone Banking
- Mobile Banking
- ATM

Other Services
- Safety Deposit Boxes

BANCASSURANCE

Life Insurance
- PNB Pangarap Series Education Package
- PNB Pangarap Series Pangkabuhayan Package
- PNB Pangarap Series DollarMAX

Non-Life Insurance
- Auto Protector Plan
- House Protector Plan
- 6-in-1 Family Accident Protector Plan

FUND TRANSFER SERVICES

Money Transfers (Foreign and Domestic)
- Remittance via
  - Rapid Remit
  - Electronic Remittance Processing System (ERPS)
  - Integrated Remittance System (IRS)
  - Payroll Remittance Interface System (PRIS)
- PNB 3D (Door-to-Door Delivery) Remittance Service
  - Check 3D Remittance Service
  - Cash 3D Remittance Service
  - Door-to-Bank (DTB) Remittance Service
  - US$ 3D Remittance Service
  - Bills Payment Delivery Service
- PNB Global Filipino Money Card (GFMC)

- Remittance Bills Payment Service
- Advise & Pay Anywhere Service
  - Domestic Branches
  - Pay-out Agents
- Telegraphic/Telex Transfers
- S.W.I.F.T. Transfers
- Gross Settlement Real Time (GSRT)
- Real Time Gross Settlement (RTGS-inward) – Peso
- End of Day Netting (PDDTS) – Dollar
- End of Day Netting (EPCS) – Peso
- Demand Drafts (Local/Foreign)
- Cashier's/Manager's Checks

Travel Funds
- FX Currency Notes
- PNB Mabuhay Peso Travelers Cheque

Regular Collection Service (Foreign and Domestic)
Special Collection Service
Standard Collection Service
Cash Letter
PNB Direct Deposit Program
PNB Mabuhay Peso Gift Cheque

TREASURY PRODUCTS AND SERVICES

Foreign Currency
- Foreign Exchange (Spot, Forward, Swap)
- Foreign Currency Money Market Transactions
- Bonds Dealership
  - Euro-Notes/Bonds
  - Convertible Bonds
  - R.P. Sovereign Bonds (ROP, BSP)
  - U.S. Treasury Bonds

Local Currency
- Money Market Transactions
- Securities Dealership
  - Government Securities
    - Treasury Bills
    - Fixed Rate Treasury Notes/Bonds
    - Retail Treasury Bonds
    - Zero-Coupon Bonds
    - Local Government Unit Bonds
  - Commercial Papers

EXPORT / IMPORT SERVICES

Export Services
- Advising of Letters of Credit
- Confirmation of Letters of Credit
- Export Negotiation/Purchase of Export Documents
  - Drawings under Letters of Credit, Documents against Payment (DP) and Documents against Acceptance (DA)
  - Payment of Exports under Prepayment and Open Account (OA) Arrangements
- Export Financing

Import Services
- Issuance and negotiation of Letters of Credit (Foreign/Domestic)
- Issuance of Shipside Bonds
- Trust Receipt Financing
- Servicing of Importations under Collection Arrangement - DA/OA and DP
- Servicing of Collection of Final Customs Duties

Special Financing Services
- Issuance of Standby Letters of Credit to serve the following bank guarantee requirements:
  - Loan Repayment Guarantee
  - Advance Payment Bonds
  - Bid Bonds
  - Performance Bonds
  - Other Bonds
- Issuance of Standby Letters of Credit under PNB's "Own a Philippine Home Loan Program"
- Issuance and Servicing of Deferred Letters of Credit as mode of payment for :
  - Importation or Local Purchase of Capital Goods
  - Services Rendered (e.g., Construction/Installation of Infrastructure Projects, etc.)

Products and SERVICES

LENDING SERVICES

Corporate/Institutional Loans
- Credit Lines
  - Revolving Credit Line (RCL)
  - Non-revolving Credit Line
  - Omnibus Line
- Export Financing Facilities
  - Export Advance Loan
  - Export Advance Line
- Bills Purchased Lines
  - Domestic Bills Purchased Line
  - Export Bills/Drafts Purchased Line
  - Discounting Line
- Import-Related Loans
  - Letters of Credit Facility
  - Trust Receipt Facility
- Standby Letters of Credit – Foreign/Domestic
- Deferred Letters of Credit – Foreign/Domestic
- Term Loans
  - Medium-and Long-Term Loan
  - Short-Term Loan
  - Project Financing
- Loans Against Deposit Hold Out
- Time Loans
  - Agricultural
  - Commercial
- Structured Trade Finance
  - Export Credit Agency Lines
  - US-EXIM Guarantee Program
- Specialized Lending Programs
  - DBP Wholesale Lending Facilities
  - LBP Wholesale Lending Facilities
  - SSS Wholesale Lending Facilities
  - BSP Rediscounting Facility
- Sugar Financing Program
  - Sugar Crop Production Line (SCPL)
  - Sugar Quedan Financing Line (SQFL)
  - Time Loan Agricultural (TLA)
  - Operational Loan (OpL)
- Small Business Loans for SMEs
  - Short-Term Loan
  - Revolving Credit Line
  - Omnibus Line
  - Term Loan

Local Guarantee Facilities
- PhilEXIM Guarantee
- SB Corp. Guarantee Program

Loans to Local Government Units (LGUs)
- Term Loans
- Import LC Facility Against Loan or Cash
- Domestic Letters of Credit Against Loan or Cash
- Standby Letters of Credit
- Loans Against Deposit Hold Out
- LGU Contractor Financing
- LGU Bond Flotation
  (thru PNB Capital and Investment Corp.)

Credit Facilities to Government-Owned and Controlled Corporations/National Government Agencies (GOCCs/NGAs)
- Term Loans
- Credit Lines
- Export Financing Facilities
- Bills Purchased Lines
- Import Letters of Credit/Trust Receipts Line
- Standby Letters of Credit
- Structured Trade Finance
  - Export Credit Agency Lines
  - Guarantee Program

Consumer Loans
- Sure Fund (Salary Loan)
- Sure Wheels (Motor Vehicle Loan)
- Sure Home (Housing Loan)
  - Sure Home Flexi Loan
- Contract to Sell Financing
- Own a Philippine Home
- Own an Overseas Home Loan
- Loans Against Deposit Hold Out
  - Peso Loan vs. Peso/FX Deposits

Credit Card Services
- PNB VISA Card
- ASTRA Secured Kredit (ASK) Card

TRUST PRODUCTS AND SERVICES

Unit Investment Trust Funds (UITF)
- PNB Mabuhay Plus UITF
- PNB Mabuhay Prime UITF
- PNB Mabuhay Prestige UITF
- PNB Dollar Profit UITF
- PNB Dollar Punla UITF
- PNB Peso Punla UITF
- PNB PHISIX UITF

Special Deposit Account (SDA)

Corporate Trust Products
- Corporate Trust
- Employee Benefit Trust / Retirement Fund
- Corporate Investment Management Accounts (IMA)
- Corporate Escrow
  - POEA Escrow
  - Japanese Escrow
- Corporate Custodianship
- Syndicated Loan Agency
- Collateral Trust / Mortgage Trust Indenture
- LGU Bonds Trusteeship

Personal Trust Products
- Living Trust / Personal Trust Accounts
- IMA
- Life Insurance Trust
- Educational Trust
- Personal Escrow
  - BIR Escrow
  - Real Estate Escrow
- Custodianship / Safekeeping
- Guardianship
- Estate Planning

CONGENERICS

Banking
- Philippine National Bank (Europe) PLC

Freight Forwarding
- PNB RCI Holding Company, Ltd. dba.
  PNB Cargo Services, Inc.

General Insurance
- PNB General Insurers Co., Inc.

Holding Company
- PNB Holdings Corporation
- PNB International Investments Corporation

Investment Banking
- PNB Capital and Investment Corporation

Leasing and Financing
- Japan-PNB Leasing and Finance Corporation

Lending
- PNB International Finance, Ltd.

Remittance
- PNB Remittance Centers, Inc. (U.S.A.)
- PNB Remittance Company (Canada)
- PNB Remittance Center, Ltd. (Hong Kong)
- PNB Italy SpA
- PNB Netherlands B.V.
- PNB Corporation, Guam
- PNB Austria Financial Services GmbH
- PNB Global Filipino Remittance Spain, S.A.

Stock Brokerage
- PNB Securities, Inc.

The Bank's CONGENERICS

JAPAN-PNB LEASING AND FINANCE CORPORATION

Japan-PNB Leasing and Finance Corporation is a joint venture between Philippine National Bank and well-established Japanese financial institutions, IBJ Leasing Co., Ltd. and Mizuho Corporate Bank. The principal activities of Japan-PNB Leasing and Finance Corporation are operating and financial leasing, chattel mortgage loans, and installment notes discounting. Likewise, it can arrange lease syndications for big-ticket transactions.

PHILIPPINE NATIONAL BANK (EUROPE) PLC

Philippine National Bank (Europe) PLC is a wholly-owned subsidiary incorporated in the United Kingdom. It is engaged in full service banking which includes, among others, deposit services, loans, fund transfers, FX trading and documentary credits. It is also authorized to provide cross-border services such as acceptance of deposits and other repayable funds from the public; and money transmission services within the 18 member states of the European Economic Area (EEA).

Philippine National Bank (Europe) PLC operates an extension office at Nottinghill Gate, London and a branch in Paris, France which primarily handle remittances.

PNB AUSTRIA FINANCIAL SERVICES GMBH

PNB Austria Financial Services GmbH is a wholly-owned subsidiary of PNB. It is registered as a limited liability company in Vienna, Austria engaged in providing remittance services to Filipinos in Austria and Switzerland.

PNB CAPITAL AND INVESTMENT CORPORATION

The PNB Capital and Investment Corporation is the wholly-owned investment banking subsidiary of PNB. It provides a full range of corporate finance services such as financial advisory, project finance and private placements, debt and equity syndication and underwriting. PNB Capital and Investment Corporation also assists in structuring and packaging mergers and acquisitions, securitization transactions and mezzanine financing.

PNB CORPORATION, GUAM

PNB Corporation, Guam (PCG) is a wholly-owned subsidiary incorporated in the Territory of Guam engaged in foreign exchange remittance service. PCG has a branch in Saipan.

PNB GLOBAL FILIPINO REMITTANCE SPAIN, S.A.

PNB Global Filipino Remittance Spain, S.A. is a wholly-owned subsidiary of PNB that provides remittance services to Filipinos in Spain. Aside from its main office in Madrid, it maintains a branch in Barcelona.

PNB HOLDINGS CORPORATION

PNB Holdings Corporation is the parent company of PNB General Insurers Co., Inc., a non-life insurance company that offers fire, marine, motor car, surety, casualty, engineering and accident insurance.

PNB INTERNATIONAL FINANCE, LTD.

PNB International Finance, Ltd. (PNB IFL) is PNB's wholly-owned subsidiary in Hong Kong principally engaged in granting retail loans to Filipino overseas workers and professionals. Its main office is located in Central, Hong Kong while its three branches are situated in Shatin, Yuen Long and Tsim Shat Sui (Kowloon).

PNB INTERNATIONAL INVESTMENTS CORPORATION

PNB International Investments Corporation (PNB IIC) is a non-bank holding subsidiary and is the parent company of PNB Remittance Centers, Incorporated (PNB RCI). PNB RCI has a network of 39 money transfer offices in 11 states of the United States of America.

PNB RCI also owns PNBRCI Holding Company, Ltd., established to be the holding company of PNB Remittance Company (Canada) [PNBRCC]. PNBRCC has six offices servicing the remittance requirements of Filipinos in Canada.

PNBRCI Holding Company, Ltd. began doing business as PNB Cargo Services, Inc. on August 1, 2007. PNB Cargo Services, Inc. is engaged in sending *balikbayan* boxes from the U.S.A. to the Philippines under a freight forwarding arrangement with a commercial freight forwarder.

PNB ITALY SPA

PNB Italy SpA is a wholly-owned subsidiary incorporated in Italy principally engaged in servicing the remittance requirements of overseas Filipino workers in Italy. It has offices in Rome, Milan and Florence.

It owns PNB Netherlands B.V., a remittance company operating in the Netherlands. The main office of PNB Netherlands B.V. is located in Amsterdam while its extension office is in Rotterdam.

PNB REMITTANCE CENTER, LTD.

The PNB Remittance Center, Ltd. (PNB RCL) is PNB's wholly-owned remittance subsidiary in Hong Kong. It has nine branches that provide remittance services for overseas Filipino workers in Hong Kong. The company also services the remittance requirements of Indonesian overseas workers in Hong Kong through a remittance tie-up with Bank Mandiri.

PNB SECURITIES, INC.

The PNB Securities, Inc. (PNBSI) is the wholly-owned stock brokerage subsidiary of PNB that deals in the trading of shares of stocks listed at the stock exchange.

2007 List of DISTINCTIONS

- **Gold Category Winner 2004–2007**
  Trusted Brand Awards, Reader's Digest
- **Hall of Fame Award–Best Paying Bank**
- **Best Collecting Bank–OFW Remittances**
- **Best Paying Commercial Bank**
  Balikat ng Bayan Awards, Social Security System
- **Outstanding Commercial Bank Reporter on OFW Remittances**
  Stakeholders' Awards, Bangko Sentral ng Pilipinas
- **Highest ATM Reply Rate**
- **Highest ATM Controllable Rate**
  MegaLink
- **Best Equity Fund–PNB PHISIX Unit Investment Trust Fund**
  Lipper Philippines
- **3rd Highest Yielding Medium-Term Dollar Bond Fund–PNB Dollar Profit Unit Investment Trust Fund**
  Lipper Philippines
- **Best Project Finance/Best Privatization–US$ 380 Million Magat Hydropower Plant Syndicated Loan with:**
  - PNB Capital and Investment Corporation as one of the peso joint lead arrangers
  - PNB as one of the lenders of the peso loan component
  The Asset Magazine (Triple A House and Deal Awards)
- **Asia Pacific Power Deal of the Year–Magat Hydropower Plant**
  Project Finance International

FINANCIAL STATEMENTS

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of Philippine National Bank and Subsidiaries (the Group) and of Philippine National Bank (the Parent Company) is responsible for all information and representations contained in the consolidated financial statements of the Group and the Parent Company financial statements which comprise the balance sheets as at December 31, 2007 and 2006 and the statements of income, statements of changes in equity and statements of cash flows for each of the three years in the period ended December 31, 2007. These financial statements have been prepared in accordance with Philippine Financial Reporting Standards, except for the deferral of losses on sale of nonperforming assets (NPAs) to special purpose vehicles (SPVs) in 2004, 2005 and 2006, non-recognition of allowance for impairment losses as of December 31, 2006 on loans sold to SPV in 2007 and the non-consolidation of the SPV that acquired the NPAs sold in 2006 and 2007 as allowed under the regulations issued by the Bangko Sentral ng Pilipinas for banks and financial institutions availing of the provisions of Republic Act No. 9182, *The Special Purpose Vehicle Act of 2002*, and reflect amounts that are based on the best estimates and informed judgment of management with an appropriate consideration to materiality.

In this regard, the management maintains a system of accounting and reporting which provides for the necessary internal controls to ensure that transactions are properly authorized and recorded, assets are safeguarded against unauthorized use or disposition and liabilities are recognized. The management likewise discloses to the Group's and Parent Company's audit committee and to its external auditors: (i) all significant deficiencies in the design or operation of internal controls that could adversely affect its ability to record, process, and report financial data; (ii) material weaknesses in the internal controls; and (iii) any fraud that involves management or other employees who exercise significant roles in internal controls.

The Board of Directors reviews the aforementioned financial statements before such statements are approved and submitted to the stockholders.

SyCip, Gorres, Velayo and Co., the independent auditors appointed by the stockholders, have audited the financial statements of the Group and the Parent Company in accordance with Philippine Standards on Auditing and expressed their opinion on the fairness of presentation upon completion of such audit, in their report to the Board of Directors and stockholders.

FLORENCIA G. TARRIELA
Chairman of the Board

OMAR BYRON T. MIER
President & Chief Executive Officer

CARMEN G. HUANG
Executive Vice President & Chief Financial Officer

SUBSCRIBED AND SWORN to before me this 14 day of April 2008 affiants exhibiting to me their Community Tax Certificates, as follows:

Names	CTC No.	Date of Issue	Place of Issue
Florencia G. Tarriela	01362816	January 3, 2008	Manila
Omar Byron T. Mier	16311518	January 25, 2008	Quezon City
Carmen G. Huang	19493148	January 22, 2008	Makati City

Notary Public
Doc. No. 73
Page No. 16
Book No. 1
Series of 2008

Notary Public
ATTY. [illegible] B. INES
Commission No. 08-16
Notary Public for Pasay City Until December [illegible]
9th Floor, [illegible]
Pres. [illegible]
Roll of Attorney No. 45760
PTR No. 8594117 01-02-08/Quezon City
IBP No. 726076/11-08-07/Quezon City

INDEPENDENT AUDITORS' REPORT

The Stockholders and the Board of Directors
Philippine National Bank

We have audited the accompanying consolidated financial statements of Philippine National Bank and Subsidiaries (the Group) and the parent company financial statements of Philippine National Bank (the Parent Company), which comprise the balance sheets as at December 31, 2007 and 2006 and the statements of income, statements of changes in equity and statements of cash flows for each of the three years in the period ended December 31, 2007, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Philippine Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

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

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

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

Opinion

As discussed in Notes 9 and 10 to the financial statements, to take advantage of incentives under Republic Act (RA) No. 9182, *The Special Purpose Vehicle Act of 2002*, and at the same time improve its chances of recovering from its non-performing assets (NPA), the Parent Company sold certain NPA to special purpose vehicle (SPV) companies. In accordance with regulatory accounting policies prescribed by the Bangko Sentral ng Pilipinas (BSP) for banks and financial institutions availing of the provisions of RA No. 9182, losses amounting to ₱1.9 billion in 2006, ₱4.3 billion in 2005 and ₱1.1 billion in 2004 from the sale of the NPA to the SPV companies, representing the allowance for impairment losses specifically provided for the NPA but released to cover other impairment losses of the Parent Company, were deferred and are being amortized over a ten-year period.

Also, as discussed in Note 9, the required additional allowance as of December 31, 2006 on the NPA sold in 2007 amounting to ₱1.3 billion was not recognized by the Parent Company since it deferred the loss on such sale as allowed by BSP. Had the impairment losses been charged against operations as required by PFRS, deferred charges and equity would have been decreased by ₱7.7 billion as of December 31, 2007 and deferred charges and equity would have been decreased by ₱6.9 billion and ₱8.2 billion, respectively, and allowance for credit losses would have been increased by ₱1.3 billion as of December 31, 2006, and the 2006 net income would have been decreased by ₱3.2 billion and 2005 net income would have been increased by ₱124.8 million.

The sale of the NPA to the SPV in 2007 and 2006 is considered as a true sale under RA No. 9182 which qualified for derecognition under BSP regulatory reporting rules. However, PFRS requires that the accounts of the SPV that acquired the NPA of the Parent Company in 2007 and 2006 should be consolidated into the Group's accounts. Had the accounts of the SPV been consolidated into the Group's accounts, total assets and liabilities would have been increased by ₱2.0 billion and ₱1.9 billion, respectively, and minority interest in equity of consolidated entities would have been increased by ₱28.8 million as of December 31, 2007. As of December 31, 2006, total assets and minority interest in equity of consolidated subsidiaries would have been increased by ₱30.0 million.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Group and of the Parent Company as of December 31, 2007 and 2006, and their financial performance and their cash flows for each of the three years in the period ended December 31, 2007 in accordance with Philippine Financial Reporting Standards, except for the effects on the 2007 balance sheet, 2006 financial statements and 2005 statement of income of not recognizing the losses on the NPA sold to SPV companies as discussed in the sixth and seventh paragraphs and the effects in the 2007 and 2006 consolidated financial statements of not consolidating the accounts of the SPV as discussed in the eighth paragraph.

SYCIP GORRES VELAYO & CO.

Wilson P. Tan

Wilson P. Tan
Partner
CPA Certificate No. 76737
SEC Accreditation No. 0100-AR-1
Tax Identification No. 102-098-469
PTR No. 0017630, January 3, 2008, Makati City

March 28, 2008

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

BALANCE SHEETS

(In Thousand Pesos)

	Consolidated		Parent Company	
	December 31			
	2007	2006	2007	2006
ASSETS				
Cash and Other Cash Items (Note 17)	**₱4,773,212**	₱4,820,155	**₱4,732,004**	₱4,753,539
Due from Bangko Sentral ng Pilipinas (Note 17)	**27,961,521**	12,566,759	**27,961,521**	12,566,759
Due from Other Banks	**3,962,000**	3,555,603	**2,859,908**	2,314,288
Interbank Loans Receivable (Note 33)	**13,197,201**	22,412,817	**12,824,611**	22,093,537
Securities Held Under Agreements to Resell (Note 17)	**11,200,000**	15,700,000	**11,200,000**	15,700,000
Financial Assets at Fair Value Through Profit or Loss (Note 8)	**3,215,235**	1,137,835	**3,194,086**	1,109,137
Loans and Receivables (Notes 9 and 28)	**76,575,031**	83,592,219	**73,162,024**	81,465,282
Receivables from Special Purpose Vehicle (Note 10)	**726,095**	1,361,074	**726,095**	1,361,074
Available-for-Sale Investments (Notes 11 and 17)	**44,821,522**	42,824,810	**43,961,027**	40,822,339
Held-to-Maturity Investments (Note 11)	**446,054**	1,554,368	**362,795**	1,420,044
Property and Equipment				
At cost (Note 12)	**821,810**	730,181	**714,513**	663,916
At appraised value (Note 12)	**15,681,869**	15,846,819	**15,681,869**	15,846,819
Investments in Subsidiaries and an Associate (Notes 2 and 13)	**665,123**	801,838	**5,381,139**	5,439,520
Investment Properties (Notes 2, 14 and 24)	**24,799,602**	24,882,076	**24,723,885**	24,803,748
Deferred Tax Assets (Note 25)	**1,857,109**	1,847,258	**1,798,662**	1,794,291
Other Assets (Note 15)	**9,001,656**	9,837,253	**8,842,847**	9,499,902
TOTAL ASSETS	**₱239,705,040**	₱243,471,065	**₱238,126,986**	₱241,654,195
LIABILITIES AND EQUITY				
Liabilities				
Deposit Liabilities (Note 17)				
Demand	**₱20,167,642**	₱17,867,651	**₱19,952,002**	₱17,823,367
Savings	**137,315,472**	140,233,120	**137,295,678**	140,085,759
Time	**21,328,855**	23,566,921	**23,642,993**	25,823,838
	178,811,969	181,667,692	**180,890,673**	183,732,964
Bills and Acceptances Payable (Notes 2 and 18)	**4,299,094**	10,955,948	**3,474,448**	10,361,715
Accrued Taxes, Interest and Other Expenses (Note 19)	**4,274,718**	4,899,427	**4,166,165**	4,823,811
Subordinated Debt (Note 20)	**8,416,424**	8,389,297	**8,416,424**	8,389,297
Other Liabilities (Note 21)	**13,673,717**	12,802,426	**11,960,255**	11,081,837
TOTAL LIABILITIES	**209,475,922**	218,714,790	**208,907,965**	218,389,624
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT COMPANY				
Capital stock (Notes 2 and 22)	**₱26,489,837**	₱22,929,837	**₱26,489,837**	₱22,929,837
Capital paid in excess of par value (Note 2)	**2,037,272**	545,745	**2,037,272**	545,745
Surplus reserves (Notes 2 and 27)	**532,136**	512,204	**532,136**	512,204
Deficit (Notes 2, 3 and 9)	**(1,547,162)**	(2,603,474)	**(3,079,723)**	(3,980,989)
Revaluation increment on land and buildings (Notes 2 and 12)	**2,471,113**	2,471,113	**2,471,113**	2,471,113
Accumulated translation adjustment (Notes 2 and 13)	**(724,360)**	(114,869)	**–**	–
Net unrealized gain on available-for-sale investments (Note 11)	**832,131**	832,490	**768,386**	786,661
Share in equity adjustments of an associate (Note 13)	**36,221**	89,592	**–**	–
Parent company shares held by a subsidiary	**(5,323)**	(5,323)	**–**	–
	30,121,865	24,657,315	**29,219,021**	23,264,571
MINORITY INTEREST	**107,253**	98,960	**–**	–
TOTAL EQUITY	**30,229,118**	24,756,275	**29,219,021**	23,264,571
TOTAL LIABILITIES AND EQUITY	**₱239,705,040**	₱243,471,065	**₱238,126,986**	₱241,654,195

See accompanying Notes to Financial Statements.

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

STATEMENTS OF INCOME

(In Thousand Pesos, Except Earnings Per Share Amounts)

	Consolidated			Parent Company		
	Years Ended December 31					
	2007	2006	2005	**2007**	2006	2005
INTEREST INCOME ON						
Loans and receivables (Notes 9 and 28)	**₱6,190,951**	₱7,147,512	₱6,340,391	**₱6,004,146**	₱6,962,022	₱6,118,239
Investment securities (Note 11)	**3,753,985**	4,224,835	4,145,956	**3,668,371**	4,053,146	4,064,096
Deposits with banks and others	**1,248,680**	684,855	600,435	**1,041,836**	640,566	530,918
	11,193,616	12,057,202	11,086,782	**10,714,353**	11,655,734	10,713,253
INTEREST EXPENSE ON						
Deposit liabilities (Note 17)	**3,886,846**	5,158,476	4,728,664	**3,883,661**	5,259,545	4,789,760
Bills payable and other borrowings (Note 18)	**1,429,173**	1,554,215	1,124,366	**1,389,540**	1,505,089	1,097,448
	5,316,019	6,712,691	5,853,030	**5,273,201**	6,764,634	5,887,208
NET INTEREST INCOME	**5,877,597**	5,344,511	5,233,752	**5,441,152**	4,891,100	4,826,045
Service fees and commission income (Note 26)	**2,481,237**	2,767,462	2,914,431	**1,558,623**	1,796,203	2,008,182
Service fees and commission expense	**107,116**	102,479	222,273	**108,807**	92,280	198,523
NET SERVICE FEES AND COMMISSION INCOME	**2,374,121**	2,664,983	2,692,158	**1,449,816**	1,703,923	1,809,659
Trading and investment securities gains - net (Notes 8 and 11)	**1,088,442**	2,071,623	1,085,737	**1,027,911**	2,047,021	1,067,980
Foreign exchange gains - net	**869,680**	1,076,607	1,085,548	**510,317**	630,806	576,223
Miscellaneous (Notes 24 and 26)	**4,308,021**	2,153,786	1,328,321	**4,294,522**	2,250,650	1,148,531
TOTAL OPERATING INCOME	**14,517,861**	13,311,510	11,425,516	**12,723,718**	11,523,500	9,428,438
OTHER EXPENSES						
Compensation and fringe benefits (Notes 23 and 28)	**3,641,425**	3,201,890	3,150,000	**3,013,436**	2,480,783	2,485,397
Provision for impairment and credit losses (Note 16)	**3,280,875**	2,802,283	504,213	**3,251,687**	2,734,736	502,855
Depreciation and amortization (Notes 12 and 14)	**1,150,314**	1,111,364	800,452	**1,118,285**	1,066,999	769,078
Taxes and licenses (Note 25)	**953,079**	1,123,155	1,001,462	**923,946**	1,099,523	973,867
Occupancy and equipment-related costs (Note 24)	**807,233**	832,172	857,259	**644,706**	672,435	699,450
Miscellaneous (Notes 25 and 26)	**2,497,234**	2,534,237	2,642,531	**1,969,366**	2,004,369	2,015,035
TOTAL OPERATING EXPENSES	**12,330,160**	11,605,101	8,955,917	**10,921,426**	10,058,845	7,445,682
INCOME BEFORE SHARE IN NET INCOME OF AN ASSOCIATE AND INCOME TAX	**2,187,701**	1,706,409	2,469,599	**1,802,292**	1,464,655	1,982,756
SHARE IN NET INCOME (LOSS) OF AN ASSOCIATE (Note 13)	**(79,739)**	46,299	49,665	**–**	–	–
INCOME BEFORE INCOME TAX	**2,107,962**	1,752,708	2,519,264	**1,802,292**	1,464,655	1,982,756
PROVISION FOR INCOME TAX (Note 25)	**609,512**	932,679	1,891,726	**467,181**	758,874	1,731,778
NET INCOME	**₱1,498,450**	₱820,029	₱627,538	**₱1,335,111**	₱705,781	₱250,978
ATTRIBUTABLE TO:						
Equity Holders of the Parent Company (Note 31)	**₱1,490,157**	₱814,435	₱620,921			
Minority Interest	**8,293**	5,594	6,617			
	₱1,498,450	₱820,029	₱627,538			
Basic/Diluted Earnings Per Share Attributable to Equity Holders of the Parent Company (Note 31)	**₱2.43**	₱1.42	₱1.08			

See accompanying Notes to Financial Statements.

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

STATEMENTS OF CHANGES IN EQUITY

(In Thousand Pesos)

For the Year Ended December 31, 2007

	Consolidated											
	Attributable to Equity Holders of the Parent Company											
	Capital Stock (Notes 2 and 22)	Capital Paid in Excess of Par Value (Note 2)	Surplus Reserves (Notes 2 and 27)	Deficit (Notes 2, 3 and 9)	Revaluation Increment on Land and Buildings (Notes 2 and 12)	Accumulated Translation Adjustment (Notes 2 and 13)	Net Unrealized Gain on AFS Investments (Note 11)	Share in Equity Adjustments of an Associate (Note 13)	Parent Company Shares held by a Subsidiary	Total	Minority Interest	Total Equity
Balance at January 1, 2007	₱22,929,837	₱545,745	₱512,204	(₱2,603,474)	₱2,471,113	(₱114,869)	₱832,490	₱89,592	(₱5,323)	₱24,657,315	₱98,960	₱24,756,275
Issuance of common shares	3,560,000	1,691,000	–	–	–	–	–	–	–	5,251,000	–	5,251,000
Transaction costs related to issuance of common shares	–	(199,473)	–	–	–	–	–	–	–	(199,473)	–	(199,473)
Unrealized gain recognized directly in equity	–	–	–	–	–	–	1,031,846	–	–	1,031,846	–	1,031,846
Amounts realized in profit or loss	–	–	–	–	–	–	(1,032,205)	–	–	(1,032,205)	–	(1,032,205)
Reduction in share in equity adjustments of an associate	–	–	–	–	–	–	–	(53,371)	–	(53,371)	–	(53,371)
Amortization of deferred losses (Note 9)	–	–	–	(413,913)	–	–	–	–	–	(413,913)	–	(413,913)
Translation adjustment during the year	–	–	–	–	–	(609,491)	–	–	–	(609,491)	–	(609,491)
Total income and expenses recognized directly in equity	–	–	–	(413,913)	–	(609,491)	(359)	(53,371)	–	(1,077,134)		(1,077,134)
Net income for the year	–	–	–	1,490,157	–	–	–	–	–	1,490,157	8,293	1,498,450
Total income and expenses for the year	–	–	–	1,076,244	–	(609,491)	(359)	(53,371)	–	413,023	8,293	421,316
Transfer to surplus reserves	–	–	19,932	(19,932)	–	–	–	–	–	–	–	–
Balance at December 31, 2007	₱26,489,837	₱2,037,272	₱532,136	(₱1,547,162)	₱2,471,113	(₱724,360)	₱832,131	₱36,221	(₱5,323)	₱30,121,865	₱107,253	₱30,229,118

	Parent Company						
	Capital Stock (Notes 2 and 22)	Capital Paid in Excess of Par Value (Note 2)	Surplus Reserves (Notes 2 and 27)	Deficit (Notes 2, 3 and 9)	Revaluation Increment on Land and Buildings (Notes 2 and 12)	Net Unrealized Gain on AFS Investments (Note 11)	Total Equity
Balance at January 1, 2007	₱22,929,837	₱545,745	₱512,204	(₱3,980,989)	₱2,471,113	₱786,661	₱23,264,571
Issuance of new common shares	3,560,000	1,691,000	–	–	–	–	5,251,000
Transaction costs related to issuance of common shares	–	(199,473)	–	–	–	–	(199,473)
Unrealized gain recognized directly in equity	–	–	–	–	–	1,013,505	1,013,505
Amounts realized in profit or loss	–	–	–	–	–	(1,031,780)	(1,031,780)
Amortization of deferred losses (Note 9)	–	–	–	(413,913)	–	–	(413,913)
Total income and expenses recognized directly in equity	–	–	–	(413,913)	–	(18,275)	(432,188)
Net income for the year	–	–	–	1,335,111	–	–	1,335,111
Total income and expenses for the year	–	–	–	921,198	–	(18,275)	902,923
Transfer to surplus reserves (Note 27)	–	–	19,932	(19,932)	–	–	–
Balance at December 31, 2007	₱26,489,837	₱2,037,272	₱532,136	(₱3,079,723)	₱2,471,113	₱768,386	₱29,219,021

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

STATEMENTS OF CHANGES IN EQUITY

(In Thousand Pesos)

For the Year Ended December 31, 2006

	Consolidated											
	Attributable to Equity Holders of the Parent Company											
	Capital Stock (Notes 2 and 22)	Capital Paid in Excess of Par Value (Note 2)	Surplus Reserves (Notes 2 and 27)	Deficit (Notes 2, 3 and 9)	Revaluation Increment on Land and Buildings (Notes 2 and 12)	Accumulated Translation Adjustment (Notes 2 and 13)	Net Unrealized Gain on AFS Investments (Note 11)	Share in Equity Adjustments of an Associate (Note 13)	Parent Company Shares held by a Subsidiary	Total	Minority Interest	Total Equity
Balance at January 1, 2006	₱22,929,837	₱545,745	₱495,118	(₱3,657,870)	₱1,480,301	₱217,479	₱810,619	₱–	(₱5,323)	₱22,815,906	₱93,366	₱22,909,272
Unrealized gain recognized directly in equity	–	–	–	–	–	–	1,046,796	–	–	1,046,796	–	1,046,796
Amounts realized in profit or loss	–	–	–	–	–	–	(1,024,925)	–	–	(1,024,925)	–	(1,024,925)
Share in equity adjustments of an associate	–	–	–	–	–	–	–	89,592		89,592		89,592
Net addition to revaluation increment	–	–	–	–	990,812	–	–	–	–	990,812	–	990,812
Amortization of deferred losses (Note 9)	–	–	–	(267,942)	–	–	–	–	–	(267,942)	–	(267,942)
Reversal of other deferred credits and unrealized profit on assets sold (Note 9)	–	–	–	524,989	–	–	–	–	–	524,989	–	524,989
Translation adjustment during the year	–	–	–	–	–	(332,348)	–	–	–	(332,348)	–	(332,348)
Total income and expenses recognized directly in equity	–	–	–	257,047	990,812	(332,348)	21,871	89,592	–	1,026,974	–	1,026,974
Net income for the year	–	–	–	814,435	–	–	–	–	–	814,435	5,594	820,029
Total income and expenses for the year	–	–		1,071,482	990,812	(332,348)	21,871	89,592	–	1,841,409	5,594	1,847,003
Transfer to surplus reserves (Note 27)	–	–	17,086	(17,086)	–	–	–	–	–	–	–	–
Balance at December 31, 2006	₱22,929,837	₱545,745	₱512,204	(₱2,603,474)	₱2,471,113	(₱114,869)	₱832,490	₱89,592	(₱5,323)	₱24,657,315	₱98,960	₱24,756,275

	Parent Company						
	Capital Stock (Notes 2 and 22)	Capital Paid in Excess of Par Value (Note 2)	Surplus Reserves (Notes 2 and 27)	Deficit (Notes 2, 3 and 9)	Revaluation Increment on Land and Buildings (Notes 2 and 12)	Net Unrealized Gain on AFS Investments (Note 11)	Total Equity
Balance at January 1, 2006	₱22,929,837	₱545,745	₱495,118	(₱4,926,731)	₱1,480,301	₱770,608	₱21,294,878
Net movement in unrealized gain on AFS investments	–	–	–	–	–	1,040,529	1,040,529
Amounts realized in profit or loss	–	–	–	–	–	(1,024,476)	(1,024,476)
Amortization of deferred losses (Note 9)	–	–	–	(267,942)	–	–	(267,942)
Reversal of other deferred credits and unrealized profit on assets sold (Note 9)	–	–	–	524,989	–	–	524,989
Addition to revaluation increment	–	–	–	–	990,812	–	990,812
Total income and expenses recognized directly in equity	–	–	–	257,047	990,812	16,053	1,263,912
Net income for the year	–	–	–	705,781	–	–	705,781
Total income and expenses for the year	–	–	–	962,828	990,812	16,053	1,969,693
Transfer to surplus reserves (Note 27)	–	–	17,086	(17,086)	–	–	–
Balance at December 31, 2006	₱22,929,837	₱545,745	₱512,204	(₱3,980,989)	₱2,471,113	₱786,661	₱23,264,571

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

STATEMENTS OF CHANGES IN EQUITY

(In Thousand Pesos)

For the Year Ended December 31, 2005

	Consolidated										
	Attributable to Equity Holders of the Parent Company										
	Capital Stock (Notes 2 and 22)	Capital Paid in Excess of Par Value (Note 2)	Surplus Reserves (Notes 2 and 27)	Deficit (Notes 2, 3 and 9)	Revaluation Increment on Land and Buildings (Notes 2 and 12)	Accumulated Translation Adjustment (Notes 2 and 13)	Net Unrealized Gain (Loss) on AFS Investments (Note 11)	Parent Company Shares held by a Subsidiary	Total	Minority Interest	Total Equity
Balance at January 1, 2005	₱22,929,837	₱545,745	₱481,694	(₱2,343,032)	₱1,443,486	₱496,817	(₱122,591)	(₱5,323)	₱23,426,633	₱86,749	₱23,513,382
Net movement in unrealized gain on AFS investments	–	–	–	–	–	–	933,210	–	933,210	–	933,210
Net addition to revaluation increment	–	–	–	–	36,815	–	–	–	36,815	–	36,815
Translation adjustment during the year	–	–	–	–	–	(279,338)	–	–	(279,338)	–	(279,338)
Valuation loss on special purpose vehicle (SPV) subordinated notes (Note 9)	–	–	–	(1,868,299)	–	–	–	–	(1,868,299)	–	(1,868,299)
Amortization of deferred losses (Note 9)	–	–	–	(54,036)	–	–	–	–	(54,036)	–	(54,036)
Total income and expenses recognized directly in equity	–	–	–	(1,922,335)	36,815	(279,338)	933,210	–	(1,231,648)	–	(1,231,648)
Net income for the year	–	–	–	620,921	–	–	–	–	620,921	6,617	627,538
Total income and expenses for the year	–	–	–	(1,301,414)	36,815	(279,338)	933,210	–	(610,727)	6,617	(604,110)
Transfer to surplus reserves (Note 27)	–	–	13,424	(13,424)	–	–	–	–	–	–	–
Balance at December 31, 2005	₱22,929,837	₱545,745	₱495,118	(₱3,657,870)	₱1,480,301	₱217,479	₱810,619	(₱5,323)	₱22,815,906	₱93,366	₱22,909,272

	Parent Company						
	Capital Stock (Notes 2 and 22)	Capital Paid in Excess of Par Value (Note 2)	Surplus Reserves (Notes 2 and 27)	Deficit (Notes 2, 3 and 9)	Revaluation Increment on Land and Buildings (Notes 2 and 12)	Net Unrealized Gain (Loss) on AFS Investments (Note 11)	Total Equity
Balance at January 1, 2005	₱22,929,837	₱545,745	₱481,694	(₱3,241,950)	₱1,439,328	(₱118,967)	₱22,035,687
Net movement in unrealized gain on AFS investments	–	–	–	–	–	889,575	889,575
Net addition to revaluation increment	–	–	–	–	40,973	–	40,973
Valuation loss on SPV subordinated notes (Note 9)	–	–	–	(1,868,299)	–	–	(1,868,299)
Amortization of deferred losses (Note 9)	–	–	–	(54,036)	–	–	(54,036)
Total income and expenses recognized directly in equity	–	–	–	(1,922,335)	40,973	889,575	(991,787)
Net income for the year	–	–	–	250,978	–	–	250,978
Total income and expenses for the year	–	–	–	(1,671,351)	40,973	889,575	(740,809)
Transfer to surplus reserves (Note 27)	–	–	13,424	(13,424)	–	–	–
Balance at December 31, 2005	₱22,929,837	₱545,745	₱495,118	(₱4,926,731)	₱1,480,301	₱770,608	₱21,294,878

See accompanying Notes to Financial Statements.

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

STATEMENTS OF CASH FLOWS

(In Thousand Pesos)

	Consolidated			Parent Company		
	Years Ended December 31					
	2007	2006	2005	2007	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES						
Income before income tax	₱2,107,962	₱1,752,708	₱2,519,264	₱1,802,292	₱1,464,655	₱1,982,756
Adjustments for:						
Provision for impairment and credit losses (Note 16)	3,280,875	2,802,283	504,213	3,251,687	2,734,736	502,855
Depreciation and amortization (Notes 12 and 14)	1,150,314	1,111,364	800,452	1,118,285	1,066,999	769,078
Share in net loss (income) of an associate (Note 13)	79,739	(46,299)	(49,665)	–	–	–
Amortization of software cost	57,286	30,540	–	55,537	29,140	–
Amortization of premium (discount)	(75,219)	(13,205)	–	(20,964)	13,096	–
Realized trading gain on available-for-sale (AFS) investments	(1,032,205)	(1,036,763)	–	(1,031,780)	(1,024,476)	–
Net gain on sale or exchange of investment properties (Note 26)	(3,410,352)	(1,317,083)	(372,542)	(3,409,364)	(1,317,083)	(372,542)
Changes in operating assets and liabilities:						
Decrease (increase) in amounts of:						
Financial assets at fair value through profit or loss (Note 8)	(2,077,400)	185,756	210,619	(2,084,949)	188,076	(584,984)
Loans and receivables	4,991,986	(9,400,615)	(5,594,019)	6,304,496	(9,295,614)	(5,770,616)
Other assets	537,610	(4,817,566)	4,652,339	417,015	(4,777,877)	5,422,119
Increase (decrease) in amounts of:						
Deposit liabilities (Note 17)	(2,855,723)	13,840,915	6,817,724	(2,842,291)	13,637,084	7,116,037
Accrued taxes, interest and other expenses (Note 19)	(671,058)	181,986	(1,404,823)	(672,401)	233,195	(1,490,972)
Other liabilities	269,439	1,138,920	2,088,545	878,418	785,851	2,396,976
Net cash generated from operations	2,353,254	4,412,941	10,172,107	3,765,981	3,737,782	9,970,707
Income taxes paid	(547,457)	(949,905)	(1,860,334)	(465,110)	(772,981)	(1,693,840)
Dividends received (Note 13)	3,605	9,012	9,212	–	7,147	9,212
Net cash provided by operating activities	1,809,402	3,472,048	8,320,985	3,300,871	2,971,948	8,286,079
CASH FLOWS FROM INVESTING ACTIVITIES						
Proceeds from sale of:						
AFS investments	146,371,960	147,467,060	–	146,215,730	145,161,445	–
Investment properties	2,399,763	6,316,502	2,123,987	2,397,286	6,315,196	2,022,742
Property and equipment	217,196	339,912	–	216,345	333,833	–
Collection of interbank loans receivables (Note 33)	3,151,961	420,276,297	2,346,334	3,151,961	420,276,297	2,346,334
Proceeds from maturity of held-to-maturity investments	–	3,763,003	8,670,327	–	3,658,545	6,697,986
Placements with the Bangko Sentral ng Pilipinas (BSP)	(12,700,000)	–	–	(12,700,000)	–	–
Acquisition of:						
AFS investments	(146,303,119)	(149,101,658)	(11,193,332)	(147,422,095)	(146,971,081)	(9,033,469)
Held-to-maturity investments	(54,942)	(37,350)	–	–	–	–
Property and equipment (Note 12)	(547,187)	(518,174)	(515,890)	(473,370)	(496,642)	(472,812)
Software cost (Note 15)	(249,146)	(54,285)	–	(249,146)	(54,285)	–
Additional interbank loans receivables (Note 33)	–	(423,428,258)	–	–	(423,428,258)	–
Additional investments in subsidiaries	–	–	–	–	(40,498)	–
Net cash provided by (used in) investing activities	(7,713,514)	5,023,049	1,431,426	(8,863,289)	4,754,552	1,560,781
CASH FLOWS FROM FINANCING ACTIVITIES						
Proceeds from:						
Bills and acceptances payable (Note 18)	556,934	12,356,184	–	556,934	11,381,465	–
Subordinated debt (Note 20)	–	5,500,000	–	–	5,500,000	–
Issuance of common shares (Note 22)	5,051,527	–	–	5,051,527	–	–
Settlement of bills and acceptances payable (Note 2)	(7,213,788)	(14,546,110)	(388,784)	(7,444,201)	(13,463,033)	(452,190)
Net cash provided by (used in) financing activities	(1,605,327)	3,310,074	(388,784)	(1,835,740)	3,418,432	(452,190)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(7,509,439)	11,805,171	9,363,627	(7,398,158)	11,144,932	9,394,670
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR						
Cash and other cash items	4,820,155	5,670,002	3,342,672	4,753,539	5,333,783	3,342,466
Due from BSP	12,566,759	3,719,362	3,765,737	12,566,759	3,719,362	3,765,737
Due from other banks	3,555,603	5,494,793	7,051,470	2,314,288	4,897,004	6,092,449
Interbank loans receivable (Note 33)	19,260,856	16,914,045	16,574,696	18,941,576	16,881,081	16,535,908
Securities held under agreements to resell	15,700,000	12,300,000	4,000,000	15,700,000	12,300,000	4,000,000
	55,903,373	44,098,202	34,734,575	54,276,162	43,131,230	33,736,560
CASH AND CASH EQUIVALENTS AT END OF YEAR						
Cash and other cash items	4,773,212	4,820,155	5,670,002	4,732,004	4,753,539	5,333,783
Due from BSP	15,261,521	12,566,759	3,719,362	15,261,521	12,566,759	3,719,362
Due from other banks	3,962,000	3,555,603	5,494,793	2,859,908	2,314,288	4,897,004
Interbank loans receivable (Note 33)	13,197,201	19,260,856	16,914,045	12,824,611	18,941,576	16,881,081
Securities held under agreements to resell	11,200,000	15,700,000	12,300,000	11,200,000	15,700,000	12,300,000
	₱48,393,934	₱55,903,373	₱44,098,202	₱46,878,044	₱54,276,162	₱43,131,230
OPERATIONAL CASH FLOWS FROM INTEREST AND DIVIDENDS						
Interest paid	₱5,837,700	₱7,109,859	₱7,116,769	₱5,806,509	₱7,148,539	₱7,159,482
Interest received	11,187,821	12,118,812	11,954,116	10,206,429	11,705,491	11,592,474
Dividends received	3,605	9,012	9,212	20,532	191,949	18,203

See accompanying Notes to Financial Statements.

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

1. Corporate Information

Philippine National Bank (the Parent Company) was established in 1916 and started commercial operations that same year. Its principal place of business is at PNB Financial Center, President Diosdado Macapagal Boulevard, Pasay City. In August 2007, the Parent Company completed its Tier 1 follow-on equity offering where it raised ₱5.1 billion in Tier 1 capital, net of issuance cost of ₱199.5 million. Together with the sale of 89 million primary shares, the 71.8 million secondary shares owned by the National Government (NG) thru Philippine Deposit Insurance Corporation (PDIC) and Department of Finance (DOF) were sold to the public and thus paving for a complete exit of the NG from the Parent Company. As of December 31, 2007, the companies and persons affiliated/associated with the Lucio Tan Group (LTG) remain the majority shareholder of the Parent Company at 69.87% and the remaining 30.13% is held by the public. As of December 31, 2006, the Parent Company's shares were held 77.43% by the companies and persons affiliated/associated with the LTG, 12.53% by the NG and the remaining 10.04% by the public.

The Parent Company provides a full range of banking and other financial services to corporate, middle-market and retail customers, the NG, local government units (LGUs) and government-owned and controlled corporations (GOCCs) and various government agencies. The Parent Company's principal commercial banking activities include deposit-taking, lending, bills discounting, foreign exchange dealing, investment banking, fund transfers/remittance servicing and a full range of retail banking and trust services through its 324 domestic and 32 overseas branches and offices in 2007 and 324 domestic and 33 overseas branches and offices in 2006. The Parent Company's international subsidiaries have a network of 73 and 69 offices in 2007 and 2006, respectively, in key cities of the United States of America (USA), Canada, Western Europe, Middle East and Asia.

The subsidiaries are engaged in a number of diversified financial and related businesses such as remittance and cargo servicing, non-life insurance, merchant banking, leasing, stock brokerage, foreign exchange trading and/or related services while an associate is engaged in the life-insurance business.

The accompanying financial statements of the Parent Company and its subsidiaries (the Group) and of the Parent Company were authorized for issue by the Parent Company's board of directors (BOD) on March 28, 2008.

2. Restructuring and Rehabilitation

The Parent Company previously operated under a rehabilitation program pursuant to the Memorandum of Agreement (MOA) signed by the Republic of the Philippines, the PDIC and the LTG on May 3, 2002.

Pursuant to the MOA, the following measures were implemented:

(1) Capital Restructuring

The Parent Company instituted a capital reduction exercise as of December 31, 2001, reducing the par value of its common shares from ₱60 per share to ₱40 per share, resulting in a total capital reduction of ₱7.6 billion. This resulted in a decrease in the authorized capital stock of the Parent Company from ₱50.0 billion divided into 833,333,334 common shares to ₱33.3 billion divided into 833,333,334 common shares. The reduction in par value and the amendment to the articles of incorporation of the Parent Company were approved by the BOD of the Parent Company on May 17, 2002 and by the Philippine Securities and Exchange Commission (SEC) on July 23, 2002.

i. On May 16, 2002, the Bangko Sentral ng Pilipinas (BSP) approved the following: (a) booking of an appraisal increment of ₱431.8 million for the year ended December 31, 2001 on properties and recognition of the same for the purpose of determiningthe Parent Company's capital adequacy ratio; and (b) booking of translation adjustment of ₱1.6 billion for the year ended December 31, 2001 representing the increase in peso value of the Parent Company's investment in foreign subsidiaries, for the purpose of the Rehabilitation Plan and as an exception to existing BSP regulations, provided that the same should be excluded for dividend distribution purposes.

ii. The translation adjustment of ₱1.6 billion was applied to eliminate the Parent Company's remaining deficit of ₱1.3 billion as of December 31, 2001, after applying the total reduction in par value amounting to ₱7.6 billion as a result of the capital reduction exercise. This corporate act was approved by the SEC on November 7, 2002, subject to the following conditions: (a) the remaining translation adjustment of ₱310.7 million as of December 31, 2001 (shown in the balance sheet as part of Capital paid in excess of par value) would not, without the prior approval of the SEC, be used for or applied towards any provisions for losses that may be incurred in the future; and (b) for purposes of declaration of dividends, any future surplus account of the Parent Company should be restricted to the extent of the deficit wiped out by the translation adjustment.

The foregoing capital restructuring measures were aimed at reducing the deficit in the equity of the Parent Company which amounted to ₱8.9 billion as of December 31, 2001.

The Parent Company's deficit before and after the quasi-reorganization follows (in thousand pesos):

Deficit before the quasi-reorganization (balance at December 31, 2001)	₱8,877,094
Reduction in par value during the year	(7,561,409)
Application of translation adjustment to deficit on quasi-reorganization	(1,626,430)
Deficit after the quasi-reorganization	(310,745)
Transfer to capital paid in excess of par value	₱310,745

(2) Debt-to-Equity Conversion

In 2002, convertible preferred shares were issued to the PDIC as payment for the ₱7.8 billion borrowed by the Parent Company from the PDIC. This increased (i) the authorized capital stock of the Parent Company to ₱50.0 billion consisting of 1,054,824,557 common shares with a par value of ₱40 each and 195,175,444 convertible preferred shares with a par value of ₱40 each and (ii) the issued capital stock of the Parent Company to ₱22.9 billion consisting of 378,070,472 common shares with a par value of ₱40 each and 195,175,444 convertible preferred shares with a par value of ₱40 each.

(3) Assignment of Certain Government Accounts to the PDIC

On July 30, 2002, the Parent Company and the PDIC signed an agreement whereby the Parent Company transferred and conveyed by way of "dacion en pago", or payment in kind, its rights and interests to the loans of the NG, certain LGUs, certain GOCCs and various government agencies and certain debt securities issued by various government entities (the Government accounts), to the PDIC. The "dacion en pago" arrangement reduced the Parent Company's outstanding obligations arising from the financial assistance given to the Parent Company by the BSP and the PDIC. The accrual of interest incurred by the Parent Company on the government accounts and on the ₱10.0 billion payable to the PDIC ceased on October 1, 2001.

After the completion of the corporate actions and rehabilitation set out above (especially, the conversion of debt to equity and the "dacion en pago" arrangement), the balance of the Parent Company's outstanding obligations to the PDIC was ₱6.1 billion as of December 31, 2002. This balance was restructured into a term loan of 10 years, with interest payable at 91-day treasury bill (T-bill) rate plus 1.00% (see Note 18). On June 19, 2007, the Parent Company fully paid the PDIC loan of ₱6.1 billion.

In line with the rehabilitation program of the Parent Company as approved under Monetary Board (MB) Resolution No. 626 dated April 30, 2003, the Parent Company and the BSP entered into a Memorandum of Understanding (MOU) on September 16, 2003. Pursuant to the MOU, the Parent Company should comply to the full extent of its capability, with the following directives of MB Resolution No. 649, among others:

(1) Maintain a strong management team supported by competent staff;
(2) Improve the Parent Company's past due ratio;
(3) Sell the PNB Financial Center;
(4) Dispose real and other properties owned or acquired - ROPA (included under investment properties); and
(5) Comply with certain prescribed limits.

In May 2007, the Parent Company's rehabilitation program ended and the MOU with the BSP has expired. As agreed with BSP, the Parent Company's BOD will implement the following:

(1) a Tier 1 capital restoration plan which should call for a short-term capital injection within one year and a second capital injection, if necessary, within three to five years;

(2) a plan to strengthen the quantity and quality of supervision by the BOD which include, at a minimum, actions to be taken to strengthen the functions of the Corporate Governance Committee, establish an effective internal audit function and an effective compliance system; and

(3) a plan to improve the Parent Company's operation and strengthen the risk management process and a new Financial Plan which will cover, at a minimum, a plan to return the Parent Company to financial health, establishment of an effective system of ROPA administration, improvement in risk management processes, Information Technology Group and Trust Banking Group function.

As discussed in Notes 1 and 22, the Parent Company completed its Tier 1 follow-on equity offering in August 2007 raising about ₱5.3 billion in Tier 1 capital.

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

3. Summary of Significant Accounting Policies

Basis of Preparation

The accompanying financial statements have been prepared on a historical cost basis except for financial assets at fair value through profit or loss (FVPL) including derivative financial instruments, available-for-sale (AFS) investments, land and building that have been measured at fair value. The financial statements are presented in Philippine pesos, the Parent Company's functional and presentation currency, and all values are rounded to the nearest thousand pesos (₱000) except when otherwise indicated.

The financial statements of the Parent Company reflect the accounts maintained in the Regular Banking Unit (RBU) and Foreign Currency Deposit Unit (FCDU). For financial reporting purposes, FCDU accounts and foreign currency-denominated accounts in the RBU are translated into their equivalents in Philippine pesos (see policy on Foreign Currency Translation). The financial statements individually prepared for these units are combined and inter-unit accounts are eliminated.

Statement of Compliance

The financial statements of the Group and the Parent Company have been prepared in compliance with Philippine Financial Reporting Standards (PFRS), except for the deferral of losses on sale of nonperforming assets (NPAs) to special purpose vehicles (SPVs) as discussed in Note 9, non-recognition of allowance for impairment losses as of December 31, 2006 on loans sold to SPV in 2007 and the non-consolidation of the SPV that acquired the NPAs sold in 2007 and 2006 as discussed in Note 10 as allowed by the regulatory accounting policies prescribed by the BSP for banks and financial institutions availing of the provisions of Republic Act (RA) No. 9182, *The Special Purpose Vehicle Act of 2002.*

Basis of Consolidation

The consolidated financial statements include the financial statements of the Parent Company and the following wholly owned and majority owned subsidiaries:

Subsidiary	Industry	Country of Incorporation	Effective Percentage of Ownership
PNB Capital and Investment Corporation (PNB Capital)	Financial Markets	Philippines	100.00
PNB Forex, Inc.	- do -	- do -	100.00
PNB Holdings Corporation (PNB Holdings)	- do -	- do -	100.00
PNB Securities, Inc. (PNB Securities)	Securities Brokerage	- do -	100.00
PNB Corporation - Guam	Financial Markets	Guam	100.00
PNB International Investments Corporation (PNBIIC)	- do -	USA	100.00
PNB Europe PLC	- do -	United Kingdom	100.00
PNB International Finance Limited (PNB IFL)	- do -	Hong Kong	100.00
PNB Global Filipino Remittance Spain (PNB GFRS)	- do -	Spain	100.00
PNB Austria Financial Services GmbH (PNB Austria)	- do -	Austria	100.00
PNB Italy SpA	- do -	Italy	100.00
PNB Remittance Center, Ltd.	Services	Hong Kong	100.00
Tanzanite Investments (SPV-AMC), Inc.	Others	Philippines	100.00
Tau Portfolio Investments (SPV-AMC), Inc.	- do -	- do -	100.00
Omicron Asset Portfolio (SPV-AMC), Inc.	- do -	- do -	100.00
Japan - PNB Leasing and Finance Corporation (Japan-PNB Leasing)	Financial Markets	- do -	60.00

The financial statements of the subsidiaries are prepared for the same reporting period as the Parent Company using consistent accounting policies. All significant intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated in full in the consolidation.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. Control is achieved where the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Consolidation of subsidiaries ceases when control is transferred out of the Group or Parent Company. The results of subsidiaries acquired or disposed of during the period are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate.

In 2006, the Parent Company sold Opal Portfolio Investments (SPV-AMC), Inc. (OPII) and certain NPAs to Golden Dragon Star Equities, Inc. under a transaction that qualified, and was approved by the BSP, as a legal true sale (see Note 10). OPII holds the NPA sold by the Parent Company. Under Standing Interpretations Committee (SIC) No. 12, *Consolidation of Special Purpose Entity*, the consolidated financial statements should include the accounts of OPII. However, the accounts of OPII were not consolidated into the accompanying financial statements as of and for the years ended December 31, 2007 and 2006.

Minority Interests
Minority interests represent the portion of profit or loss and the net assets not held by the Group and are presented separately in the consolidated statement of income and within equity in the consolidated balance sheet, separately from equity attributable to the Parent Company. Acquisitions of minority interests are accounted for using the entity concept method, whereby the difference between the consideration and the book value of the share of the net assets acquired is recognized as an equity transaction.

Changes in Accounting Policies
The accounting policies adopted are consistent with those of the previous financial years except as follows:

The Group has adopted the following PFRS and Philippine Interpretation which became effective beginning January 1, 2007.

PFRS 7, *Financial Instruments: Disclosures*, and complementary amendment to Philippine Accounting Standard (PAS) 1, *Presentation of Financial Statements: Capital Disclosures*
PFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, as well as sensitivity analysis to market risk. It replaces PAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions,* and the disclosure requirements in PAS 32, *Financial Instruments: Disclosure and Presentation*. It is applicable to all entities that report under PFRS. Adoption of this standard resulted in the inclusion of additional disclosures such as market risk, sensitivity analysis, contractual maturity analysis of financial liabilities for liquidity risk and aging analysis on financial assets that are either past due or impaired. The amendment to PAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The required new disclosures are reflected in the financial statements of the Group, where applicable.

In December 2007, the Financial Reporting Standards Council has approved an amendment to the transition provision of PFRS 7 that gives transitional relief with respect to the presentation of comparative information for the new risk disclosures about the nature and extent of risks arising from financial instruments under paragraphs 31 to 42 of PFRS 7. In relation to such relief, the Group is allowed not to present comparative information for the new risk disclosures under paragraphs 31 to 42 of PFRS 7 unless the disclosure was previously required under PAS 30 or PAS 32.

Philippine Interpretation IFRIC 8, *Scope PFRS 2*
This Interpretation requires PFRS 2 to be applied to any arrangements where equity instruments are issued for consideration which appears to be less than fair value. The Interpretation has no impact on the financial statements of the Group.

Philippine Interpretation IFRIC 10, *Interim Financial Reporting and Impairment*
This Interpretation prohibits the reversal of impairment losses on goodwill and AFS equity investments recognized in the interim financial reports even if impairment is no longer present at the annual balance sheet date. This Interpretation has no significant impact on the financial statements of the Group.

Foreign Currency Translation
Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

Transactions and balances
The books of accounts of the RBU are maintained in Philippine pesos, while those of the FCDU are maintained in United States (US) dollars. For financial reporting purposes, the monetary assets and liabilities of the FCDU and the foreign currency-denominated monetary assets and liabilities in the RBU are translated in Philippine pesos based on the Philippine Dealing System (PDS) closing rate prevailing at end of the year and for foreign currency-denominated income and expenses, at the PDS weighted average rate (PDSWAR) for the year. Foreign exchange differences arising from restatements of foreign currency-denominated assets and liabilities are credited to or charged against operations in the year in which the rates change. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Group companies
As at the reporting date, the assets and liabilities of overseas subsidiaries are translated into the Parent Company's presentation currency (the Philippine peso) at the rate of exchange ruling at the balance sheet date, and their income and expenses are translated at the weighted average exchange rates for the year. Exchange differences arising on translation are taken directly to a separate component of equity in the consolidated balance sheet. On disposal of a foreign entity, the deferred cumulative amount recognized in equity relating to the particular foreign operation is recognized in the consolidated statement of income.

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Financial Instruments - Initial Recognition and Subsequent Measurement

Date of recognition

Purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace are recognized on settlement date. Derivatives are recognized on trade date basis (i.e., the date that the Group commits to purchase or sell). Deposits, amounts due to banks and customers and loans are recognized when cash is received by the Group or advanced to the borrowers. For PNB Securities, securities transactions are recorded on a trade date basis.

Initial recognition of financial instruments

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

Determination of fair value

The fair value for financial instruments traded in active markets at the balance sheet date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and asking prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation methodologies. Valuation methodologies include net present value techniques, comparison to similar instruments for which market observable prices exist, option pricing models, and other relevant valuation models.

'Day 1' profit

Where the transaction price in a non-active market is different to the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Group recognizes the difference between the transaction price and fair value (a 'Day 1' profit) in the statement of income in 'Trading and investment securities gains - net'. In cases where data is not observable, the difference between the transaction price and model value is only recognized in the statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Group determines the appropriate method of recognizing the 'Day 1' profit amount.

Derivatives recorded at FVPL

The Parent Company and some of its subsidiaries are counterparties to derivative contracts, such as currency forwards, currency swaps, and interest rate swaps. These derivatives are entered into as a service to customers and as a means of reducing or managing their respective foreign exchange and interest rate exposures, as well as for trading purposes. Such derivative financial instruments are initially recorded at fair value on the date at which the derivative contract is entered into and are subsequently remeasured at fair value. Any gains or losses arising from changes in fair values of derivatives (except those accounted for as accounting hedges) are taken directly to the statement of income and are included in 'Trading and investment securities gains - net'. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

For the purpose of hedge accounting, hedges are classified primarily as either: a) a hedge of the fair value of an asset, liability or a firm commitment (fair value hedge); or b) a hedge of the exposure to variability in cash flows attributable to an asset or liability or a forecasted transaction (cash flow hedge). In 2007 and 2006, the Group did not apply hedge accounting treatment for its derivatives transactions.

The Group has certain derivatives that are embedded in host financial (such as structured notes, debt investments, and loan receivables) and non-financial (such as purchase orders and service agreements) contracts. These embedded derivatives include credit default swaps (which are linked either to a single reference entity or a basket of reference entities; conversion options in loans receivable; call options in certain long-term debt, and foreign-currency derivatives in debt instruments, purchase orders and service agreements. Embedded derivatives are bifurcated from their host contracts and carried at fair value with fair value changes being reported through profit or loss, when the entire hybrid contracts (composed of both the host contract and the embedded derivative) are not accounted for as financial assets at FVPL, and when their economic risks and characteristics are not closely related to those of their respective host contracts, and when a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative. The Group assesses whether embedded derivatives are required to be separated from the host contracts when the Group first becomes a party to the contract. Reassessment of embedded derivatives is only done when there are changes in the contract that significantly modifies the contractual cash flows.

Other financial assets or financial liabilities held for trading
Other financial assets or financial liabilities held for trading (classified as 'Financial assets at FVPL' or 'Financial liabilities at FVPL') are recorded in the balance sheet at fair value. Changes in fair value relating to the held-for-trading positions are recognized in 'Trading and investment securities gains - net'. Interest earned or incurred is recorded in interest income or expense, respectively, while dividend income is recorded in 'Miscellaneous income' when the right to receive payment has been established.

Included in this classification are debt and equity securities which have been acquired principally for the purpose of selling or repurchasing in the near term.

Designated financial assets or financial liabilities at FVPL
Financial assets or financial liabilities classified in this category are designated by management on initial recognition when any of the following criteria are met:

- The designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognizing gains or losses on them on a different basis; or
- The assets and liabilities are part of a group of financial assets, financial liabilities or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- The financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

Designated financial assets and financial liabilities at FVPL are recorded in the balance sheet at fair value. Changes in fair value are recorded in 'Trading and investment securities gains - net'. Interest earned or incurred is recorded in interest income or expense, respectively, while dividend income is recorded in 'Miscellaneous income' according to the terms of the contract, or when the right of payment has been established.

HTM investments
HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Group's management has the positive intention and ability to hold to maturity. Where the Group sells other than an insignificant amount of HTM investments, the entire category would be tainted and reclassified as AFS investments. After initial measurement, these HTM investments are subsequently measured at amortized cost using the effective interest method, less impairment in value. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortization is included in 'Interest income' in the statement of income. Gains and losses are recognized in income when the HTM investments are derecognized and impaired, as well as through the amortization process. The losses arising from impairment of such investments are recognized in the statement of income under 'Provision for impairment and credit losses'. The effects of restatement on foreign currency-denominated HTM investments are recognized in the statement of income.

Loans and receivables, amounts due from BSP and other banks, and interbank loans receivable
Classified as loans and receivables are 'Due from BSP', 'Due from other banks', 'Interbank loans receivable', and 'Loans and receivables'. These are financial assets with fixed or determinable payments and fixed maturities and are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as Financial assets at FVPL or designated as AFS investments.

Loans and receivables also include receivables arising from transactions on credit cards issued directly by the Parent Company. Furthermore, 'Loans and receivables' include the aggregate rental on finance lease transactions. Unearned income on finance lease transactions is shown as a deduction from 'Loans and receivables' (included in 'Unearned discounts').

After initial measurement, the 'Loans and receivables', 'Due from BSP', 'Due from other banks' and 'Interbank loans receivable' are subsequently measured at amortized cost using the effective interest method, less allowance for credit losses. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortization is included in the 'Interest income' in the statement of income. The losses arising from impairment are recognized in 'Provision for impairment and credit losses' in the statement of income.

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

After initial measurement, AFS investments are subsequently measured at fair value. The effective yield component of AFS debt securities, as well as the impact of restatement on foreign currency-denominated AFS debt securities, is reported as income. The unrealized gains and losses arising from the fair valuation of AFS investments are excluded, net of tax, from reported income and are reported as 'Net unrealized gain on AFS investments' in the equity section of the balance sheet.

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When the security is disposed of, the cumulative gain or loss previously recognized in equity is recognized as 'Trading and investment securities gains - net' in the statement of income. Interest earned on holding AFS investments are reported as 'Interest income' using the effective interest rate. Dividends earned on holding AFS investments are recognized in the statement of income as 'Miscellaneous income' when the right of the payment has been established. The losses arising from impairment of such investments are recognized as 'Provision for impairment and credit losses' in the statement of income.

Bills payable and other borrowed funds
Issued financial instruments or their components, which are not designated at FVPL, are classified as bills payable or other appropriate account titles for such borrowed funds, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares. The components of issued financial instruments that contain both liability and equity elements are accounted for separately, with the equity component being assigned the residual amount after deducting from the instrument as a whole the amount separately determined as the fair value of the liability component on the date of issue.

After initial measurement, bills payable and other borrowings are subsequently measured at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into account any discount or premium on the issue and fees that are an integral part of the effective interest rate.

Derecognition of Financial Assets and Liabilities
Financial asset
A financial asset (or, where applicable a part of a financial asset or part of a group of financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired;
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained the risk and rewards of the asset but has transferred control over the asset.

Where the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control over the asset, the asset is recognized to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Financial liability
A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the statement of income.

Repurchase and Reverse Repurchase Agreements
Securities sold under agreements to repurchase at a specified future date ('repos') are not derecognized from the balance sheet. The corresponding cash received, including accrued interest, is recognized in the balance sheet as a loan to the Group, reflecting the economic substance of such transaction.

Conversely, securities purchased under agreements to resell at a specified future date ('reverse repos') are not recognized in the balance sheet. The corresponding cash paid, including accrued interest, is recognized on the balance sheet as 'Securities held under agreements to resell', and is considered a loan to the counterparty. The difference between the purchase price and resale price is treated as interest income and is accrued over the life of the agreement using the effective interest method.

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

Loans and receivables, amounts due from BSP and other banks, and interbank loans receivable
For loans and receivables, due from BSP and other banks, and interbank loans receivable carried at amortized cost, the Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses for impairment. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment for impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred). The carrying amount of the asset is reduced through use of an allowance account and the amount of loss is charged to the statement of income. Interest income continues to be recognized based on the original effective interest rate of the asset. Loans, together with the associated allowance accounts, are written off when there is no realistic prospect of future recovery and all collateral has been realized. If subsequently, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is reduced by adjusting the allowance account. If a future write-off is later recovered, any amounts formerly charged are credited to the 'Provision for impairment and credit losses' account.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate, adjusted for the original credit risk premium. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of such credit risk characteristics as industry, collateral type, past-due status and term. Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the year on which the historical loss experience is based and to remove the effects of conditions in the historical year that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with changes in related observable data from year to year (such changes in property prices, payment status, or other factors that are indicative of incurred losses in the Group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

Restructured loans
Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews restructured loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate. The difference between the recorded value of the original loan and the present value of the restructured cash flows, discounted at the original effective interest rate, is recognized in 'Provision for impairment and credit losses' in the statement of income.

AFS investments
For AFS investments, the Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired.

In case of equity investments classified as AFS investments, this would include a significant or prolonged decline in the fair value of the investments below its cost. Where there is evidence of impairment, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the statement of income - is removed from equity and recognized in the statement of income. Impairment losses on equity investments are not reversed through the statement of income. Increases in fair value after impairment are recognized directly in equity.

In the case of debt instruments classified as AFS investments, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Interest continues to be accrued at the original effective interest rate on the reduced carrying amount of the asset and is recorded as part of 'Interest income' in the statement of income. If subsequently, the fair value of a debt instrument increased and the increase can be objectively related to an event occurring after the impairment loss was recognized in the statement of income, the impairment loss is reversed through the statement of income.

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HTM investments

For HTM investments, the Group assesses whether there is objective evidence of impairment. If there is objective evidence that an impairment loss 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 expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through use of an allowance account and the amount of loss is charged against the statement of income. Interest income continues to be recognized based on the original effective interest rate of the asset.

If subsequently, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, any amount formerly charged are credited to the 'Provision for impairment and credit losses' in the statement of income and the allowance account reduced. The HTM investments, together with the associated allowance accounts, are written off when there is no realistic prospect of future recovery and all collateral has been realized.

Offsetting Financial Instruments

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the balance sheet.

Terminal Value of Leased Assets and Deposits on Finance Leases

The terminal value of leased assets, which approximates the amount of guaranty deposit paid by the lessee at the inception of the lease, is the estimated proceeds from the sale of the leased asset at the end of the lease term. At the end of the lease term, the terminal value of the leased asset is generally applied against the guaranty deposit of the lessee when the lessee decides to buy the leased asset.

Financial Guarantees

In the ordinary course of business, the Group gives financial guarantees consisting of letters of credit, letters of guarantees, and acceptances. Financial guarantees are initially recognized in the financial statements at fair value under 'Other liabilities'. Subsequent to initial recognition, the Group's liabilities under such guarantees are each measured at the higher of the initial fair value less, when appropriate, cumulative amortization calculated to recognize the fee in the statement of income in 'Service fees and commission income', over the term of the guarantee, and the best estimate of the expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the statement of income in 'Provision for impairment and credit losses'. Any financial guarantee liability remaining is recognized in the statement of income in 'Service fees and commission income', when the guarantee is discharged, cancelled or expires.

Revenue Recognition

Revenue is recognized to the extent that it is probable that economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized:

Interest income

For all financial instruments measured at amortized cost and interest bearing financial instruments classified as AFS investments, interest income is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options), includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The adjusted carrying amount is calculated based on the original effective interest rate. The change in carrying amount is recorded as interest income.

Once the recorded value of a financial asset or group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original effective interest rate applied to the new carrying amount.

Fee and commission income

The Group earns fee and commission income from diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

a) Fee income earned from services that are provided over a certain period of time
   Fees earned for the provision of services over a period of time are accrued over that period. These fees include investment fund fees, custodian fees, fiduciary fees, commission income, credit related fees, asset management fees, portfolio and other management fees, and advisory fees. However, loan commitment fees for loans that are likely to be drawn down are deferred (together with any incremental costs) and recognized as an adjustment to the effective interest rate on the loan.

b) Fee income from providing transaction services
Fees arising from negotiating or participating in the negotiation of a transaction for a third party - such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses - are recognized on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognized after fulfilling the corresponding criteria. These fees include underwriting fees, corporate finance fees, and brokerage fees. Loan syndication fees are recognized in the statement of income when the syndication has been completed and the Group retains no part of the loans for itself or retains part at the same effective interest rate as for the other participants.

Dividend income
Dividend income is recognized when the Group's right to receive payment is established.

Trading and investment securities gains - net
Results arising from trading activities including all gains and losses from changes in fair value for financial assets and financial liabilities at FVPL.

Rental income
Rental income arising on leased properties is accounted for on a straight-line basis over the lease terms on ongoing leases and is recorded in the statement of income under 'Miscellaneous income'.

Commissions earned on credit cards
Commissions earned are taken up as income upon receipt from member establishments of charges arising from credit availments by credit cardholders. These commissions are computed based on certain agreed rates and are deducted from amounts remittable to member establishments.

Purchases by the credit cardholders, collectible on installment basis, are recorded at the cost of the items purchased plus certain percentage of cost. The excess over cost is credited to 'Unearned discounts' account and is shown as a deduction from 'Loans and receivables' in the consolidated balance sheet. The unearned discount is taken up to income over the installment terms and is computed using the effective interest method.

Income on direct financing leases and receivables financed
Income of Japan-PNB Leasing on loans and receivables financed with short-term maturities is recognized using the effective interest method.

Interest and finance fees on finance leases and loans and receivables financed with long-term maturities and the excess of the aggregate lease rentals plus the estimated terminal value of the leased equipment over its cost are credited to unearned discounts and amortized over the term of the note or lease using the effective interest method.

Other Income
Income from sale of services is recognized upon rendition of the service. Income from sale of properties is recognized upon completion of the earning process and the collectibility of the sales price is reasonably assured.

<u>Cash and Cash Equivalents</u>
For purposes of reporting cash flows, cash and cash equivalents include cash and other cash items (COCI), amounts due from BSP and other banks and interbank loans receivable and securities held under agreements to resell that are convertible to known amounts of cash, with original maturities of three months or less from dates of placements and that are subject to an insignificant risk of changes in fair value.

<u>Receivables from SPV</u>
Receivables from SPV are stated at the face value of the related note reduced by an allowance for credit losses. The allowance for credit losses is determined based on the difference between the outstanding principal amount and the recoverable amount which is the present value of the future cash flow expected to be received in payment of the receivable.

<u>Investments in Subsidiaries and an Associate</u>
Investments in subsidiaries
Subsidiaries pertain to entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity (see Basis of Consolidation).

Investment in an associate
Associate pertains to an entity over which the Group has significant influence but not control, generally accompanying a shareholding of between 20.00% and 50.00% of the voting rights. In the consolidated financial statements, investment in an associate is accounted for under the equity method of accounting.

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Under the equity method, investment in an associate is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of the net assets of the associate. The Group's share of its associates' post-acquisition profits or losses is recognized in the statement of income, and its share of post-acquisition movements in the associates' equity reserves is recognized directly in equity. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

In the Parent Company financial statements, investments in subsidiaries and an associate are carried at cost, less any impairment in value. Cost represents the carrying value of the investments as at the quasi-reorganization date of the Parent Company as discussed in Note 2, reduced by dividends subsequently received from the investees.

Property and Equipment

Depreciable properties such as leasehold improvements, and furniture, fixture and equipment are stated at cost less accumulated depreciation and amortization and any impairment in value.

Land is stated at appraised values less any impairment in value while buildings are stated at appraised value less accumulated depreciation and any impairment in value. The appraised values were determined by professionally qualified, independent appraisers in 2006. The revaluation increment resulting from revaluation is credited to the 'Revaluation increment on land and buildings' under equity, net of applicable deferred income tax.

The initial cost of property and equipment consists of its purchase price, including import duties, taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after items of property and equipment have been put into operation, such as repairs and maintenance are normally charged against operations in the year in which the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of property and equipment.

Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are amortized over the shorter of the terms of the covering leases and the estimated useful lives of the improvements.

The estimated useful lives follow:

	Useful Lives in Years
Buildings	25 - 50
Furniture, fixtures and equipment	5
Leasehold improvements	3 - 10

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

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

Investment Properties

Investment properties are measured initially at cost, including transaction costs. An investment property acquired through an exchange transaction is measured at fair value of the asset acquired unless the fair value of such an asset cannot be measured in which case the investment property acquired is measured at the carrying amount of asset given up. Foreclosed properties are classified under 'Investment properties' from foreclosure date.

Subsequent to initial recognition, depreciable investment properties are carried at cost less accumulated depreciation and impairment in value.

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

Expenditures incurred after the investment properties have been put into operations, such as repairs and maintenance costs, are normally charged to income in the year in which the costs are incurred.

Depreciation is calculated on a straight-line basis using the remaining useful lives from the time of acquisition of the depreciable investment properties ranging from 25 to 50 years.

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

Intangible Assets

Exchange trading right

The exchange trading right, included in 'Other assets', was acquired, together with Philippine Stock Exchange (PSE) shares, in exchange for the exchange membership seat under the conversion program of the PSE. The exchange trading right is carried at the amount allocated from the original cost of the exchange membership seat (after a corresponding allocation for the value of the PSE shares) less allowance for impairment losses, if any. The Group does not intend to sell the exchange trading right in the near future.

The exchange trading right is deemed to have an indefinite useful life as there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the Group. It is tested annually for any impairment in realizable value. Any impairment loss is charged directly to the statement of income (see accounting policy on Impairment of Nonfinancial Assets).

Software costs

Software costs are capitalized on the basis of the cost incurred to acquire and bring to use the specific software. These costs are amortized over five years on a straight-line basis.

Costs associated with maintaining the computer software programs are recognized as expense when incurred.

Impairment of Property and Equipment, Investment Properties and Intangible Assets

At each reporting date, the Group assesses whether there is any indication that its nonfinancial assets may be impaired. When an indicator of impairment exists or when an annual impairment testing for an asset is required, the Group makes a formal estimate of recoverable amount. Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case the recoverable amount is assessed as part of the cash generating unit to which it belongs. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is charged to operations in the period in which it arises, unless the asset is carried at a revalued amount, in which case the impairment loss is charged to the revaluation increment of the said asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation and amortization, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the statement of income unless the asset is carried at a revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal, the depreciation and amortization expense is adjusted in future period to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining life.

Intangible assets with indefinite useful lives are tested for impairment annually as of December 31 either individually or at the cash generating unit level, as appropriate.

Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

(a) There is a change in contractual terms, other than a renewal or extension of the arrangement;
(b) A renewal option is exercised or extension granted, unless that term of the renewal or extension was initially included in the lease term;
(c) There is a change in the determination of whether fulfillment is dependent on a specified asset; or
(d) There is a substantial change to the asset.

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Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios (a), (c) or (d) above, and at the date of renewal or extension period for scenario (b).

Group as lessee
Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments and included in 'Property and equipment' account with the corresponding liability to the lessor included in 'Other liabilities' account. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to 'Interest expense'.

Capitalized leased assets are depreciated over the shorter of the estimated useful lives of the assets or the respective lease terms, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term.

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

Group as lessor
Finance leases, where the Group transfers substantially all the risks and benefits incidental to ownership of the leased item to the lessee, are included in the balance sheet under 'Loans and receivables' account. A lease receivable is recognized at an amount equivalent to the net investment (asset cost) in the lease. All income resulting from the receivable is included in 'Interest income' in the statement of income.

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

Retirement Benefits
The Group has a noncontributory defined benefit retirement plan.

The retirement cost of the Parent Company and certain subsidiaries is determined using the projected unit credit method. Under this method, the current service cost is the present value of retirement benefits payable in the future with respect to services rendered in the current period. The liability recognized in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by an independent actuary 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 rate on government bonds that have terms to maturity approximating the terms of the related retirement liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are credited to or charged against income when the net cumulative unrecognized actuarial gains and losses at the end of the previous period exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These excess gains or losses are recognized over the expected average remaining working lives of the employees participating in the plan.

Past-service costs, if any, are recognized immediately in the statement of income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortized on a straight-line basis over the vesting period.

The defined benefit asset or liability comprises the present value of the defined benefit obligation less past service costs not yet recognized and less the fair value of plan assets out of which the obligations are to be settled directly. The value of any asset is restricted to the sum of any past service cost not yet recognized and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

Provisions
Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of assets embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Group expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of income, net of any reimbursement. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an interest expense.

Contingent Liabilities and Contingent Assets
Contingent liabilities are not recognized in the financial statements but are disclosed unless the possibility of an outflow of assets embodying economic benefits is remote. Contingent assets are not recognized but are disclosed in the financial statements when an inflow of economic benefits is probable.

Income Taxes
Deferred tax is provided, using the balance sheet liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognized for all taxable temporary differences, including asset revaluations. Deferred tax assets are recognized for all deductible temporary differences, carryforward of unused tax credits from the excess of minimum corporate income tax (MCIT) over the regular corporate income tax (RCIT), and unused net operating loss carryover (NOLCO), to the extent that it is probable that sufficient taxable income will be available against which the deductible temporary differences and carryforward of unused tax credits from MCIT and unused NOLCO can be utilized. Deferred income tax, however, is not recognized on temporary differences that arise from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting income nor taxable income.

Deferred tax liabilities are not provided on non-taxable temporary differences associated with investments in domestic subsidiaries and an associate. With respect to investments in foreign subsidiaries and associates, deferred tax liabilities are recognized except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

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

Deferred tax assets and liabilities are measured at the tax rates that are applicable to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

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

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

Treasury Shares and Contracts on Own Shares
Own equity instruments which are acquired (treasury shares) are deducted from equity and accounted for at weighted average cost. No gain or loss is recognized in the statement of income on the purchase, sale, issue or cancellation of the Parent Company's own equity instruments.

Earnings Per Share
Basic earnings per share (EPS) is computed by dividing net income for the year attributable to common shareholders by the weighted average number of common shares outstanding during the year after giving retroactive effect to stock dividends declared and stock rights exercised during the year, if any.

Diluted EPS is calculated by dividing the aggregate of net income attributable to common shareholders and convertible preferred shareholders by the weighted average number of common shares outstanding during the year adjusted for the effects of dilutive convertible preferred shares.

Dividends on Common Shares
Dividends on common shares are recognized as a liability and deducted from equity when approved by the respective shareholders of the Parent Company and subsidiaries. Dividends for the year that are approved after the balance sheet date are dealt with as an event after the balance sheet date.

Subsequent Events
Any post-year-end event that provides additional information about the Group's position at the balance sheet date (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.

Segment Reporting
The Group's operating businesses are organized and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets.

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Fiduciary Activities

Assets and income arising from fiduciary activities together with related undertakings to return such assets to customers are excluded from the financial statements where the Parent Company acts in a fiduciary capacity such as nominee, trustee or agent.

Future Changes in Accounting Policies

The Group has not applied the following PFRS and Philippine Interpretations which are not yet effective for the year ended December 31, 2007:

Philippine Interpretation IFRIC 11, *PFRS 2 Group and Treasury Share Transactions (effective for annual periods beginning on or after March 1, 2007)*

This Interpretation requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme by the entity even if (a) the entity chooses or is required to buy those equity instruments (e.g., treasury shares) from another party, or (b) the shareholder(s) of the entity provide the equity instruments needed. It also provides guidance on how subsidiaries, in their separate financial statements, account for such schemes when their employees receive rights to the equity instruments of the parent. The Group currently does not have any stock option plan and therefore, does not expect this Interpretation to have significant impact on its financial statements.

Philippine Interpretation IFRIC 12, *Service Concession Arrangements (effective for annual periods beginning on or after January 1, 2008)*

This Interpretation covers contractual arrangements arising from private entities providing public services and is not relevant to the Group's current operations.

Philippine Interpretation IFRIC 14, *PAS 19, The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective for annual periods beginning on or after January 1, 2008)*

This Interpretation provides guidance on how to assess the limit in PAS 19, *Employee Benefits,* on the amount of the surplus that can be recognized as an asset, and how the pension assets or liability may be affected when there is a statutory or contractual minimum funding requirement. The Group will assess the impact of adoption when it applies Philippine Interpretation IFRIC 14 in 2008.

Philippine Interpretation IFRIC 13, *Customer Loyalty Programmes (effective for annual periods beginning on or after July 1, 2008)*

This Interpretation addresses the accounting by an entity that grants award credits to its customers. The Group will assess the impact of adoption when it applies Philippine Interpretation IFRIC 13 in 2008.

PFRS 8, *Operating Segments (effective for annual periods beginning on or after January 1, 2009)*

This PFRS adopts a management approach to reporting segment information. The information reported would be that which management uses internally for evaluating the performance of operating segments and allocating resources to those segments. Such information may be different from that reported in the balance sheet and statement of income and companies will need to provide explanations and reconciliations of the differences. PFRS 8 will replace PAS 14, *Segment Reporting* and is required to be adopted only by entities whose debt or equity instruments are publicly traded, or are in the process of filing with the SEC for purposes of issuing any class of instruments in a public market. The Group will assess the impact of the standard on its current manner of reporting segment information.

Amendment to PAS 1, *Presentation of Financial Statements - Amendment on Statement of Comprehensive Income, (effective for annual periods beginning on or after January 1, 2009)*

In accordance with the amendment to PAS 1, the statement of changes in equity shall include only transactions with owners, while all non-owner changes will be presented in equity as a single line with details included in a separate statement. Owners are defined as holders of instruments classified as equity.

The amendment to PAS 1 also provides for the introduction of a new statement of comprehensive income that combines all items of income and expense recognized in the statement of income and expenses together with 'other comprehensive income'. The revisions specify what is included in other comprehensive income, such as gains and losses on AFS investments, actuarial gains and losses on defined benefit pension plans and changes in the asset revaluation reserve. Entities can choose to present all items in one statement, or to present two linked statements, a separate statement of income and expenses and a statement of comprehensive income. The Group does not expect this amendment to have a significant impact on the financial statements.

PAS 23, *(Revised) Borrowing Cost (effective for annual periods beginning on or after January 1, 2009)*

The revised standard requires capitalization of borrowing costs that relate to a qualifying asset. The transitional requirements of the standard require it to be adopted as a prospective change from the effective date. The Group expects that this Standard will not have any significant impact on its financial statements.

4. Significant Accounting Judgments and Estimates

The preparation of the financial statements in accordance with PFRS requires the Group to make judgments and estimates that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingent assets and contingent liabilities. Future events may occur which will cause the assumptions used in arriving at the estimates to change. The effects of any change in estimates are reflected in the financial statements as they become reasonably determinable.

Judgments and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Judgments

(a) Operating leases

The Group has entered into commercial property leases on its investment property portfolio. The Group has determined that it retains all the significant risks and rewards of ownership of these properties which are leased out on operating lease basis.

(b) Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of liquidity and model inputs such as correlation and volatility for longer dated derivatives.

(c) HTM investments

The classification to HTM investment requires significant judgment. In making this judgment, the Group evaluates its intention and ability to hold such investments to maturity. If the Group fails to hold these investments to maturity other than in certain specific circumstances - for example, selling an insignificant amount close to maturity - it will be required to reclassify the entire portfolio as 'AFS investments'. The investments would therefore be measured at fair value and not at amortized cost.

(d) Financial assets not quoted in an active market

The Group classifies financial assets by evaluating, among others, whether the asset is quoted or not in an active market. Included in the evaluation on whether a financial asset is quoted in an active market is the determination on whether quoted prices are readily and regularly available, and whether those prices represent actual and regularly occurring market transactions on an arm's length basis.

Estimates

(a) Impairment losses on loans and receivables

The Group reviews its impaired loans and receivables at each reporting date to assess whether additional provision for credit losses should be recorded in the statement of income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of required allowance. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

In addition to specific allowance against individually significant loans and receivables, the Group also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This collective allowance takes into consideration any deterioration in the loan or investment rating from the time the account was granted or amended, and such other factors as any deterioration in country risk, industry, and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows and underlying property prices, among others.

As of December 31, 2007 and 2006, allowance for credit losses on loans and receivables amounted to ₱12.0 billion and ₱13.5 billion, respectively, for the Group and ₱11.7 billion and ₱13.3 billion, respectively, for the Parent Company. As of December 31, 2007 and 2006, loans and receivables are carried at ₱76.6 billion and ₱83.6 billion, respectively, for the Group and ₱73.2 billion and ₱81.5 billion, respectively, for the Parent Company (see Note 9).

(b) Fair values of structured debt instruments and derivatives

The fair values of structured debt instruments and derivatives that are not quoted in active markets are determined using valuation techniques. Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are reviewed before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices.

To the extent practicable, models use only observable data, however, areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments. Refer to Notes 6 and 30 for information on the fair values of these instruments.

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(c) *Valuation of unquoted equity investments*
Valuation of unquoted equity investments is normally based on one of the following:

- recent arm's length market transactions;
- current fair value of another instrument that is substantially the same;
- the expected cash flows discounted at current rates applicable for terms with similar terms and risk characteristics; or
- other valuation models.

The determination of the cash flows and discount factors for unquoted equity investments requires significant estimation. The Group reviews the valuation techniques periodically and tests them for validity using either prices from observable current market transactions in the same instrument or from other available observable market data. As of December 31, 2007 and 2006, unquoted equity instruments amounted to ₱322.1 million and ₱533.3 million, respectively, for the Group and ₱319.6 million and ₱530.8 million, respectively, for the Parent Company (see Note 11).

(d) *Impairment of AFS equity investments*
The Group treats AFS equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is 'significant' or 'prolonged' requires judgment. The Group treats 'significant' generally as 20.00% or more and 'prolonged' greater than 6 months. In addition, the Group evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for unquoted equities.

Refer to Note 11 for the information on the carrying amounts of these investments.

(e) *Recognition of deferred income taxes*
Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable income together with future tax planning strategies.

The Group's estimates of future taxable income indicate that certain temporary differences will be realized in the future. As discussed in Note 25, recognized net deferred tax assets as of December 31, 2007 and 2006 amounted to ₱1.8 billion for the Group and the Parent Company. Deferred tax assets on the temporary differences amounting to ₱8.9 billion and ₱9.3 billion for the Group and the Parent Company as of December 31, 2007 and 2006, respectively, were not recognized.

(f) *Present value of retirement obligation*
The cost of defined benefit pension plan and other post employment benefits is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty.

The expected rate of return on plan assets was based on the market prices prevailing on the date applicable to the period over which the obligation is to be settled. The assumed discount rates were determined using the market yields on Philippine government bonds with terms consistent with the expected employee benefit payout as of balance sheet dates. Refer to Note 23 for the details of assumption used in the calculation.

As of December 31, 2007 and 2006, the present value of the defined benefit obligation of the Parent Company amounted to ₱1.6 billion and ₱2.0 billion, respectively (see Note 23).

(g) *Impairment of property and equipment and investment properties*
The Group assesses impairment on assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The factors that the Group considers important which could trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of use of the acquired assets or the strategy for overall business; and
- significant negative industry or economic trends.

The Group recognizes an impairment loss whenever the carrying amount of an asset exceeds its recoverable amount. The recoverable amount is computed using the value in use approach. Recoverable amounts are estimated for individual assets.

As of December 31, 2007, the carrying value of the property and equipment and investment properties amounted to ₱16.5 billion and ₱24.8 billion, respectively, for the Group and ₱16.4 billion and ₱24.7 billion, respectively, for the Parent Company. As of December 31, 2006, the carrying value of the property and equipment and investment properties amounted to ₱16.6 billion and ₱24.9 billion, respectively, for the Group and ₱16.5 billion and ₱24.8 billion, respectively, for the Parent Company (see Notes 12 and 14).

(h) Estimated useful lives of property and equipment and investment properties
The Group estimates the useful lives of its property and equipment and investment properties. This estimate is reviewed periodically to ensure that the period of depreciation and amortization are consistent with the expected pattern of economic benefits from the items of property and equipment and investment properties.

As of December 31, 2007, the carrying value of depreciable property and equipment and investment properties amounted to ₱5.5 billion and ₱4.1 billion, respectively, for the Group and ₱5.4 billion and ₱4.1 billion, respectively, for the Parent Company. As of December 31, 2006, the carrying value of depreciable property and equipment and investment properties amounted to ₱5.6 billion and ₱6.6 billion, respectively, for the Group and ₱5.5 billion and ₱6.5 billion, respectively, for the Parent Company (see Notes 12 and 14).

5. Financial Risk Management Objectives and Policies

Introduction
A bank's ability to capture and measure risks on an enterprise wide basis, to monitor them on a regular basis, and to manage them is increasingly becoming a compelling factor, not only on a compliance basis, but where competitive advantage is concerned.

The Group's activities are principally related to the development, delivery, servicing and use of financial instruments. Risk is inherent in these activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability.

To ensure the long-term success of the Parent Company, and its subsidiaries and affiliates as a whole, and to assure growth, the Parent Company's risk management and risk controlling activities are directed at ensuring the careful handling and professional management of credit risks, market, liquidity and funding risks and operational risks.

Further, the Parent Company is also exposed to other types of risk such as technology risk, strategic and business risks, compliance risk and legal risk. These are correspondingly monitored by the Parent Company's Risk Management Group (RMG). Compliance risk is regularly managed and monitored by the Parent Company's Compliance Division.

The Group accepts deposits from customers at fixed rates, and for various periods, and seeks to earn above-average interest margins by investing these funds in high-quality assets. The Group seeks to optimize net interest margin by managing its sources and uses of funds according to interest rate, tenor and diversity.

The Group also seeks to raise its interest margins by obtaining above-average margins, net of allowances, through lending to commercial and retail borrowers with a range of credit standing. Such exposures involve not just on-balance sheet loans and advances. The Group also enters into guarantees and other commitments such as letters of credit (LCs) and performance and other bonds. Further, the Parent Company also engages in various structured transactions which are managed by the Business Development Sector in coordination with Credit Management and Treasury Sectors.

The Group trades in financial instruments where it takes positions in traded and over-the-counter instruments, including derivatives, and takes advantage of short-term market movements in equities and bonds and in currency and interest rate. The Group places trading limits on the level of exposure that can be taken in relation to both overnight and intra-day market positions.

Risk Management Functional Organization
The risk functional organization of the Parent Company must conform to the BSP regulations, that the risk management function must be independent of the business line.

The Parent Company adheres to the three primary functions involved in the risk management process in order to attain a system of "check and balance":

1. Risk-Taking Personnel (RTP) Function - initiates and takes the risks duly authorized by the BOD which includes personnel in the front office of treasury and lending.

2. Risk Management Function - assists the RTP and the back office (operations) in identifying, measuring, analyzing and managing risks. This function also performs the independent limits monitoring.

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3. Audit and Compliance Function - performs the day-today compliance check with the approved risk policies. This function is the task of the Internal Audit Group, Compliance Office and External Auditors.

The fulfillment of the risk management functions of the BOD is delegated to the Risk Management Committee (RMC), which is composed of five (5) directors. It is primarily responsible for the execution of the Enterprise Risk Management (ERM) framework. The RMC's main concerns include:

- Formulation of the risk policies, strategies, principles, framework and limits;
- Management of the fundamental risk issues and monitoring of relevant risk decisions;
- Providing support to management in implementing the risk policies and strategies; and
- Development of a risk awareness program.

Enterprise Risk Management Framework
The Parent Company's ERM framework revolves around the following eight (8) interrelated risk management approaches:

1. Internal Environment Scanning. The internal environment scanning involves the review of the overall prevailing risk framework to determine how risk is viewed and addressed by management, including risk management philosophy, risk appetite, integrity and ethical values.

2. Objective Setting. The BOD mandates management to set the overall annual target via the business planning activities. Enterprise risk management ensures that management has a process in place to set objectives and that the chosen objectives support and are aligned with the entity's mission and are consistent with its risk appetite.

3. Event Identification. Internal and external events affecting the achievement of the Parent Company's objectives are identified, distinguishing between risks and opportunities. Opportunities are channeled back to management's strategy or objective-setting processes.

4. Risk Assessment. Risks are analyzed, considering the likelihood (probability) and impact (severity) of potential loss, as a basis for determining how they should be managed. Under this approach, the Parent Company focuses on the Business Impact Analysis of major risks. Risks are assessed on an inherent and a residual basis and the process initially considers which risks are controllable, uncontrollable, requires immediate management's attention, or which risk shall materially weaken the Parent Company's earnings and capital.

5. Risk Response. Management has discretion to select risk appropriate responses to mitigate risk either to avoid, accept, reduce, transfer or share risk. Management, in coordination with RMC, establishes limits to align risks with the Parent Company's risk tolerances and risk appetite.

6. Control Activities. Policies and procedures are established and implemented to help ensure that the decided responses are uniformly and effectively carried out across the institution.

7. Information and Communication. Relevant information is identified, captured, and communicated in a form, substance and timeframe that enable all Parent Company personnel to carry out their responsibilities.

8. Monitoring. Under the ERM, the middle office (i.e., RMG, Internal Audit Group, and Compliance Office) constantly monitor the management of risk via risk limits, audit review, revalidation of risk strategies and compliance check, with modifications being made as necessary. Monitoring is accomplished through a continuous reporting system with the support of the Parent Company's Management Information System (MIS) Group.

Risk Management Group
The RMG, which reports to the RMC, is composed of the following:

i. Credit Risk Management Division
ii. Market Risk Management Division
iii. Operations Risk Management Division
iv. Information Security and Technology Risk Unit

The RMG is responsible for ensuring that management implements and maintains risk related procedures. It is also responsible for monitoring compliance with risk principles, policies and limits across the Parent Company. It is mandated to:

- identify, analyze and measure risks from the Parent Company's trading, position-taking, lending, borrowing and other risk taking activities;

- assist the risk-taking personnel in implementing risk reduction strategies; and
- analyze exposures and recommend limits.

Credit Risk

Credit risk is the non-recovery of credit exposures (on and off balance sheet exposures). Managing credit risk also involves monitoring of migration risk, concentration risk, country risk and settlement risk. The Parent Company manages its credit risk at various levels (i.e., strategic level, portfolio level down to individual transaction).

The credit risk management of the entire loan portfolio is under the direct oversight of the RMC. Credit risk management of individual borrower is performed by the business sector and remedial sector. Risk management is embedded in the entire credit process i.e. from credit origination to remedial management (if needed).

Among the tools used by the Parent Company in identifying, assessing and managing credit risk include:

- Documented credit policies and procedures: sound credit granting process, risk asset acceptance criteria, target market, approving authorities, and etc.;
- System for administration and monitoring of exposure;
- Portfolio management;
- Pre-approval review of loan proposals;
- Post approval review of implemented loans;
- Work out system for managing problem credits;
- Regular review of the sufficiency of valuation reserves;
- Monitoring of the adequacy of capital for credit risk via the capital adequacy ratio (CAR) report;
- Monitoring of breaches in regulatory and internal limits;
- Credit Risk Management Dashboard;
- Diversification; and
- Active loan portfolio management undertaken to identify the following:
    a. portfolio growth
    b. loss rate
    c. recovery rate
    d. trend of nonperforming loans (NPL)
    e. concentration risk (per classified account, per industry, clean exposure, large exposure, contingent exposure, demographic, etc)
    f. Internal Risk Rating System for corporate accounts
    g. Credit Scoring for retail accounts

The magnitude of key changes in the Parent Company has been quite comprehensive for the last five years under the new management. Continuous changes have been made in the policies, procedures, system and quality of people. The Parent Company has moved one step further by collecting data on risk rating of loan borrowers with an asset size of ₱15.0 million and above as initial requirement in the Parent Company's model for internal Probability of Default (PD) and Loss Given Default (LGD).

Credit-related commitments

The exposures represent guarantees, standby LCs issued by the Parent Company and documentary/commercial LCs which are written undertakings by the Parent Company. To mitigate this risk the Parent Company requires hard collaterals for standby LCs lines while commercial LCs are collateralized by the underlying shipments of goods to which they relate.

Excessive risk concentration

Credit risk concentrations can arise whenever a significant number of borrowers have similar characteristics. The Parent Company analyzes the credit risk concentration to an individual borrower, related group of accounts, industry, geographic, internal rating buckets, currency, term and security. For risk concentration monitoring purposes, the financial assets are broadly categorized into (1) loans and receivables and (2) trading and financial investment securities. To mitigate risk concentration, the Parent Company constantly checks for breaches in regulatory and internal limits.

Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the balance sheet.

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Credit risk exposures

The table below shows the gross maximum exposure to on- and off-balance sheet credit risk exposures (including derivatives) as of December 31, 2007 and 2006, without considering the effects of collateral, credit enhancements and other credit risk mitigation techniques:

	Consolidated		Parent Company	
	2007	2006	**2007**	2006
		(In Million Pesos)		
COCI and due from BSP (excluding cash on hand)	**₱28,020**	₱13,861	**₱28,017**	₱13,858
Due from other banks	**3,962**	3,556	**2,860**	2,314
Interbank loans receivable	**13,197**	22,413	**12,825**	22,093
SPURA	**11,200**	15,700	**11,200**	15,700
Financial assets at FVPL:				
Government securities	**1,963**	148	**1,963**	148
Derivative assets	**1,173**	961	**1,173**	961
Equity securities	**79**	29	**58**	–
	3,215	1,138	**3,194**	1,109
Loans and receivables (excluding unquoted debt securities)*:				
Business loans	**36,640**	32,013	**35,300**	30,631
GOCCs and NGAs	**11,304**	14,198	**11,304**	14,198
LGUs	**5,312**	4,668	**5,312**	4,667
Consumers	**3,954**	3,244	**3,719**	2,950
Fringe benefits	**859**	738	**859**	733
Others	**10,202**	9,211	**8,364**	8,766
	68,271	64,072	**64,858**	61,945
Receivables from SPV - net	**726**	1,361	**726**	1,361
Financial investments:				
Government securities	**32,756**	29,711	**32,075**	27,867
Other debt securities	**11,767**	13,801	**11,585**	13,575
Unquoted debt securities - net	**8,304**	19,520	**8,304**	19,520
Unquoted equity securities - net	**422**	533	**320**	531
Quoted equity securities - net	**322**	334	**344**	269
	53,571	63,899	**52,628**	61,762
	182,162	186,000	**176,308**	180,142
Commitments	**9,783**	10,049	**9,783**	10,049
	₱191,945	₱196,049	**₱186,091**	₱190,191

*The Group follows the BOD approved policy on the generic classification of loans based on the type of borrowers and the purpose of the loan.

a. Limit per Client or Counterparty

For loans and receivables, the Parent Company sets an internal limit for each individual borrower up to 5% of the qualifying capital (see Note 22). The limit to group exposure is 100% of the single borrower's limit (SBL) for loan accounts rated credit risk rating (CRR) 1 to CRR 5 or 50% of SBL if rated below CRR 5.

For trading and investment securities, the Parent Company limits investments to government issues and securities issued by entities with high-quality investment ratings.

b. Geographic Concentration

The Group's credit risk exposures, before taking into account any collateral held or other credit enhancements, are categorized by geographic location as follows:

	Consolidated		Parent Company	
	2007	2006	**2007**	2006
		(In Million Pesos)		
Philippines	**₱164,018**	₱166,779	**₱159,641**	₱162,867
Other European Union Countries	**14,681**	17,548	**14,308**	17,369
Asia (excluding the Philippines)	**6,717**	6,497	**6,715**	5,315
USA and Canada	**3,863**	1,195	**2,761**	1,051
United Kingdom	**2,666**	4,030	**2,666**	3,589
Total	**₱191,945**	₱196,049	**₱186,091**	₱190,191

c. Concentration by Industry
The tables below show the industry sector analysis of the Group and Parent Company's financial assets as of December 31, 2007 at gross amounts, before taking into account the fair value of the loan collateral held or other credit enhancements.

	Consolidated		
	December 31, 2007		
	Gross Maximum Exposure		Fair Market Value
	Amount	%	of Collateral
	(Amounts in Million Pesos)		
Loans and Receivables			
Primary target industry			
Manufacturing	₱9,621	12.16	₱9,581
Electricity, gas and water	9,613	12.15	13,052
Wholesale and retail	8,891	11.23	13,105
Agriculture, hunting and forestry	7,541	9.53	2,515
Financial intermediaries	6,112	7.72	13,840
Transport, storage and communications	4,959	6.27	3,074
Public administration and defense	2,444	3.09	1,371
Secondary target industry			
Real estate, renting and business activities	8,396	10.61	17,094
Construction	2,120	2.68	4,325
Others*	5,091	6.43	31,226
Other receivables	14,361	18.13	–
	₱79,149	100.00	₱109,183
Trading and Financial Investment Securities			
Government	₱37,492	66.02	₱–
Financial intermediaries	12,047	21.21	–
Manufacturing	5,290	9.32	–
Electricity, gas and water	823	1.45	–
Real estate, renting and business activities	255	0.45	–
Others	879	1.55	–
	₱56,786	100.00	₱–
Other Financial Assets			
Government	₱42,302	74.07	₱11,200
Financial intermediaries	14,077	24.65	–
Others	726	1.28	–
	₱57,105	100.00	₱11,200

	Consolidated		
	December 31, 2006		
	Gross Maximum Exposure		Fair Market Value
	Amount	%	of Collateral
	(Amounts in Million Pesos)		
Loans and Receivables			
Primary target industry			
Wholesale and retail	₱13,520	17.71	₱108,969
Manufacturing	8,943	11.72	9,251
Transport, storage and communications	7,299	9.56	3,991
Public administration and defense	5,192	6.80	2,425
Electricity, gas and water	5,071	6.64	2,590
Financial intermediaries	4,341	5.69	7,073
Agriculture, hunting and forestry	3,240	4.24	2,919
Secondary target industry			
Real estate, renting and business activities	6,299	8.25	9,358
Construction	2,400	3.14	4,571
Others*	5,883	7.71	15,797
Other receivables	14,144	18.54	–
	₱76,332	100.00	₱166,944

(Forward)

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	Consolidated December 31, 2006		
	Gross Maximum Exposure		Fair Market Value of Collateral
	Amount	%	
	(Amounts in Million Pesos)		
Trading and Financial Investment Securities			
Government	₱43,010	66.13	₱–
Financial intermediaries	13,654	20.99	–
Manufacturing	6,473	9.95	–
Electricity, gas and water	993	1.52	–
Real estate, renting and business activities	325	0.50	–
Others	582	0.91	–
	₱65,037	100.00	₱–
Other Financial Assets			
Government	₱34,333	59.57	₱15,700
Financial intermediaries	21,197	37.99	–
Others	1,361	2.44	–
	₱56,891	100.00	₱15,700

* *Others include the following sectors - Other community, social and personal services, private household, hotel and restaurant, education, mining and quarrying, and health and social work*

	Parent Company December 31, 2007		
	Gross Maximum Exposure		Fair Market Value of Collateral
	Amount	%	
	(Amounts in Million Pesos)		
Loans and Receivables			
Loans receivables			
Primary target industry			
Electricity, gas and water	₱9,613	12.76	₱13,052
Manufacturing	9,084	12.06	9,581
Wholesale and retail	8,680	11.52	13,105
Agriculture, hunting and forestry	7,518	9.98	2,515
Financial intermediaries	6,089	8.08	13,832
Transport, storage and communications	4,657	6.18	3,074
Public administration and defense	2,444	3.25	1,371
Secondary target industry			
Real estate, renting and business activities	8,387	11.14	17,094
Construction	2,111	2.80	4,325
Others*	4,275	5.68	31,045
Other receivables	12,457	16.55	–
	₱75,315	100.00	₱108,994
Trading and Financial Investment Securities			
Government	₱36,811	65.94	₱–
Financial intermediaries	11,996	21.49	–
Real estate, renting and business activities	5,290	9.48	–
Manufacturing	823	1.47	–
Electricity, gas and water	206	0.37	–
Others	696	1.25	–
	₱55,822	100.00	₱–
Other Financial Assets			
Government	₱42,300	76.04	₱11,200
Financial intermediaries	12,602	22.65	–
Others	726	1.31	–
	₱55,628	100.00	₱11,200

	Parent Company		
	December 31, 2006		
	Gross Maximum Exposure		Fair Market Value
	Amount	%	of Collateral
	(Amounts in Million Pesos)		
Loans and Receivables			
Loans receivable			
Primary target industry			
Wholesale and retail	₱13,336	18.05	₱108,969
Manufacturing	8,277	11.21	9,251
Transport, storage and communications	6,900	9.34	3,991
Public administration and defense	5,119	6.93	2,425
Electricity, gas and water	5,071	6.86	2,590
Financial intermediaries	4,820	6.53	7,073
Agriculture, hunting and forestry	2,872	3.89	2,919
Secondary target industry			
Real estate, renting and business activities	6,271	8.49	9,358
Construction	2,400	3.25	4,571
Others*	5,230	7.08	15,797
Other receivable	13,569	18.36	–
	₱73,865	100.00	₱166,944
Trading and Financial Investment Securities			
Government	₱41,166	65.48	₱–
Financial intermediaries	13,604	21.64	–
Manufacturing	6,444	10.25	–
Electricity, gas and water	993	1.58	–
Real estate, renting and business activities	308	0.49	–
Others	356	0.56	–
	₱62,871	100.00	₱–
Other Financial Assets			
Government	₱34,492	62.34	₱15,700
Financial intermediaries	19,473	35.20	–
Others	1,361	2.46	–
	₱55,326	100.00	₱15,700

* *Others include the following sectors – Other community, social and personal services, private household, hotel and restaurant, education, mining and quarrying, and health and social work*

The internal limit of the Parent Company is 12% for primary target industry, 10% for secondary market and 7% for non-target industry vs. total loan portfolio. As of December 31, 2007, the Parent Company does not have loan concentration risk to any particular industry.

Collateral and other credit enhancement

As a general rule, character is the single most important consideration in granting loans. However, collaterals are requested to mitigate risk. The loan value and type of collateral required depend on the assessment of the credit risk of the borrower or counterparty. The Parent Company follows guidelines on the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For corporate accounts - cash, guarantees, securities, physical collaterals (e.g. real estate, chattels, inventory, etc.); as a general rule, commercial, industrial and residential lots are preferred
- For retail lending - mortgages on residential properties and vehicles financed

The disposal of the foreclosed properties is handled by the Asset Management Sector which adheres to the general policy of disposing assets at the highest possible market value.

Management regularly monitors the market value of collateral and requests additional collateral in accordance with the underlying agreement. The existing market value of collateral is considered during the review of the adequacy of the allowance for credit losses.

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Credit quality per class of financial assets

The credit quality of financial assets is assessed and managed using external and internal ratings. For loan exposures, the credit quality is generally monitored using the 14-grade CRRS which is integrated in the credit process particularly in loan pricing and allocation of valuation reserves. The model on risk ratings is assessed and updated regularly.

Validation of the internal risk rating is conducted by the Credit Policy Division to maintain accurate and consistent risk ratings across the credit portfolio. The rating system has two parts, namely, the borrower's rating and the facility rating. It is supported by a variety of financial analytics, combined with an assessment of management and market information to provide the main inputs for the measurement of credit or counterparty risk.

The table below shows the Parent Company's loans receivables exposure per rating as of December 31, 2007.

	Moody's Equivalent grades	Unsecured share of exposure	Total
Risk rating class 1	High Grade	₱4,162	₱4,622
Risk rating class 2	High Grade	1,086	1,316
Risk rating class 3	High Grade	2,980	4,043
Risk rating class 4	High Grade	4,874	7,166
Risk rating class 5	Standard	1,205	1,380
Risk rating class 6	Standard	1,022	1,315
Risk rating class 7	Standard	4,866	5,452
Risk rating class 8	Standard	357	662
Risk rating class 9	Standard	180	572
Risk rating class 10	Standard	212	383
Risk rating class 11	Substandard	224	1,659
Risk rating class 12	Substandard	1,731	2,961
Risk rating class 13	Substandard	1,561	5,000
Risk rating class 14	Impaired	984	1,538
Total		25,444	38,069
Unrated		14,291	24,789
		₱39,735	₱62,858

The table below shows the credit quality by class of debt financial assets, excluding other receivables (gross of allowance for credit losses) of the Group as of December 31, 2007:

	Neither Past Due nor Individually Impaired				Past Due or Individually Impaired	Total
	High Grade	Standard Grade	Substandard Grade	Others		
			(In Million Pesos)			
COCI and due from BSP	₱27,962	₱–	₱–	₱52	₱–	₱28,014
Due from other banks	3,962	–	–	–	–	3,962
Interbank loans receivable	13,197	–	–	–	–	13,197
SPURA	11,200	–	–	–	–	11,200
Financial assets at FVPL:						
Derivative assets	63	1,110	–	–	–	1,173
Government securities	131	1,832	–	–	–	1,963
Loans receivables:						
Business loans	17,147	9,726	3,294	2,166	8,864	41,197
GOCCs and NGAs	–	–	–	9,772	1,671	11,443
LGUs	–	–	–	5,322	–	5,322
Consumers	–	–	–	5,458	458	5,916
Fringe benefits	–	–	–	858	52	910
Receivables from SPV	–	–	–	–	726	726
Financial investments:						
Quoted government debt securities	–	32,758	–	–	–	32,758
Other debt securities	10,910	855	–	–	–	11,765
Unquoted debt securities	–	1,684	2,741	–	5,460	9,885
Total	₱84,572	₱47,965	₱6,035	₱23,628	₱17,231	₱179,431

The 'Individually Impaired' category includes restructured loans receivables of the Parent Company, with the carrying amounts as of December 31, 2007 shown below. Of the ₱11 billion total impaired loans, 39% or ₱4.3 billion is restructured loans (in million pesos):

Business loans	₱4,277
Consumers	5
	₱4,282

The table below shows the aging analysis of past due but not impaired loans receivables per class that the Parent Company held as of December 31, 2007. Under PFRS 7, a financial asset is past due when a counterparty has failed to make a payment when contractually due.

	Less than 30 days	31 to 90 days	91 to 180 days	Total
		(In Million Pesos)		
Business loans	₱981	₱92	₱54	₱1,127
LGUs	63	–	36	99
Consumers	55	33	70	158
Fringe benefits	2	3	1	6
Total	₱1,101	₱128	₱161	₱1,390

Impairment Assessment

The Parent Company recognizes impairment losses based on the results of its specific (individual) and collective assessment of its credit exposures. Impairment has taken place when there is a presence of known difficulties in the payment of obligation by counterparties, a significant credit rating downgrade takes place, infringement of the original terms of the contract has happened, or when there is an inability to pay principal or interest overdue beyond a certain threshold (e.g., 90 days). These and other factors, either singly or in tandem with other factors, constitute observable events and/or data that meet the definition of an objective evidence of impairment.

The two methodologies applied by the Parent Company in assessing and measuring impairment include:

a. Specific (individual) assessment

   The Parent Company assesses each individually significant credit exposure or advances for any objective evidence of impairment.

   Among the items and factors considered by the Parent Company when assessing and measuring specific impairment allowances are:

   - the going concern of the borrower's business
   - the ability of the borrower to repay its obligations during financial crises
   - the projected receipts or expected cash flows
   - the availability of other sources of financial support
   - the existing realizable value of collateral
   - the timing of the expected cash flows

The impairment allowances, if any, are evaluated every quarter or as the need arises in view of favorable or unfavorable developments.

b. Collective assessment

   Allowances are assessed collectively for losses on loans and advances that are not individually significant (e.g. credit cards, housing loans, car loans, development incentives loans, fringe benefit loans) and for individually significant loans and advances where there is no apparent evidence of individual impairment. A particular portfolio is reviewed every quarter to determine its corresponding appropriate allowances.

   Impairment losses are estimated by taking into consideration the following information:

   - historical losses of the portfolio;
   - current adverse economic conditions that have direct impact on the portfolio;
   - losses which are likely to occur but has not yet occurred; and
   - expected receipts and recoveries once impaired.

See Note 16 for more detailed information with respect to the allowance for impairment losses on loans and advances to customers.

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Liquidity Risk and Funding Management

Liquidity risk is generally defined as the current and prospective risk to earnings or capital arising from the Parent Company's inability to meet its obligations when they come due without incurring unacceptable losses or costs.

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

Liquidity risk is monitored and controlled primarily by a gap analysis of maturities of relevant assets and liabilities reflected in the maximum cumulative outflow (MCO) report, as well as an analysis of available liquid assets. The MCO focuses on a 12-month period wherein the 12-month cumulative outflow is compared to the acceptable MCO limit set by the BOD. Furthermore, an internal liquidity ratio has been set to determine sufficiency of liquid assets over deposit liabilities.

Liquidity is monitored by the Parent Company on a daily basis and under assumed stressed situations. The table below shows the maturity profile of the Parent Company's liabilities as of December 31, 2007 based on the contractual undiscounted cash flows:

	2007					
	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	Beyond 1 year	Total
			(In Million Pesos)			
Deposit liabilities:						
Demand	₱19,952	₱–	₱–	₱–	₱–	₱19,952
Savings	112,606	11,048	3,493	1,922	8,227	137,296
Time	14,331	4,382	3,974	879	77	23,643
Bills and acceptances payable	970	36	353	–	2,115	3,474
Subordinated debt	–	–	–	–	8,416	8,416
Derivative liabilities	68	–	–	–	–	68
Accrued taxes, interest and expenses and other liabilities*	190	613	251	543	6,025	7,622
Total financial liabilities	₱148,117	₱16,079	₱8,071	₱3,344	₱24,860	₱200,471

* includes future interest payments of deposit liabilities, bills and acceptances payable and subordinated debt.

The table below shows the maturity profile of the Parent Company's liabilities based on its internal methodology that manages liquidity based on expected undiscounted cash flows, rather than contractual undiscounted cash flows:

	2006					
	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	Beyond 1 year	Total
			(In Million Pesos)			
Deposit liabilities:						
Demand	₱827	₱1,161	₱1,741	₱3,483	₱10,611	₱17,823
Savings	3,399	6,004	9,006	18,012	103,665	140,086
Time	5,304	4,615	6,843	9,062	–	25,824
Bills and acceptances payable	854	1	–	–	9,507	10,362
Subordinated debt	–	–	–	–	8,389	8,389
Accrued taxes, interest and expenses and other liabilities	10,730	771	130	1,091	3,184	15,906
Total financial liabilities	₱21,114	₱12,552	₱17,720	₱31,648	₱135,356	₱218,390

Further, the liquidity information for 2007 includes coupon cash flows categorized by contractual timing. Had the Parent Company's time buckets include "On Demand" financial liabilities that are demandable and due (such as the demand deposit liabilities), ₱20.0 billion as of December 31, 2007 would have to be presented separately under a category captioned "On Demand".

As of December 31, 2007, the Parent Company's combined contingent liabilities and commitments amounted to ₱9.8 billion.

<u>Market Risk</u>
Market risk is the risk to earnings or capital arising from adverse movements in factors that affect the market value of instruments, products, and transactions in an institutions' overall portfolio. Market risk arises from market making, dealing, and position taking in interest rate and foreign exchange markets. The succeeding sections provide discussion on the impact of market risk on the Parent Company's trading and structural portfolios.

Trading Market Risk
Trading market risk exists in the Parent Company as the values of its trading positions are sensitive to changes in market rates such as interest rates, foreign exchange rates and equity prices. The Parent Company is exposed to trading market risk in the course of market making as well as from taking advantage of market opportunities. The Parent Company adopts the parametric Value at Risk (VaR) methodology (with 99% confidence level and one to ten day holding period) to measure the Parent Company's trading market risk with volatilities based on historical data for a rolling one year period. VaR limits have been established annually and exposures against the VaR limits are monitored on a daily basis. The VaR figures are back tested against actual and hypothetical profit and loss to validate the robustness of the VaR model. To complement VaR measure, the Parent Company performs stress testing wherein the trading portfolios are valued under extreme market scenarios not covered by the confidence interval of the VaR model.

Objectives and Limitations of the VaR Methodology
The VaR models are designed to measure market risk in a normal market environment. The models assume that any changes occurring in the risk factors affecting the normal market environment will follow a normal distribution. The use of VaR has limitations because it is based on historical correlations and volatilities in market prices and assumes that future price movements will follow a statistical distribution. Due to the fact that VaR relies heavily on historical data to provide information and may not clearly predict the future changes and modifications of the risk factors, the probability of large market moves may be underestimated if changes in risk factors fail to align with the normal distribution assumption. VaR may also be under- or over- estimated due to the assumptions placed on risk factors and the relationship between such factors for specific instruments. Even though positions may change throughout the day, the VaR only represents the risk of the portfolios at the close of each business day, and it does not account for any losses that may occur beyond the 99.00% confidence level.

The VaR figures are back tested against actual and hypothetical profit and loss of the trading book to validate the robustness of the VaR model. Likewise, to complement VaR measure, the Parent Company performs stress tests wherein the trading portfolios are valued under extreme market scenarios not covered by the confidence interval of the Parent Company's VaR model.

VaR Assumptions/Parameters
VaR estimates the potential loss on the current portfolio assuming a specified time horizon and level of confidence at 99.00%. The use of a 99.00% confidence level means that, within a one day horizon, losses exceeding the VaR figure should occur, on average, not more than once every one hundred days.

Since VaR is an integral part of the Parent Company's market risk management, VaR limits have been established annually for all financial trading activities and exposures against the VaR limits are monitored on a daily basis. Limits are based on the tolerable risk appetite of the Parent Company.

There is no instance for the year ended December 31, 2007 that the aggregate daily losses were greater than the total VaR (amounts in million pesos).

	Foreign Exchange	Interest Rate	Equities Price	Total VaR
December 31, 2007	₱18.54	₱37.02	₱3.27	₱58.83
2007-Average Daily	14.60	91.35	4.04	105.95
2007-Highest	33.30	224.66	5.68	257.96
2007-Lowest	1.96	0.06	2.84	2.02

Note: The high and low of the total portfolio may not equal to the sum of the individual components as the high and lows of the individual portfolios may have occurred on different trading days.

The VaR for foreign exchange is the foreign exchange risk throughout the Parent Company. The Parent Company, when aggregating the foreign exchange VaR and interest VaR, does not consider the correlation effects between the two risks.

Equities trading was approved by the BOD and commenced in October 2007.

The Parent Company also dimensions the potential risk on AFS portfolio. As of December 31, 2007, VAR for the AFS portfolio amounted to ₱747.9 million for the 10 day horizon.

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Structural Market Risk

Interest Rate Risk

The Parent Company seeks to ensure that exposure to fluctuations in interest rates are kept within acceptable limits. Interest margins may increase as a result of such changes but may be reduced or may create losses in the event that unexpected movements arise.

Repricing mismatches will expose the Parent Company to interest rate risk. The Parent Company measures the sensitivity of its assets and liabilities to interest rate fluctuations by way of a "repricing gap" analysis using the repricing characteristics of its balance sheet positions tempered with approved assumptions. To evaluate earnings exposure, interest rate sensitive liabilities in each time band are subtracted from the corresponding interest rate assets to produce a "repricing gap" for that time band. The difference in the amount of assets and liabilities maturing or being repriced over a one year period would then give the Parent Company an indication of the extent to which it is exposed to the risk of potential changes in net interest income. A negative gap occurs when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. Vice versa, positive gap occurs when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities.

During a period of rising interest rates, a company with a positive gap is better positioned because the company's assets are refinanced at increasingly higher interest rates increasing the net interest margin of the company over time. During a period of falling interest rates, a company with a positive gap would show assets repricing at a faster rate than one with a negative gap, which may restrain the growth of its net income or result in a decline in net interest income.

For risk management purposes, the repricing gap covering the one year period is multiplied by an assumed change in interest rates to yield an approximation of the change in net interest income that would result from such an interest rate movement. The Parent Company's BOD sets a limit on the level of earnings at risk (EaR) exposure tolerable to the Parent Company. Compliance to the EaR limit is monitored monthly by the RMG.

The following table sets forth the repricing gap position of the Parent Company as of December 31, 2007 and 2006:

	2007					
	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	Beyond 1year	Total
				(In Million Pesos)		
Financial Assets						
COCI	₱–	₱–	₱–	₱–	₱4,732	₱4,732
Placements with the BSP and other banks	13,458	6,880	8,083	2,400	–	30,821
Interbank loans receivable	12,825	–	–	–	–	12,825
SPURA	11,200	–	–	–	–	11,200
Financial assets at FVPL						
Derivative assets	–	–	–	–	1,173	1,173
Government securities	–	–	–	–	1,963	1,963
Loans receivables	19,284	24,379	3,740	3,711	11,744	62,858
Unquoted debt securities	1	1	2	16	9,865	9,885
Receivables from SPV	–	726	–	–	–	726
AFS investments	4,773	4,784	972	725	32,707	43,961
HTM investments	179	–	–	184	–	363
Total financial assets	61,720	36,770	12,797	7,036	62,184	180,507
Financial Liabilities						
Deposit liabilities:						
Demand	–	–	–	–	19,952	19,952
Savings	51,973	7,692	3,459	1,925	72,246	137,295
Time	14,261	4,474	3,841	1,066	1	23,643
Bills and acceptances payable	1,436	–	351	–	1,687	3,474
Subordinated debt	–	–	–	–	8,416	8,416
Other liabilities	320	260	21	–	1,446	2,047
Total financial liabilities	67,990	12,426	7,672	2,991	103,748	194,827
Repricing gap	(₱6,270)	₱24,344	₱5,125	₱4,045	(₱41,564)	(₱14,320)
Cumulative gap	(6,270)	18,074	23,199	27,244	(14,320)	

Note: Non-interest bearing financial assets and liabilities are lumped in greater than 1 year bucket.

	2006					
	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	Beyond 1 year	Total
	(In Million Pesos)					
Financial Assets						
COCI	₱–	₱–	₱–	₱–	₱4,754	₱4,754
Placements with the BSP and other banks	14,591	–	–	–	290	14,881
Interbank loans receivable	22,094	–	–	–	–	22,094
SPURA	15,700	–	–	–	–	15,700
Financial assets at FVPL:						
Derivative assets	961	–	–	–	–	961
Government securities	148	–	–	–	–	148
Loans and receivables	16,456	23,894	3,591	2,946	13,276	60,163
Unquoted debt securities	11,208	323	–	–	9,771	21,302
Receivables from SPV	–	–	–	–	1,361	1,361
AFS investments	7,232	10,991	1,536	2,892	18,171	40,822
HTM investments	–	269	–	–	1,151	1,420
Total financial assets	88,390	35,477	5,127	5,838	48,774	183,606
Financial Liabilities						
Deposit liabilities:						
Demand	₱–	₱–	₱–	₱–	₱17,823	₱17,823
Savings	41,162	11,306	8,211	10,746	68,661	140,086
Time	14,304	4,824	2,677	4,006	13	25,824
Bills and acceptances payable	7,502	–	–	–	2,860	10,362
Subordinated debt	–	–	–	–	8,389	8,389
Other liabilities	11,182	771	104	47	–	12,104
Total financial liabilities	74,150	16,901	10,992	14,799	97,746	214,588
Repricing Gap	₱14,240	₱18,576	(₱5,865)	(₱8,961)	(₱48,972)	(₱30,982)
Cumulative Gap	14,240	32,816	26,951	17,990	(30,982)	

Note: Non-interest bearing financial assets and liabilities are lumped in greater than 1 year bucket.

The following table sets forth, the impact of changes in interest rates on the Parent Company's non-consolidated net interest income for the year ended December 31, 2007:

	2007			
Changes in interest rates (in basis points)	(50)	(100)	50	100
Change on annualized net interest income[1]	(110)	(291)	110	291

[1] In ₱ millions

If interest rates increased by 100 basis points (given the repricing position of the assets and liabilities of the Parent Company as of December 31, 2007), the Parent Company would expect annualized non-consolidated net interest income to increase by ₱291 million. If interest rates decreased by 100 basis points, the annualized non-consolidated net interest income would decrease by ₱291 million. This EaR computation is accomplished monthly, with a quarterly stress test.

As one of the long-term goals in the risk management process, the Parent Company has set the adoption of the economic value approach in measuring the interest rate risk in the Banking book to complement the earnings approach currently used.

Foreign Currency Risk

Foreign exchange is the risk to earnings or capital arising from changes in foreign exchange rates. The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial and cash flows.

Foreign currency liabilities generally consist of foreign currency deposits in the Parent Company's FCDU books, accounts made in the Philippines or which are generated from remittances to the Philippines by Filipino expatriates and overseas Filipino workers who retain for their own benefit or for the benefit of a third party, foreign currency deposit accounts with the Parent Company and foreign currency-denominated borrowings appearing in the regular books of the Parent Company.

Foreign currency deposits are generally used to fund the Parent Company's foreign currency-denominated loan and investment portfolio in the FCDU. Banks are required by the BSP to match the foreign currency liabilities with the foreign currency assets held through FCDUs. In addition, the BSP requires a 30.00% liquidity reserve on all foreign currency liabilities held through FCDUs. Outside the FCDU, the Parent Company has additional foreign currency assets and liabilities in its foreign branch network.

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The Group's policy is to maintain foreign currency exposure within acceptable limits and within existing regulatory guidelines. The Group believes that its profile of foreign currency exposure on its assets and liabilities is within conservative limits for a financial institution engaged in the type of business in which the Group is involved.

The table below summarizes the Group's exposure to foreign exchange rate risk as of December 31, 2007 and 2006. Included in the table are the Group's assets and liabilities at carrying amounts (in million pesos), categorized by currency.

	Consolidated					
	2007			2006		
	USD	Others	Total	USD	Others	Total
Assets						
COCI and due from BSP	₱761	₱146	₱907	₱981	₱105	₱1,086
Due from other banks	1,325	1,105	2,430	1,779	687	2,466
Interbank loans receivable and SPURA	8,807	542	9,349	18,506	410	18,916
Loans and receivables	10,229	21	10,250	10,010	34	10,044
Financial assets at FVPL	63	–	63	108	–	108
AFS investments	24,270	160	24,430	24,953	182	25,135
HTM investments	310	–	310	1,484	–	1,484
Other assets	3,093	42	3,135	3,829	4	3,833
Total assets	48,858	2,016	50,874	61,650	1,422	63,072
Liabilities						
Deposit liabilities	37,556	776	38,332	42,737	783	43,520
Bills and acceptances payable	2,159	10	2,169	3,059	–	3,059
Accrued taxes, interest and other expenses	108	1	109	105	1	106
Other liabilities	4,000	473	4,473	5,727	581	6,308
Total liabilities	43,823	1,260	45,083	51,628	1,365	52,993
Net exposure	₱5,035	₱756	₱5,791	₱10,022	₱57	₱10,079

	Parent Company					
	2007			2006		
	USD	Others	Total	USD	Others	Total
Assets						
COCI and due from BSP	₱761	₱146	₱907	₱981	₱105	₱1,086
Due from other banks	1,709	1,105	2,814	1,760	707	2,467
Interbank loans receivable and SPURA	8,807	542	9,349	18,506	410	18,916
Loans and receivables	10,229	21	10,250	10,010	34	10,044
Financial assets at FVPL	63	–	63	–	–	–
AFS investments	24,270	160	24,430	24,953	182	25,135
HTM investments	310	–	310	1,484	–	1,484
Other assets	3,073	42	3,115	3,910	4	3,914
Total assets	49,222	2,016	51,238	61,604	1,442	63,046
Liabilities						
Deposit liabilities	37,556	776	38,332	42,737	783	43,520
Bills and acceptances payable	2,159	10	2,169	3,059	–	3,059
Accrued taxes, interest and other expenses	108	1	109	105	1	106
Other liabilities	4,000	473	4,473	5,727	581	6,308
Total liabilities	43,823	1,260	45,082	51,628	1,365	52,993
Net exposure	₱5,399	₱756	₱6,156	₱9,976	₱77	₱10,053

Information relating to the Parent Company's currency derivatives is contained in Note 30. The Parent Company has outstanding foreign currency spot transactions (in equivalent peso amounts) of ₱0.8 billion (sold) and ₱0.2 billion (bought) as of December 31, 2007 and ₱1.3 billion (sold) and ₱0.9 billion (bought) as of December 31, 2006.

Prepayment Risk

Prepayment risk is the risk that the Parent Company will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall. The Parent Company has exposures in consumer loans e.g., housing loans, motor vehicles. These activities generate market risk since these loan products are inherently sensitive to changes in the level of market interest rates. Based on historical data from 2005 to 2007, prepayment received by the Parent Company is less than 1.00% of the total housing loan and motor vehicle loan portfolio.

6. Financial Instruments and Fair Value Measurement

Shown below are the assets and liabilities of the Group and of the Parent Company as they appear in the balance sheets, which are divided into financial and non-financial items, with the financial items being mapped to the categories of financial instruments under PAS 39.

	Consolidated						
	2007						
	Financial instruments						
	Fair Value Through Profit or Loss	Held-to-Maturity Investments	Loans and Receivables	Available-for-Sale Investments	Other Financial Liabilities	Other Non-financial Items	Total
	(In Thousand Pesos)						
ASSETS							
Cash and other cash items	₱–	₱–	₱4,773,212	₱–	₱–	₱–	₱4,773,212
Due from BSP	–	–	27,961,521	–	–	–	27,961,521
Due from other banks	–	–	3,962,000	–	–	–	3,962,000
Interbank loans receivable	–	–	13,197,201	–	–	–	13,197,201
SPURA	–	–	11,200,000	–	–	–	11,200,000
Financial assets at FVPL	3,215,235	–	–	–	–	–	3,215,235
Loans and receivables	–	–	76,575,031	–	–	–	76,575,031
Receivable from SPV	–	–	726,095	–	–	–	726,095
AFS investments	–	–	–	44,821,522	–	–	44,821,522
HTM investments	–	446,054	–	–	–	–	446,054
Property and equipment	–	–	–	–	–	16,503,679	16,503,679
Investments in subsidiaries and an associate	–	–	–	–	–	665,123	665,123
Investment Properties	–	–	–	–	–	24,799,602	24,799,602
Deferred tax assets	–	–	–	–	–	1,857,109	1,857,109
Other assets	–	–	–	–	–	9,001,656	9,001,656
Total Assets	₱3,215,235	₱446,054	₱138,395,060	₱44,821,522	₱–	₱52,827,169	₱239,705,040
LIABILITIES							
Deposit liabilities	₱–	₱–	₱–	₱–	₱178,811,969	₱–	₱178,811,969
Bills and acceptances payable	–	–	–	–	4,299,094	–	4,299,094
Accrued taxes, interest and other expenses	–	–	–	–	2,053,372	2,221,542	4,274,914
Subordinated debt	–	–	–	–	8,416,424	–	8,416,424
Other liabilities	67,612	–	–	–	10,323,541	3,282,368	13,673,521
Total Liabilities	₱67,612	₱–	₱–	₱–	₱203,904,400	₱5,503,910	₱209,475,922

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NOTES TO FINANCIAL STATEMENTS

	Parent Company						
	2007						
	Financial instruments						
	Fair Value Through Profit or Loss	Held-to-Maturity Investments	Loans and Receivables	Available-for-Sale Investments	Other Financial Liabilities	Other Non-financial Items	Total
	(In Thousand Pesos)						
ASSETS							
Cash and other cash items	₱–	₱–	₱4,732,004	₱–	₱–	₱–	₱4,732,004
Due from BSP	–	–	27,961,521	–	–	–	27,961,521
Due from other banks	–	–	2,859,908	–	–	–	2,859,908
Interbank loans receivable	–	–	12,824,611	–	–	–	12,824,611
SPURA	–	–	11,200,000	–	–	–	11,200,000
Financial assets at FVPL	3,194,086	–	–	–	–	–	3,194,086
Loans and receivables	–	–	73,162,024	–	–	–	73,162,024
Receivable from SPV	–	–	726,095	–	–	–	726,095
AFS investments	–	–	–	43,961,027	–	–	43,961,027
HTM investments	–	362,795	–	–	–	–	362,795
Property and equipment	–	–	–	–	–	16,396,382	16,396,382
Investments in subsidiaries and an associate	–	–	–	–	–	5,381,139	5,381,139
Investment properties	–	–	–	–	–	24,723,885	24,723,885
Deferred tax assets	–	–	–	–	–	1,798,662	1,798,662
Other assets	–	–	–	–	–	8,842,847	8,842,847
Total Assets	₱3,194,086	₱362,795	₱133,466,163	₱43,961,027	₱–	₱57,142,915	₱238,126,986
LIABILITIES							
Deposit liabilities	₱–	₱–	₱–	₱–	P180,890,673	₱–	₱180,890,673
Bills and acceptances payable	–	–	–	–	3,474,448	–	3,474,448
Accrued taxes, interest and other expenses	–	–	–	–	2,046,474	2,119,691	4,166,165
Subordinated debt	–	–	–	–	8,416,424	–	8,416,424
Other liabilities	67,612	–	–	–	10,163,426	1,729,217	11,960,255
Total Liabilities	₱67,612	₱–	₱–	₱–	P204,991,445	₱3,848,908	₱208,907,965

	Consolidated						
	2006						
	Financial instruments						
	Fair Value Through Profit or Loss	Held-to-Maturity Investments	Loans and Receivables	Available-for-Sale Investments	Other Financial Liabilities	Other Non-financial Items	Total
	(In Thousand Pesos)						
ASSETS							
Cash and other cash items	₱–	₱–	₱4,820,155	₱–	₱–	₱–	₱4,820,155
Due from BSP	–	–	12,566,759	–	–	–	12,566,759
Due from other banks	–	–	3,555,603	–	–	–	3,555,603
Interbank loans receivable	–	–	22,412,817	–	–	–	22,412,817
SPURA	–	–	15,700,000	–	–	–	15,700,000
Financial assets at FVPL	1,137,835	–	–	–	–	–	1,137,835
Loans and receivables	–	–	83,592,219	–	–	–	83,592,219
Receivable from SPV	–	–	1,361,074	–	–	–	1,361,074
AFS investments	–	–	–	42,824,810	–	–	42,824,810
HTM investments	–	1,554,368	–	–	–	–	1,554,368
Property and equipment	–	–	–	–	–	16,577,000	16,577,000
Investments in subsidiaries and an associate	–	–	–	–	–	801,838	801,838
Investment properties	–	–	–	–	–	24,882,076	24,882,076
Deferred tax assets	–	–	–	–	–	1,847,258	1,847,258
Other assets	–	–	–	–	–	9,837,253	9,837,253
Total Assets	₱1,137,835	₱1,554,368	₱144,008,627	₱42,824,810	₱–	₱53,945,425	₱243,471,065

(Forward)

	Consolidated						
	2006						
	Financial instruments						
	Fair Value Through Profit or Loss	Held-to-Maturity Investments	Loans and Receivables	Available-for-Sale Investments	Other Financial Liabilities	Other Non-financial Items	Total
	(In Thousand Pesos)						
LIABILITIES							
Deposit liabilities	₱–	₱–	₱–	₱–	P181,667,692	₱–	₱181,667,692
Bills and acceptances payable	–	–	–	–	10,955,948	–	10,955,948
Accrued taxes, interest and other expenses	–	–	–	–	2,575,054	2,324,373	4,899,427
Subordinated debt	–	–	–	–	8,389,297	–	8,389,297
Other liabilities	6,633	–	–	–	10,167,060	2,628,733	12,802,426
Total Liabilities	₱6,633	₱–	₱–	₱–	₱213,755,051	₱4,953,106	₱218,714,790

	Parent Company						
	2006						
	Financial instruments						
	Fair Value Through Profit or Loss	Held-to-Maturity Investments	Loans and Receivables	Available-for-Sale Investments	Other Financial Liabilities	Other Non-financial Items	Total
	(In Thousand Pesos)						
ASSETS							
Cash and other cash items	₱–	₱–	₱4,753,539	₱–	₱–	₱–	₱4,753,539
Due from BSP	–	–	12,566,759	–	–	–	12,566,759
Due from other banks	–	–	2,314,288	–	–	–	2,314,288
Interbank loans receivable	–	–	22,093,537	–	–	–	22,093,537
SPURA	–	–	P15,700,000	–	–	–	P15,700,000
Financial assets at FVPL	1,109,137	–	–	–	–	–	1,109,137
Loans and receivables	–	–	81,465,282	–	–	–	81,465,282
Receivable from SPV	–	–	1,361,074	–	–	–	1,361,074
AFS investments	–	–	–	40,822,339	–	–	40,822,339
HTM investments	–	1,420,044	–	–	–	–	1,420,044
Property and equipment	–	–	–	–	–	16,510,735	16,510,735
Investments in subsidiaries and an associate	–	–	–	–	–	5,439,520	5,439,520
Investment properties	–	–	–	–	–	24,803,748	24,803,748
Deferred tax assets	–	–	–	–	–	1,794,291	1,794,291
Other assets	–	–	–	–	–	9,499,902	9,499,902
Total Assets	₱1,109,137	₱1,420,044	₱140,254,479	₱40,822,339	₱–	₱58,048,196	₱241,654,195
LIABILITIES							
Deposit liabilities	₱–	₱–	₱–	₱–	₱183,732,964	₱–	₱183,732,964
Bills and acceptances payable	–	–	–	–	10,361,715	–	10,361,715
Accrued taxes, interest and other expenses	–	–	–	–	2,579,782	2,244,029	4,823,811
Subordinated debt	–	–	–	–	8,389,297	–	8,389,297
Other liabilities	6,633	–	–	–	9,517,601	1,557,603	11,081,837
Total Liabilities	₱6,633	₱–	₱–	₱–	₱214,581,359	₱3,801,632	₱218,389,624

The methods and assumptions used by the Group in estimating the fair value of the financial instruments are:

Cash equivalents and short-term investments - Carrying amounts approximate fair values due to the relatively short-term maturity of these investments.

Debt securities - Fair values are generally based upon quoted market prices. If the market prices are not readily available, fair values are estimated using either values obtained from independent parties offering pricing services or adjusted quoted market prices of comparable investments or using the discounted cash flow methodology.

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Quoted equity securities - Fair values are based on quoted prices published in markets.

Unquoted equity securities - Fair values could not be reliably determined due to the unpredictable nature of future cash flows and the lack of suitable methods of arriving at a reliable fair value.

Loans and receivables - For loans with fixed interest rates, fair values are estimated by discounted cash flow methodology, using the Group's lending rates for similar types of loans. For loans with floating interest rates, with repricing frequencies on a regular basis, the Group assumes that the carrying amount approximates fair value. Where the repricing frequency is beyond three months, the fair value of floating rate loans is determined using the discounted cash flow methodologies.

Liabilities - Fair values of quoted debt instruments are based on quotes obtained from an independent pricing service. For unquoted instruments, fair values are estimated using the discounted cash flow methodology using the Group's current incremental borrowing rates for similar borrowings with maturities consistent with those remaining for the liability being valued. Except for subordinated notes, the carrying values approximate fair values due to either the presence of a demand feature or the relatively short-term maturities of these liabilities.

Derivative instruments - Fair values are estimated based on quoted market prices, prices provided by independent parties or acceptable valuation models.

The following tables summarize the carrying amounts and fair values of the financial assets and liabilities as of December 31, 2007:

	Consolidated					
		Fair Market Value				
	Carrying Value	Quoted Market Price	Valuation Technique (Market Observable)	Valuation Technique (Market Non-observable)	Cost	Total
			(In Thousand Pesos)			
Financial Assets						
COCI and due from BSP	₱32,734,733	₱–	₱–	₱–	₱32,734,733	₱32,734,733
Due from other banks	3,962,000	–	–	–	3,962,000	3,962,000
Interbank loans receivable	13,197,201	–	–	–	13,197,201	13,197,201
Securities held under agreements to resell	11,200,000	–	–	–	11,200,000	11,200,000
Financial assets at FVPL:						
Government securities	1,963,207	1,963,207	–	–	–	1,963,207
Derivative assets	1,173,297	–	1,173,297	–	–	1,173,297
Equity securities	78,731	78,731	–	–	–	78,731
Loans and receivables:						
Business loans	36,640,171	–	–	8,754,979	28,309,746	37,064,725
GOCCs and NGAs	11,303,641	–	–	241,187	11,050,631	11,291,818
LGUs	5,312,104	–	–	8,360	5,304,512	5,312,872
Unquoted debt securities	8,304,396			4,806,436	4,239,219	9,045,655
Consumers	3,954,387	–	–	1,163,745	2,887,254	4,050,999
Fringe benefits	858,573	–	–	760,202	98,371	858,573
Others	10,201,759	–	–	2,393,289	8,253,429	10,646,718
Receivables from SPV	726,095	–	–	–	726,095	726,095
AFS investments:						
Government securities	32,310,169	32,190,796	–	119,373	–	32,310,169
Other debt securities	11,767,435	438,132	9,172,819	2,156,484	–	11,767,435
Equity securities	743,918	421,787	–	–	322,130	743,917
HTM investments:						
Government securities	446,054	450,433	–	–	–	450,433

(Forward)

	Consolidated					
		Fair Market Value				
	Carrying Value	Quoted Market Price	Valuation Technique (Market Observable)	Valuation Technique (Market Non-observable)	Cost	Total
			(In Thousand Pesos)			
Financial Liabilities						
Deposit liabilities:						
Demand	₱20,167,642	₱–	₱–	₱–	₱20,167,642	₱20,167,642
Savings	137,315,472	–	–	–	137,315,472	137,315,472
Time	21,328,855	–	–	–	21,328,855	21,328,855
Bills and acceptances payable:						
BSP and local bank	2,456,145	–	–	–	2,456,145	2,456,145
Foreign banks	1,002,912	–	–	–	1,002,912	1,002,912
PDIC and others	420,530	–	–	–	420,530	420,530
Acceptances outstanding	419,507	–	–	–	419,507	419,507
Subordinated debt	8,416,424	–	–	9,265,602	–	9,265,602
Accrued interest payable	2,053,372	–	–	–	2,053,372	2,053,372
Other liabilities	10,391,153	–	67,612	–	10,323,541	10,391,153

	Parent Company					
		Fair Market Value				
	Carrying Value	Quoted Market Price	Valuation Technique (Market Observable)	Valuation Technique (Market Non-observable)	Cost	Total
			(In Thousand Pesos)			
Financial Assets						
COCI and due from BSP	₱32,693,525	₱–	₱–	₱–	₱32,693,525	₱32,693,525
Due from other banks	2,859,908	–	–	–	2,859,908	2,859,908
Interbank loans receivable	12,824,611	–	–	–	12,824,611	12,824,611
Securities held under agreements to resell	11,200,000	–	–	–	11,200,000	11,200,000
Financial assets at FVPL:						
Government securities	1,963,207	1,963,207	–	–	–	1,963,207
Derivative assets	1,173,297	–	1,173,297	–	–	1,173,297
Equity securities	57,582	57,582	–	–	–	57,582
Loans and receivables:						
Business loans	35,299,961	–	–	8,754,979	27,112,334	35,867,313
GOCCs and NGAs	11,303,641	–	–	241,187	11,050,631	11,291,818
LGUs	5,312,104	–	–	8,360	5,304,512	5,312,872
Unquoted debt securities	8,304,396			4,806,436	4,239,219	9,045,665
Consumers	3,719,148	–	–	1,028,834	2,711,378	3,740,212
Fringe benefits	858,573	–	–	760,202	98,371	858,573
Others	8,364,201	–	–	2,393,289	6,349,876	8,743,165
Receivables from SPV	726,095	–	–	–	726,095	726,095
AFS investments:						
Government securities	31,712,872	31,714,279	–	–	–	31,714,279
Other debt securities	11,584,565	256,233	9,169,641	2,156,484	–	11,582,358
Equity securities	664,390	344,760	–	–	319,630	664,390
HTM investments:						
Government securities	362,795	366,581	–	–	–	366,851

(Forward)

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	Parent Company					
		Fair Market Value				
	Carrying Value	Quoted Market Price	Valuation Technique (Market Observable)	Valuation Technique (Market Non-observable)	Cost	Total
	(In Thousand Pesos)					
Financial Liabilities						
Deposit liabilities:						
Demand	₱19,952,002	₱–	₱–	₱–	₱19,952,002	₱19,952,002
Savings	137,295,678	–	–	–	137,295,678	137,295,678
Time	23,642,993	–	–	–	23,642,993	23,642,993
Bills and acceptances payable:						
BSP and local bank	1,748,311	–	–	–	1,748,311	1,748,311
Foreign banks	768,099	–	–	–	768,099	768,099
PDIC and others	538,531	–	–	–	538,531	538,531
Acceptances outstanding	419,507	–	–	–	419,507	419,507
Subordinated debt	8,416,424	–	–	9,265,607	–	9,265,607
Accrued interest payable	2,046,474	–	–	–	2,046,474	2,046,474
Other liabilities	10,231,038	–	67,612	–	10,163,426	10,231,038

The following tables summarize the carrying amounts and fair values of the financial assets and liabilities as of December 31, 2006:

	Consolidated					
		Fair Market Value				
	Carrying Value	Quoted Market Price	Valuation Technique (Market Observable)	Valuation Technique (Market Non-observable)	Cost	Total
	(In Thousand Pesos)					
Financial Assets						
COCI and due from BSP	₱17,386,914	₱–	₱–	₱–	₱17,386,914	₱17,386,914
Due from other banks	3,555,603	–	–	–	3,555,603	3,555,603
Interbank loans receivable	22,412,817	–	–	–	22,412,817	22,412,817
Securities held under agreements to resell	15,700,000	–	–	–	15,700,000	15,700,000
Financial assets at FVPL:						
Derivative assets	961,067	–	961,067	–	–	961,067
Government securities	148,070	148,070	–	–	–	148,070
Equity securities	28,698	28,698	–	–	–	28,698
Loans and receivables:						
Business loans	32,013,423	–	–	7,815,571	23,704,956	31,520,527
GOCCs and NGAs	14,198,097	–	–	2,019	14,195,837	14,197,856
LGUs	4,667,479	–	–	–	4,667,479	4,667,479
Consumers	3,244,321	–	–	908,407	2,486,521	3,394,928
Fringe benefits	738,049	–	–	426,702	90,264	516,966
Unquoted debt securities	19,519,655			3,967,563	15,534,780	19,502,343
Others	9,211,195	–	–	–	9,211,195	9,211,195
Receivables from SPV	1,361,074	–	–	–	1,361,074	1,361,074
AFS investments:						
Government securities	28,225,866	26,422,845	–	1,803,021	–	28,225,866
Other debt securities	13,732,557	5,125,262	8,407,413	199,882	–	13,732,557
Equity securities	866,387	333,125	–	–	533,262	866,387
HTM investments:						
Government securities	1,485,616	1,692,927	–	–	–	1,692,927
Other debt securities	68,752	26,317	–	–	–	26,317

(Forward)

	Consolidated					
		Fair Market Value				
	Carrying Value	Quoted Market Price	Valuation Technique (Market Observable)	Valuation Technique (Market Non-observable)	Cost	Total
			(In Thousand Pesos)			
Financial Liabilities						
Deposit liabilities:						
Demand	₱17,867,651	₱–	₱–	₱–	₱17,867,651	₱17,867,651
Savings	140,233,120	–	–	–	140,233,120	140,233,120
Time	23,566,921	–	–	–	23,566,921	23,566,921
Bills and acceptances payable:						
BSP and local bank	2,571,515	–	–	–	2,571,515	2,571,515
Foreign banks	1,425,893	–	–	–	1,425,893	1,425,893
PDIC and others	6,548,580	–	–	–	6,548,580	6,548,580
Acceptances outstanding	409,960	–	–	–	409,960	409,960
Subordinated debt	8,389,297	–	–	9,588,439	–	9,588,439
Accrued interest payable	2,575,054	–	–	–	2,575,054	2,575,054
Other liabilities	10,173,693	–	6,633	–	10,167,060	10,173,693

	Parent Company					
		Fair Market Value				
	Carrying Value	Quoted Market Price	Valuation Technique (Market Observable)	Valuation Technique (Market Non-observable)	Cost	Total
			(In Thousand Pesos)			
Financial Assets						
COCI and due from BSP	₱17,320,298	₱–	₱–	₱–	₱17,320,298	₱17,320,298
Due from other banks	2,314,288	–	–	–	2,314,288	2,314,288
Interbank loans receivable	22,093,537	–	–	–	22,093,537	22,093,537
Securities held under agreements to resell	15,700,000	–	–	–	15,700,000	15,700,000
Financial assets at FVPL:						
Derivative assets	961,067	–	961,067	–	–	961,067
Government securities	148,070	148,070	–	–	–	148,070
Loans and receivables:						
Business loans	30,630,776	–	–	6,664,637	23,541,416	30,206,053
GOCCs and NGAs	14,198,097	–	–	2,019	14,195,837	14,197,856
LGUs	4,667,479	–	–	–	4,667,479	4,667,479
Consumers	2,949,885	–	–	908,407	2,192,084	3,100,491
Fringe benefits	732,898	–	–	426,702	85,113	511,815
Unquoted debt instruments	19,519,655	–	–	3,967,563	15,534,780	19,502,343
Others	8,766,492	–	–	–	8,766,492	8,766,492
Receivables from SPV	1,361,074	–	–	–	1,361,074	1,361,074
AFS investments:						
Government securities	26,516,171	25,109,206	–	1,406,965	–	26,516,171
Other debt securities	13,506,146	–	11,571,417	1,934,729	–	13,506,146
Equity securities	800,022	269,260	–	–	530,762	800,022
HTM investments:						
Government securities	1,420,044	1,584,920	–	–	–	1,584,920
(Forward)						

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	Parent Company					
		Fair Market Value				
	Carrying Value	Quoted Market Price	Valuation Technique (Market Observable)	Valuation Technique (Market Non-observable)	Cost	Total
			(In Thousand Pesos)			
Financial Liabilities						
Deposit liabilities:						
Demand	₱17,823,367	₱–	₱–	₱–	₱17,823,367	₱17,823,367
Savings	140,085,759	–	–	–	140,085,759	140,085,759
Time	25,823,838	–	–	–	25,823,838	25,823,838
Bills and acceptances payable:						
BSP and local bank	2,072,515	–	–	–	2,072,515	2,072,515
Foreign banks	1,140,888	–	–	–	1,140,888	1,140,888
PDIC and others	6,738,352	–	–	–	6,738,352	6,738,352
Acceptances outstanding	409,960	–	–	–	409,960	409,960
Subordinated debt	8,389,297	–	–	9,588,439	–	9,588,439
Accrued interest payable	2,579,782	–	–	–	2,579,782	2,579,782
Other liabilities	9,524,434	–	6,633	–	9,517,601	9,524,434

The discount rates used in estimating the fair value of loans and receivables ranges from 6.50% to 12.00% in 2007 and 7.94% to 12.00% in 2006.

7. Segment Information

Business Segments

The Group's operating businesses are determined and managed separately according to the nature of services provided and the different markets served with each segment representing a strategic business unit. The Group's business segments follow:

Retail Banking - principally handling individual customer's deposits, and providing consumer type loans, credit card facilities and fund transfer facilities

Corporate Banking - principally handling loans and other credit facilities and deposit accounts for corporate and institutional customers

Treasury - principally providing money market, trading and treasury services, as well as the management of the Group's funding operations by use of T-bills, government securities and placements and acceptances with other banks, through treasury and wholesale banking

These segments are the bases on which the Group reports its primary segment information. Other operations of the Group comprise of the operations and financial control groups. Transactions between segments are conducted at estimated market rates on an arm's length basis. Interest is credited to or charged against business segments based on a pool rate which approximates the marginal cost of funds.

Business segment information of the Group follows (amounts in thousand pesos):

	2007				
	Retail Banking	Corporate Banking	Treasury	Others	Total
Gross income	₱3,272,399	₱6,946,369	₱7,396,271	₱2,246,218	₱19,861,257
Segment result	₱1,363,031	₱2,068,703	₱2,318,296	₱501,946	₱6,251,976
Unallocated expenses					4,144,014
Income before tax					2,107,962
Provision for income tax					(609,512)
Minority interest					(8,293)
Net income for the year attributable to equity holders of the Parent Company					₱1,490,157
Other Information					
Segment assets	₱25,584,199	₱81,660,513	₱88,021,554	₱40,669,227	₱235,935,493
Unallocated assets					3,769,547
Total assets					₱239,705,040
Segment liabilities	₱116,046,872	₱25,577,424	₱54,121,499	₱10,997,390	₱206,743,185
Unallocated liabilities					2,732,737
Total liabilities					₱209,475,922
Other Segment Information					
Capital expenditures	₱167,132	₱6,616	₱657	₱9,829	₱184,234
Unallocated capital expenditures					362,953
Total capital expenditures					₱547,187
Depreciation and amortization	₱157,606	₱351,913	₱8,015	₱14,887	₱532,421
Unallocated depreciation and amortization					617,893
Total depreciation and amortization					₱1,150,314
Provision for impairment and credit losses					₱3,280,875

	2006				
	Retail Banking	Corporate Banking	Treasury	Others	Total
Gross income	₱3,153,057	₱5,964,411	₱9,272,896	₱1,782,615	₱20,172,979
Segment result	P744,233	₱1,524,341	₱3,008,677	₱356,997	₱5,634,248
Unallocated expenses					3,881,540
Income from operations before tax					1,752,708
Provision for income tax					(932,679)
Minority interest					(5,594)
Net income for the year attributable to equity holders of the Parent Company					₱814,435
Other Information					
Segment assets	₱29,588,781	₱70,393,516	₱80,011,081	₱31,342,309	₱211,335,687
Unallocated assets					32,135,378
Total assets					₱243,471,065
Segment liabilities	₱26,305,449	₱62,582,268	₱71,132,617	₱27,864,396	₱187,884,730
Unallocated liabilities					30,830,060
Total liabilities					₱218,714,790
Other Segment Information					
Capital expenditures	₱272,729	₱6,144	₱380	₱24,370	₱303,623
Unallocated capital expenditures					214,551
Total capital expenditures					₱518,174
Depreciation and amortization	₱273,198	₱373,412	₱14,876	₱47,700	₱709,186
Unallocated depreciation and amortization					402,178
Total depreciation and amortization					₱1,111,364
Provision for impairment and credit losses					₱2,802,283

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	2005				
	Retail Banking	Corporate Banking	Treasury	Others	Total
Gross income	₱3,253,014	₱5,700,770	₱6,593,889	₱2,002,811	₱17,550,484
Segment result	₱1,895,821	₱824,859	₱2,264,326	₱805,175	₱5,790,181
Unallocated expenses					3,270,917
Income from operations before tax					2,519,264
Provision for income tax					(1,891,726)
Minority interest					(6,617)
Net income for the year attributable to equity holders of the Parent Company					₱620,921
Other Information					
Segment assets	₱31,222,190	₱78,238,539	₱67,164,137	₱26,468,019	₱203,092,885
Unallocated assets					19,565,365
Total assets					₱222,658,250
Segment liabilities	₱27,783,779	₱69,622,352	₱59,767,542	₱23,553,171	₱180,726,844
Unallocated liabilities					19,022,134
Total liabilities					₱199,748,978
Other Segment Information					
Capital expenditures	₱259,386	₱8,519	₱2,044	₱30,743	₱300,692
Unallocated capital expenditures					215,198
Total capital expenditures					₱515,890
Depreciation and amortization	₱181,717	₱9,997	₱41,540	₱10,664	₱243,918
Unallocated depreciation and amortization					556,534
Total depreciation and amortization					₱800,452
Provision for impairment and credit losses					₱504,213

Geographical Segments

Although the Group's businesses are managed on a worldwide basis, the Group operates in five (5) principal geographical areas of the world. The distribution of assets, liabilities, credit commitments items and revenues by geographic region of the Group as of December 31, 2007 and 2006 follows (amounts in thousand pesos):

	Assets		Liabilities		Credit Commitments		Revenues	
	2007	2006	**2007**	2006	**2007**	2006	**2007**	2006
Philippines	**₱229,728,831**	₱230,693,390	**₱200,877,990**	₱208,345,788	**₱9,379,970**	₱8,299,916	**₱17,822,127**	₱17,767,691
Asia (excluding Philippines)	**5,626,513**	6,572,548	**5,505,600**	6,373,945	**371,413**	1,706,168	**766,395**	895,672
USA and Canada	**2,813,821**	4,093,909	**2,166,554**	2,486,008	**31,837**	37,640	**987,999**	1,248,935
United Kingdom	**1,140,063**	1,257,561	**577,187**	712,116	**90**	5,021	**177,861**	172,822
Other European Union Countries	**395,812**	853,657	**348,591**	796,933	**–**	–	**106,875**	87,859
	₱239,705,040	₱243,471,065	**₱209,475,922**	₱218,714,790	**₱9,783,310**	₱10,048,745	**₱19,861,257**	₱20,172,979

The Philippines is the home country of the Parent Company, which is also the main operating company. The Group offers a wide range of financial services as discussed in Note 1. Additionally, most of the remittance services are managed and conducted in Asia, Canada, USA and United Kingdom.

The areas of operations include all the primary business segments.

8. Financial Assets at Fair Value Through Profit or Loss

This account consists of:

	Consolidated		Parent Company	
	2007	2006	2007	2006
	(In Thousand Pesos)			
Government securities	**₱1,963,207**	₱148,070	**₱1,963,207**	₱148,070
Derivative assets (Note 30)	**1,173,297**	961,067	**1,173,297**	961,067
Equity securities	**78,731**	28,698	**57,582**	–
	₱3,215,235	₱1,137,835	**₱3,194,086**	₱1,109,137

Government securities include unrealized loss of ₱9.4 million and ₱1.1 million as of December 31, 2007 and 2006, respectively, for the Group and the Parent Company.

For the years ended December 31, 2007 and 2006, the effective interest rates of government securities range from 6.26% to 10.63% and 4.10% to 9.65%, respectively.

Equity securities include unrealized gain of ₱3.5 million and ₱1.0 million as of December 31, 2007 and 2006, respectively, for the Group.

9. Loans and Receivables

This account consists of:

	Consolidated		Parent Company	
	2007	2006	2007	2006
	(In Thousand Pesos)			
Loans receivables:				
Loans and discounts	**₱57,038,829**	₱55,533,021	**₱56,256,936**	₱54,643,968
Bills purchased	**4,168,527**	3,003,647	**4,168,527**	3,003,647
Customers' liabilities on acceptances, letters of credit and trust receipts	**1,873,498**	2,078,947	**1,873,498**	2,078,947
Lease contracts receivable	**1,148,977**	1,002,423	**–**	–
Credit card accounts	**558,624**	569,915	**558,624**	569,915
	64,788,455	62,187,953	**62,857,585**	60,296,477
Less unearned and other deferred income	**492,963**	543,861	**354,725**	431,438
	64,295,492	61,644,092	**62,502,860**	59,865,039
Unquoted debt securities	**9,885,248**	21,301,724	**9,885,248**	21,301,724
Other receivables:				
Accrued interest receivable	**5,958,476**	5,952,681	**5,930,497**	5,914,611
Accounts receivable	**4,592,332**	5,233,271	**3,697,554**	4,926,892
Sales contract receivables	**2,113,878**	2,110,298	**2,113,878**	2,110,298
Miscellaneous	**1,695,893**	847,376	**715,097**	617,521
	14,360,579	14,143,626	**12,457,026**	13,569,322
	88,541,319	97,089,442	**84,845,134**	94,736,085
Less allowance for credit losses (Note 16)	**11,966,288**	13,497,223	**11,683,110**	13,270,803
	₱76,575,031	₱83,592,219	**₱73,162,024**	₱81,465,282

As of December 31, 2007 and 2006, 82.59% and 57.48%, respectively, of the total loans receivables of the Parent Company were subject to periodic interest repricing. Remaining receivables carry annual fixed interest rates ranging from 8.65% to 13.26% in 2007 and 5.25% to 13.26% in 2006 for foreign currency-denominated receivables, and from 5.00% to 22.00% in 2007 5.75% to 22.75% in 2006 for peso-denominated receivables.

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Sales contract receivables bear fixed interest rate per annum of 0.58% to 26.00% in 2007 and 0.58% to 21% in 2006.

The effective interest rates of 'Loans receivable', 'Unquoted debt instruments' and 'Sales contract receivables' range from 5.43% to 10.68% in 2007 and 5.67% to 10.69% in 2006 for foreign currency-denominated receivables, and from 3.29% to 18.29% in 2007 and 5.51% to 18.84% in 2006 for peso-denominated receivables.

BSP Circular 520 dated March 20, 2006 requires that the difference between the selling price and the carrying value of investment properties sold under installment should be recognized in profit or loss at the date of sale. Accordingly, the Parent Company reversed the outstanding deferred income and credits representing the unrealized gain on sale of investment properties amounting to ₱750.0 million and credited to the beginning balance of deficit, net of deferred income tax amounting to ₱225.0 million.

In 2004, the Parent Company sold the outstanding loans receivable of ₱5.3 billion from National Steel Corporation (NSC) to SPV companies under the provisions of RA No. 9182. In consideration for such sale, the Parent Company received zero-coupon notes and cash totaling ₱4.2 billion. In accordance with the BSP Memorandum dated February 16, 2004, *Accounting Guidelines on the Sale of Nonperforming Assets (NPAs) to Special Purpose Vehicles*, the ₱1.6 billion allowance for impairment losses previously provided for the NSC loans receivable was released by the Parent Company to cover additional allowance for credit and impairment losses required for other existing NPAs and other risk assets of the Parent Company. With the release of such allowance, the loss on the sale of the NSC loans receivable to the SPV amounting to ₱1.1 billion representing the difference between the carrying value of the receivables and consideration received was deferred by the Parent Company as allowed under the regulations issued by the BSP for banks and financial institutions availing of the provisions of RA No. 9182 (see Note 15).

Unquoted debt instruments include the zero-coupon notes received by the Parent Company on October 15, 2004, as discussed above, at the principal amount of ₱803.5 million (Tranche A Note) payable in five (5) years and at the principal amount of ₱3.4 billion (Tranche B Note) payable in eight (8) years in exchange for the outstanding loans receivable from NSC of ₱5.3 billion. The notes are secured by a first ranking mortgage and security interest over the NSC plant assets. As of December 31, 2007 and 2006, these notes had a carrying value of ₱2.7 billion and ₱2.2 billion, respectively.

In 2005, the Parent Company sold another pool of NPL with outstanding balance of ₱4.7 billion. Upon adoption of PAS 39 on January 1, 2005, the Parent Company did not set up allowance for credit losses on the NPLs sold to SPV since it availed of the provisions of RA No. 9182 in the recognition of the loss from sale of ₱4.3 billion (see Note 15). This loss was deferred and amortized over 10 years.

In 2006, the Parent Company entered into a sale and purchase agreement for the sale of certain NPLs and foreclosed properties booked under 'Investment properties'. The loss on sale amounting to ₱1.9 billion was deferred and amortized over 10 years as allowed under RA No. 9182. As part of this sale and purchase agreement, another pool of NPLs was sold in 2007. As allowed by the regulatory accounting policies prescribed by the BSP for banks and financial institutions availing of the provisions of RA No. 9182, the additional required allowance for credit losses on these NPLs amounting to ₱1.3 billion was not recognized in the financial statements as of December 31, 2006 since upon sale in March 2007, the loss was deferred and amortized over 10 years (see Notes 10 and 15).

Under RA No. 9182, losses on sale of NPL to SPV companies can be amortized over 10 years based on the following schedule:

End of Period From Date of Transaction	Cumulative Write-down of Deferred Charges
Year 1	5%
Year 2	10%
Year 3	15%
Year 4	25%
Year 5	35%
Year 6	45%
Year 7	55%
Year 8	70%
Year 9	85%
Year 10	100%

For the purpose of computing the Parent Company's regular corporate income tax, the loss is treated as an ordinary loss and will be carried over as a deduction from the Parent Company's taxable income for five consecutive taxable years immediately following the year of sale.

Had the impairment losses been charged against operations as required by PFRS, deferred charges and equity would have decreased by ₱7.7 billion as of December 31, 2007 and deferred charges and equity would have decreased by ₱6.9 billion and ₱8.2 billion, respectively, and allowance for credit losses would have increased by ₱1.3 billion as of December 31, 2006. The 2006 net income would have decreased by ₱3.2 billion and 2005 net income would have increased by ₱124.8 million.

For the years ended December 31, 2007, 2006 and 2005, the amortization of the loss on sale of NPAs amounting to ₱413.9 million, ₱267.9 million and ₱54.0 million, respectively, was charged to deficit.

As discussed in Note 10, as allowed by the BSP regulatory reporting rules, the Group did not consolidate the accounts of the SPV that acquired the NPAs sold in 2007 and 2006. PFRS requires such consolidation.

Unquoted debt instruments also include the following securities:

a. Twelve-year peso-denominated bonds with face value amounting to ₱11.2 billion. These bonds, with an original amount of ₱24.3 billion, were issued by the NG in settlement of the Parent Company's claims from NG. These bonds, ₱1.0 billion and ₱10.2 billion which matured on July 1, 2007 and August 1, 2007, respectively, were eligible as part of the liquidity cover requirements on government deposits.

   As of December 31, 2006, these bonds were pledged as collateral to secure the Parent Company's borrowing from PDIC (see Note 18).

b. Bonds issued by Philippine Sugar Corporation (PSC) amounting to ₱2.8 billion. The bonds carry an annual interest rate of 4.00% and will mature in 2014. The full repayment of principal and accumulated interest to maturity is guaranteed by a sinking fund managed by the Parent Company's Trust Banking Group (TBG). As of December 31, 2007 and 2006, the net asset value of the sinking fund amounted to ₱4.1 billion and ₱3.9 billion, respectively, earning an average rate of return of 7.77% per annum. Management expects that the value of the sinking fund in the year 2014 will be more than adequate to cover the full redemption value of PSC bonds.

On November 27, 1997, Maybank Philippines, Inc. (Maybank) and the Parent Company signed a deed of assignment transferring to the Parent Company certain Maybank assets (included under 'Accounts receivables') and liabilities amounting to ₱1.9 billion and ₱1.3 billion, respectively, in connection with the sale of the Parent Company's 60.00% equity in Maybank. As of December 31, 2007 and 2006, the balance of these receivables amounting to ₱1.7 billion and ₱2.0 billion, respectively, which is included under 'Loans and receivables', may be offset against the equivalent amount of transferred liabilities (included under 'Bills payable to BSP and local banks' - see Note 18). The excess of the transferred receivables over the transferred liabilities is fully covered by an allowance for credit losses amounting to ₱39.3 million and ₱40.9 million as of December 31, 2007 and 2006, respectively. The remaining equity ownership of the Parent Company in Maybank was sold in June 2000 (see Note 29).

Miscellaneous receivables include assets previously transferred to the NG as part of the Parent Company's rehabilitation in 1986. These receivables were repurchased by the Parent Company in 1992 from the NG at a discount and are mostly secured by real estate mortgages. These receivables are likewise fully covered by allowance for credit losses amounting to ₱147.4 million and ₱172.6 million as of December 31, 2007 and 2006, respectively.

BSP Reporting

The information relating to loans receivables as to secured and unsecured and as to collateral follows:

	Consolidated			
	2007		2006	
	Amount	%	Amount	%
	(In Thousand Pesos)			
Secured:				
Real estate mortgage	₱21,148,948	32.64	₱24,094,623	38.74
Chattel mortgage	3,484,198	5.38	3,313,479	5.33
Bank deposit hold-out	967,825	1.49	1,413,766	2.27
Shares of stocks	588,506	0.91	1,218,750	1.96
Others	1,707,473	2.64	6,708,757	10.79
	27,896,950	43.06	36,749,375	59.09
Unsecured	36,891,505	56.94	25,438,578	40.91
	₱64,788,455	100.00	₱62,187,953	100.00

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	Parent Company			
	2007		2006	
	Amount	%	Amount	%
	(In Thousand Pesos)			
Secured:				
Real estate mortgage	₱21,088,999	33.55	₱24,015,647	39.83
Chattel mortgage	1,963,517	3.12	2,643,098	4.38
Bank deposit hold-out	866,343	1.38	1,319,105	2.19
Shares of stocks	588,506	0.94	1,218,750	2.02
Others	1,706,302	2.71	5,848,232	9.70
	26,213,667	41.70	35,044,832	58.12
Unsecured	36,643,918	58.30	25,251,645	41.88
	₱62,857,585	100.00	₱60,296,477	100.00

NPLs as to secured and unsecured follows:

	Consolidated		Parent Company	
	2007	2006	2007	2006
	(In Thousand Pesos)			
Secured	₱6,403,140	₱7,436,035	₱6,377,317	₱7,436,035
Unsecured	3,923,583	4,860,651	3,766,084	4,702,983
	₱10,326,723	₱12,296,686	₱10,143,401	₱12,139,018

Generally, NPLs refer to loans whose principal and/or interest is unpaid for thirty (30) days or more after due date or after they have become past due in accordance with existing BSP rules and regulations. This shall apply to loans payable in lump sum and loans payable in quarterly, semi-annual, or annual installments, in which case, the total outstanding balance thereof shall be considered nonperforming.

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

In the case of loans that are payable in daily, weekly, or semi-monthly installments, the total outstanding balance thereof shall be considered nonperforming at the same time that they become past due in accordance with existing BSP regulations, i.e., the entire outstanding balance of the receivable shall be considered as past due when the total amount of arrearages reaches ten percent (10.00%) of the total loan balance.

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

Loans which do not meet the requirements to be treated as performing loans shall also be considered as NPLs. Current banking regulations allow banks that have no unbooked valuation reserves and capital adjustments to exclude from nonperforming classification those loans classified as Loss in the latest examination of the BSP which are fully covered by allowance for credit losses, provided that interest on said receivables shall not be accrued.

The details of the NPL of the Group and the Parent Company follow:

	Consolidated		Parent Company	
	2007	2006	2007	2006
	(In Thousand Pesos)			
Total NPL	₱10,326,723	₱12,296,686	₱10,143,401	₱12,139,018
Less NPL fully covered by allowance for credit losses	1,324,255	2,117,804	1,176,196	1,974,600
	₱9,002,468	₱10,178,882	₱8,967,205	₱10,164,418

Most of these loans are secured mainly by real estate or chattel mortgages.

Restructured loans of the Group and the Parent Company as of December 31, 2007 and 2006 amounted to ₱9.6 billion and ₱14.5 billion, respectively.

Interest income on loans and receivables for the years ended December 31, 2007 and 2006 consists of:

	Consolidated			Parent Company		
	2007	2006	2005	**2007**	2006	2005
			(In Thousand Pesos)			
Loans and receivable	**₱4,929,802**	₱5,238,176	₱5,266,830	**₱4,742,998**	₱5,052,686	₱5,044,678
Interbank loans receivables	**848,798**	1,106,984	990,994	**848,798**	1,106,984	990,994
Unquoted debt instruments	**412,351**	802,352	82,567	**412,351**	802,352	82,567
	₱6,190,951	₱7,147,512	₱6,340,391	**₱6,004,147**	₱6,962,022	₱6,118,239

Interest income accrued on impaired loans and receivable amounted to ₱436.15 million and ₱932.5 million for the years ended December 31, 2007 and 2006, respectively.

10. Receivables from Special Purpose Vehicle

Receivables from SPV represent the present value of the note received by the Parent Company from the sale of the first pool of NPAs to an SPV on December 29, 2006. The asset sale and purchase agreements (ASPA) were executed on December 19, 2006. The BSP issued the certificate of eligibility on January 31, 2007. However, the BSP confirmed that this transaction qualified as a true sale under RA No. 9182 and that the NPAs may be derecognized already from its books as of December 31, 2006.

The more significant terms of the sale are as follows:

a. Certain NPAs of the Parent Company will be sold to the SPV and divided into two pools. The sale of the first pool of NPAs with an outstanding balance of ₱11.7 billion was made on December 29, 2006 for a total consideration of ₱11.7 billion. The sale of the second pool was completed on March 30, 2007 for a total consideration of ₱7.6 billion.

b. The agreed purchase price of the first pool of NPAs shall be paid as follows:

   i. An initial amount of ₱1.1 billion (included in 'Accounts receivable' as of December 31, 2006), which was received in full and acknowledged by the Parent Company on February 14, 2007; and

   ii. The balance of ₱10.6 billion, through issuance of SPV Notes, shall be paid over five (5) years based on a cash flow waterfall arrangement and at an interest equivalent to the 3-month MART prevailing as of the end of the quarter prior to the payment date.

As of December 31, 2007, Receivables from SPV is net of allowance for credit losses amounting to ₱683.0 million (see Note 16).

The Parent Company availed of the incentives provided under RA No. 9182 in the recognition of loss from the sale amounting to ₱1.9 billion (included in deferred charges under 'Other assets'). Under RA No. 9182, the loss on sale of NPAs to SPV companies can be amortized over 10 years (see Note 9).

Under the ASPA, the sale of the second pool of NPAs amounting to ₱7.6 billion with allowance for credit losses of ₱5.5 billion became effective in March 2007. The BSP confirmed in its letter dated February 28, 2007 that these NPAs qualify as a true sale under RA No. 9182 as of December 31, 2006. The agreed purchase price of this pool of NPAs shall be paid as follows:

a. An initial amount of ₱751.1 million which was received in full and acknowledged by the Parent Company on April 26, 2007; and

b. The balance of ₱6.8 billion through issuance of SPV Notes, shall be paid over five (5) years based on a cash flow waterfall arrangement and at an interest equivalent to the 3-month MART prevailing as of the end of the quarter prior to the payment date.

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As discussed in Note 9, since the Parent Company again availed of the incentives mentioned above, the loss amounting to ₱1.3 billion was amortized over 10 years. The sale of the NPAs to the SPV qualified for derecognition under BSP regulatory reporting rules. However, PFRS requires that the accounts of the SPV that acquired the NPA of the Parent Company should be consolidated into the Group's accounts. Had the accounts of the SPV been consolidated into the Group's accounts, total assets and liabilities would have increased by ₱2.0 billion and ₱1.9 billion, respectively, and minority interest in equity of consolidated entities would have decreased by ₱28.8 million as of December 31, 2007. As of December 31, 2006, total assets and minority interest in equity of consolidated entities would have increased by ₱30.0 million.

11. Investment Securities

This account consists of:

	Consolidated		Parent Company	
	2007	2006	**2007**	2006
	(In Thousand Pesos)			
AFS investments:				
Government securities (Notes 17 and 27)	**₱32,310,169**	₱28,225,866	**₱31,712,072**	₱26,516,171
Other debt securities	**11,767,435**	13,732,557	**11,584,565**	13,506,146
Equity securities - net of allowance for credit losses of ₱619.4 million and ₱445.4 million in 2007 and 2006, respectively (Notes 15 and 16)	**743,918**	866,387	**664,390**	800,022
	44,821,522	42,824,810	**43,961,027**	40,822,339
HTM investments:				
Government securities (Note 27)	**446,054**	1,485,615	**362,795**	1,351,291
Other debt securities	**–**	68,753	**–**	68,753
	446,054	1,554,368	**362,795**	1,420,044
	₱45,267,576	₱44,379,178	**₱44,323,822**	₱42,242,383

Unquoted AFS equity securities as of December 31, 2007 and 2006 amounted to ₱322.1 million and ₱533.3 million, respectively, for the Group and ₱319.6 million and ₱530.8 million, respectively, for the Parent Company.

Unrealized gain on AFS investments amounted to ₱888.8 million and ₱809.8 million as of December 31, 2007 for the Group and the Parent Company, respectively. Unrealized gain on AFS investments amounted to ₱862.2 million and ₱819.8 million as of December 31, 2006 for the Group and the Parent Company, respectively.

Effective interest rates range from 3.90% to 11.85% and 3.39% to 9.28% for peso-denominated and foreign currency-denominated AFS investments, respectively, for the year ended December 31, 2007. Effective interest rates range from 4.50% to 17.58% and 3.33% to 9.17% for peso-denominated and foreign currency-denominated AFS investments, respectively, for the year ended December 31, 2006.

Effective interest rates range from 10.38% and 5.81% to 6.49% for peso-denominated and foreign currency-denominated HTM investments, respectively, for the year ended December 31, 2007. Effective interest rate for peso-denominated HTM investments is 7.75% and ranges from 5.19% to 8.87% for foreign currency-denominated HTM investments for the year ended December 31, 2006.

Interest income on trading and investment securities for the years ended December 31, 2007, 2006 and 2005 consists of:

	Consolidated			Parent Company		
	2007	2006	2005	**2007**	2006	2005
	(In Thousand Pesos)					
AFS investments	**₱2,864,562**	₱2,756,421	₱2,859,362	**₱2,778,947**	₱2,584,733	₱2,777,502
Financial assets at FVPL	**806,872**	1,102,862	654,304	**806,872**	1,102,862	654,304
HTM investments	**82,551**	365,552	632,290	**82,552**	365,551	632,290
	₱3,753,985	₱4,224,835	₱4,145,956	**₱3,668,371**	₱4,053,146	₱4,064,096

Trading and investment securities gains - net for the years ended December 31, 2007, 2006 and 2005 consists of:

	Consolidated			Parent Company		
	2007	2006	2005	2007	2006	2005
	(In Thousand Pesos)					
AFS investments	₱1,032,205	₱1,024,925	₱784,113	₱1,031,780	₱1,024,476	₱783,042
Derivatives	103,437	929,503	169,308	103,437	929,503	169,308
Financial assets at FVPL	(47,200)	117,195	132,316	(107,306)	93,042	115,630
	₱1,088,442	₱2,071,623	₱1,085,737	₱1,027,911	₱2,047,021	₱1,067,980

The movements of net unrealized gains (losses) are as follows:

	Consolidated		Parent Company	
	2007	2006	2007	2006
	(In Thousand Pesos)			
Balance at the beginning of the year	₱875,740	₱917,420	₱819,765	₱868,720
Unrealized gains recognized in equity	1,049,038	983,245	1,021,819	975,521
Realized gains	(1,032,205)	(1,024,925)	(1,031,780)	(1,024,476)
Balance at end of the year	₱892,573	₱875,740	₱809,804	₱819,765

In view of the increased risk-weights of foreign currency denominated national government bonds under the new risk-based capital adequacy framework (BSP Circular 538), BSP and PAS 39 allow banks to reclassify their portfolio booked under HTM investments to AFS investments and be exempted from the "tainting rule" provision. The Parent Company has transferred a total of $23.0 million worth of ROP bonds from HTM investments to AFS investments in February 2007.

12. Property and Equipment

The composition of and changes in furniture, fixtures and equipment and leasehold improvements follow:

	Consolidated 2007		
	Furniture, Fixtures and Equipment	Leasehold Improvements	Total
	(In Thousand Pesos)		
Cost			
Balance at beginning of year	₱2,603,625	₱223,391	₱2,827,016
Additions	503,882	33,010	536,892
Disposals	(344,646)	(24,929)	(369,575)
Balance at end of year	2,762,861	231,472	2,994,333
Accumulated Depreciation and Amortization			
Balance at beginning of year	1,975,338	121,497	2,096,835
Depreciation and amortization	204,694	30,823	235,517
Disposals	(142,443)	(17,386)	(159,829)
Balance at end of year	2,037,589	134,934	2,172,523
Net Book Value at End of Year	₱725,272	₱96,538	₱821,810

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	Consolidated 2006		
	Furniture, Fixtures and Equipment	Leasehold Improvements	Total
		(In Thousand Pesos)	
Cost			
Balance at beginning of year	₱3,130,447	₱176,822	₱3,307,269
Additions	309,316	27,257	336,573
Disposals/others	(836,138)	19,312	(816,826)
Balance at end of year	2,603,625	223,391	2,827,016
Accumulated Depreciation and Amortization			
Balance at beginning of year	2,437,301	81,091	2,518,392
Depreciation and amortization	200,913	18,681	219,594
Disposals/others	(662,876)	21,725	(641,151)
Balance at end of year	1,975,338	121,497	2,096,835
Net Book Value at End of Year	₱628,287	₱101,894	₱730,181

	Parent Company 2007		
	Furniture, Fixtures and Equipment	Leasehold Improvements	Total
		(In Thousand Pesos)	
Cost			
Balance at beginning of year	₱2,391,005	₱140,157	₱2,531,162
Additions	441,832	21,243	463,075
Disposals/others	(309,152)	(702)	(309,854)
Balance at end of year	2,523,685	160,698	2,684,383
Accumulated Depreciation and Amortization			
Balance at beginning of year	₱1,810,126	₱57,120	₱1,867,246
Depreciation and amortization	181,656	21,926	203,582
Disposals	(100,993)	35	(100,958)
Balance at end of year	1,890,789	79,081	1,969,870
Net Book Value at End of Year	₱632,896	₱81,617	₱714,513

	Parent Company 2006		
	Furniture, Fixtures and Equipment	Leasehold Improvements	Total
		(In Thousand Pesos)	
Cost			
Balance at beginning of year	₱2,893,249	₱118,140	₱3,011,389
Additions	293,024	22,017	315,041
Disposals	(795,268)	–	(795,268)
Balance at end of year	2,391,005	140,157	2,531,162
Accumulated Depreciation and Amortization			
Balance at beginning of year	2,272,372	38,672	2,311,044
Depreciation and amortization	156,900	18,448	175,348
Disposals	(619,146)	–	(619,146)
Balance at end of year	1,810,126	57,120	1,867,246
Net Book Value at End of Year	₱580,879	₱83,037	₱663,916

The composition of and changes in land and buildings follow:

	Consolidated		
	2007		
	Land	Buildings	Total
	(In Thousand Pesos)		
Appraised Value			
Balance at beginning of year	₱11,242,706	₱6,304,011	₱17,546,717
Additions	–	10,295	10,295
Disposals	(928)	(747)	(1,675)
Balance at end of year	11,241,778	6,313,559	17,555,337
Accumulated Depreciation			
Balance at beginning of year	–	1,392,972	1,392,972
Depreciation	–	167,795	167,795
Disposals/others	–	5,775	5,775
Balance at end of year	–	1,566,542	1,566,542
Allowance for Impairment Losses (Note 16)	264,388	42,538	306,926
Net Book Value at End of Year	₱10,977,390	₱4,704,479	₱15,681,869

	Consolidated		
	2006		
	Land	Buildings	Total
	(In Thousand Pesos)		
Appraised Value			
Balance at beginning of year	₱10,404,098	₱5,712,302	₱16,116,400
Appraisal increase	838,200	577,247	1,415,447
Additions	156,000	25,601	181,601
Disposals	(155,592)	(11,139)	(166,731)
Balance at end of year	11,242,706	6,304,011	17,546,717
Accumulated Depreciation			
Balance at beginning of year	–	1,250,113	1,250,113
Depreciation	–	145,353	145,353
Disposals	–	(2,494)	(2,494)
Balance at end of year	–	1,392,972	1,392,972
Allowance for Impairment Loss (Note 16)	264,388	42,538	306,926
Net Book Value at End of Year	₱10,978,318	₱4,868,501	₱15,846,819

	Parent Company		
	2007		
	Land	Buildings	Total
	(In Thousand Pesos)		
Appraised Value			
Balance at beginning of year	₱11,242,706	₱6,304,011	₱17,546,717
Additions	–	10,295	10,295
Disposals	(928)	(747)	(1,675)
Balance at end of year	11,241,778	6,313,559	17,555,337
Accumulated Depreciation			
Balance at beginning of year	–	1,392,972	1,392,972
Depreciation	–	167,795	167,795
Disposals/others	–	5,775	5,775
Balance at end of year	–	1,566,542	1,566,542
Allowance for Impairment Losses (Note 16)	264,388	42,538	306,926
Net Book Value at End of Year	₱10,977,390	₱4,704,479	₱15,681,869

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	Parent Company		
	2006		
	Land	Buidings	Total
	(In Thousand Pesos)		
Appraised Value			
Balance at beginning of year	₱10,404,098	₱5,705,468	₱16,109,566
Appraisal increase	838,200	574,668	1,412,868
Additions	156,000	25,601	181,601
Disposals/others	(155,592)	(1,726)	(157,318)
Balance at end of year	11,242,706	6,304,011	17,546,717
Accumulated Depreciation			
Balance at beginning of year	–	1,247,253	1,247,253
Depreciation	–	145,326	145,326
Disposals/others	–	393	393
Balance at end of year	–	1,392,972	1,392,972
Allowance for Impairment Loss (Note 16)	264,388	42,538	306,926
Net Book Value at End of Year	₱10,978,318	₱4,868,501	₱15,846,819

Depreciation on the revaluation increment of the buildings amounted to ₱77.7 million, ₱57.3 million and ₱55.7 million in 2007, 2006 and 2005, respectively, for the Parent Company.

Depreciation and amortization expense, inclusive of the depreciation on revaluation increment of the buildings, charged against operations of the Group amounted to ₱403.3 million, ₱365.0 million and ₱550.6 million in 2007, 2006 and 2005, respectively, and ₱371.4 million in 2007, ₱320.7 million in 2006 and ₱524.6 million in 2005 for the Parent Company. Had the land and buildings been carried at cost, the net book value of the land and buildings would have been ₱4.8 billion and ₱4.9 billion as of December 31, 2007 and 2006, respectively, for the Group and Parent Company.

13. Investments in Subsidiaries and an Associate

The details of this account follow:

	Consolidated		Parent Company	
	2007	2006	**2007**	2006
	(In Thousand Pesos)			
At equity:				
Acquisition cost of:				
PNB IIC	**₱–**	₱–	**₱2,028,202**	₱2,028,202
PNB Europe PLC	**–**	–	**785,309**	785,309
PNB IFL	**–**	–	**753,061**	753,061
PNB Holdings	**–**	–	**577,876**	577,876
PNB Capital	**–**	–	**350,000**	350,000
PNB Forex, Inc.	**–**	–	**50,000**	50,000
PNB Securities, Inc.	**–**	–	**62,351**	62,351
PNB Italy - SpA	**–**	–	**58,380**	58,380
PNB GFRS	**–**	–	**33,777**	33,777
PNB Remittance Center, Ltd.	**–**	–	**32,042**	32,042
Omicron Asset Portfolio (SPV - AMC), Inc.	**–**	–	**31,250**	31,250
Tanzanite Investments (SPV - AMC), Inc.	**–**	–	**31,250**	31,250
Tau Portfolio Investments (SPV - AMC), Inc.	**–**	–	**31,250**	31,250
PNB Corporation - Guam	**–**	–	**7,672**	7,672
PNB Austria	**–**	–	**6,721**	6,721
Japan - PNB Leasing (60% owned)	**–**	–	**103,176**	103,176
PNB Venture Capital Corporation (60% owned)	**5,061**	5,061	**5,061**	5,061
Beneficial - PNB Life Insurance Company, Inc. (40% owned)	**499,814**	499,814	**499,814**	499,814
	504,875	504,875	**5,447,192**	5,447,192

(Forward)

	Consolidated		Parent Company	
	2007	2006	2007	2006
	(In Thousand Pesos)			
Accumulated equity in net earnings:				
Balance at beginning of year	₱207,371	₱179,296	₱–	₱–
Equity in net earnings (losses) for the year	(79,739)	46,299	–	–
Dividends/adjustment during the year	(3,605)	(18,224)	–	–
Balance at end of year	124,027	207,371	–	–
Share in the equity adjustments of an associate:				
Equity in net unrealized gain on AFS investments	10,201	51,840	–	–
Equity in revaluation increment	29,278	33,438	–	–
Equity in accumulated translation adjustment	(3,258)	4,314	–	–
	36,221	89,592	–	–
Less allowance for impairment losses (Note 16)	–	–	66,053	7,672
	₱665,123	₱801,838	₱5,381,139	₱5,439,520

As discussed in Note 2, the SEC approved on November 7, 2002 the application of the accumulated translation adjustment of ₱1.6 billion to eliminate the Parent Company's remaining deficit of ₱1.3 billion as of December 31, 2001, after applying the total reduction in par value amounting to ₱7.6 billion. The SEC approval is subject to the following conditions: (a) remaining translation adjustment of ₱310.7 million as of December 31, 2001 (shown as part of Capital Paid in Excess of Par Value) will not be used to wipe out losses that may be incurred in the future without prior approval of SEC; and (b) for purposes of dividend declaration, any future surplus account of the Parent Company shall be restricted to the extent of the deficit wiped out by the translation adjustment.

As of December 31, 2007 and 2006, acquisition cost of the investments in the Parent Company financial statements include the translation adjustment and accumulated equity in net earnings, net of dividends subsequently received from the quasi-reorganization date, that were closed to deficit on restructuring date.

The following table illustrates the summarized financial information of the Group's investment in Beneficial - PNB Life Insurance Company, Inc.:

	2007	2006
	(In Thousand Pesos)	
Total assets	₱3,080,005	₱3,008,088
Total liabilities	1,429,852	1,115,220
Total revenues	744,938	675,982
Net income (loss)	(105,763)	115,748

14. Investment Properties

The composition of and changes in this account follow:

	Consolidated		
	2007		
	Land	Building and Improvements	Total
	(In Thousand Pesos)		
Cost			
Balance at beginning of year	₱22,131,711	₱8,396,950	₱30,528,661
Additions	3,971,196	576,570	4,547,766
Disposals/others	50,345	(1,251,381)	(1,201,036)
Balance at end of year	26,153,252	7,722,139	33,875,391
Accumulated Depreciation and Impairment Losses			
Balance at beginning of year	3,852,843	1,793,742	5,646,585
Depreciation	–	621,985	621,985
Provision for impairment losses	2,161,353	90,623	2,251,976
Reversals/others	(533,228)	1,088,471	555,243
Balance at end of year	5,480,968	3,594,821	9,075,789
Net Book Value at End of Year	₱20,672,284	₱4,127,318	₱24,799,602

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	Consolidated		
	2006		
	Land	Building and Improvements	Total
		(In Thousand Pesos)	
Cost			
Balance at beginning of year	₱25,027,393	₱7,799,810	₱32,827,203
Additions	2,281,555	1,901,900	4,183,455
Disposals/others	(5,177,237)	(1,304,760)	(6,481,997)
Balance at end of year	22,131,711	8,396,950	30,528,661
Accumulated Depreciation and Impairment Losses			
Balance at beginning of year	3,210,227	2,769,209	5,979,436
Depreciation	–	746,417	746,417
Provision for impairment losses	642,616	13,030	655,646
Reversals/others	–	(1,734,914)	(1,734,914)
Balance at end of year	3,852,843	1,793,742	5,646,585
Net Book Value at End of Year	₱18,278,868	₱6,603,208	₱24,882,076

	Parent Company		
	2007		
	Land	**Building and Improvements**	**Total**
		(In Thousand Pesos)	
Cost			
Balance at beginning of year	**₱22,131,135**	**₱8,297,011**	**₱30,428,146**
Additions	**3,971,196**	**575,711**	**4,546,907**
Disposals/others	**50,921**	**(1,250,108)**	**(1,199,187)**
Balance at end of year	**26,153,252**	**7,622,614**	**33,775,866**
Accumulated Depreciation and Impairment Losses			
Balance at beginning of year	**3,852,691**	**1,771,707**	**5,624,398**
Depreciation	**–**	**620,004**	**620,004**
Provision for impairment losses	**2,161,353**	**90,623**	**2,251,976**
Reversal/others	**(533,076)**	**1,088,679**	**555,603**
Balance at end of year	**5,480,968**	**3,571,013**	**9,051,981**
Net Book Value at End of Year	**₱20,672,284**	**₱4,051,601**	**₱24,723,885**

	Parent Company		
	2006		
	Land	Building and Improvements	Total
		(In Thousand Pesos)	
Cost			
Balance at beginning of year	₱25,026,817	₱7,698,565	₱32,725,382
Additions	2,281,555	1,901,900	4,183,455
Disposals/others	(5,177,237)	(1,303,454)	(6,480,691)
Balance at end of year	22,131,135	8,297,011	30,428,146
Accumulated Depreciation and Impairment Losses			
Balance at beginning of year	3,210,075	2,750,286	5,960,361
Depreciation	–	746,324	746,324
Provision for impairment losses	642,616	13,030	655,646
Reversal/others	–	(1,737,933)	(1,737,933)
Balance at end of year	3,852,691	1,771,707	5,624,398
Net Book Value at End of Year	₱18,278,444	₱6,525,304	₱24,803,748

The fair value of the investment properties as of December 31, 2007 and 2006 of the Group amounted to ₱37.8 billion and ₱34.4 billion, respectively, of which ₱37.6 billion and ₱34.1 billion, respectively, pertains to the Parent Company as determined by independent and/or in-house appraisers.

15. Other Assets

This account consists of:

	Consolidated		Parent Company	
	2007	2006	2007	2006
	(In Thousand Pesos)			
Deferred charges	**₱7,772,368**	₱6,886,491	**₱7,769,531**	₱6,883,295
Software cost	**422,545**	230,685	**417,674**	224,065
Prepaid expenses	**62,369**	229,617	**41,786**	53,140
Sundry debits	**24,324**	51,192	**24,324**	51,192
NPAs to be sold to SPV - net of allowance for credit losses of ₱5.5 billion (Notes 10 and 16)	**–**	2,053,934	**–**	2,053,934
Miscellaneous	**752,315**	900,846	**621,531**	747,867
	9,033,921	10,352,765	**8,874,846**	10,013,493
Less allowance for impairment losses (Note 16)	**32,265**	515,512	**31,999**	513,591
	₱9,001,656	₱9,837,253	**₱8,842,847**	₱9,499,902

Deferred charges mainly represent the loss on sale to SPVs being amortized over 10 years as allowed by RA No. 9182 (see Notes 9 and 10).

Miscellaneous include exchange trading rights. Under the PSE rules, all exchange trading rights are pledged at its full value to the PSE to secure the payment of all debts due to other members of the PSE arising out of or in connection with the present or future members' contracts.

The carrying values of the investment in PSE shares and the exchange trading right in the accounts of PNB Securities were as follows:

	2007	2006
	(In Thousand Pesos)	
AFS investments - 50,000 PSE shares	**₱51,000**	₱14,000
Exchange trading rights	**967**	967
	₱51,967	₱14,967

As of December 31, 2007 and 2006, the latest transacted price of the exchange trading right (as provided by the PSE) amounted to ₱8.0 million and ₱5.0 million, respectively. As of December 31, 2007, the market value of the PSE shares based on quoted price is ₱1,020 per share.

Changes in the software cost are as follows:

	Consolidated		Parent Company	
	2007	2006	2007	2006
	(In Thousand Pesos)			
Balance at beginning of the year	**₱230,685**	₱206,940	**₱224,065**	₱198,920
Additions	**249,146**	54,285	**249,146**	54,285
Amortizations	**(57,286)**	(30,540)	**(55,537)**	(29,140)
Balance at end of the year	**₱422,545**	₱230,685	**₱417,674**	₱224,065

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16. Allowance for Impairment and Credit Losses

Changes in the allowance for impairment losses follow:

	Consolidated		Parent Company	
	2007	2006	**2007**	2006
	(In Thousand Pesos)			
Balance at beginning of year				
Property and equipment	**₱306,926**	₱325,922	**₱306,926**	₱325,922
Investment properties	**4,134,211**	4,036,162	**4,134,211**	4,036,162
Other assets	**515,512**	1,008,022	**513,591**	906,181
Investments in subsidiaries and an associate	**–**	–	**7,672**	–
	4,956,649	5,370,106	**4,962,400**	5,268,265
Provisions during the year	**2,452,653**	636,650	**2,452,653**	636,649
Disposals, transfers and others	**(650,395)**	(1,050,107)	**(590,359)**	(942,514)
Balance at end of year				
Property and equipment (Note 12)	**306,926**	306,926	**306,926**	306,926
Investment properties (Note 14)	**6,419,716**	4,134,211	**6,419,716**	4,134,211
Other assets (Note 15)	**32,265**	515,512	**31,999**	513,591
Investments in subsidiaries and an associate (Note 13)	**–**	–	**66,053**	7,672
	₱6,758,907	₱4,956,649	**₱6,824,694**	₱4,962,400

Changes in the allowance for credit losses follow:

	Consolidated		Parent Company	
	2007	2006	**2007**	2006
	(In Thousand Pesos)			
Balance at beginning of year:				
Loans and receivables	**₱13,497,223**	₱24,131,080	**₱13,270,803**	₱23,936,782
AFS investments	**445,428**	122,846	**445,428**	122,846
NPAs to be sold to SPV	**5,466,310**	–	**5,466,310**	–
	19,408,961	24,253,926	**19,182,541**	24,059,628
Provisions during the year	**828,222**	2,165,633	**799,034**	2,098,087
Accounts charged off, transfers and others	**(6,968,564)**	(7,010,598)	**(6,996,134)**	(6,975,174)
Balance at end of year:				
Loans and receivables (Note 9)	**11,966,288**	13,497,223	**11,683,110**	13,270,803
AFS investments (Note 11)	**619,399**	445,428	**619,399**	445,428
Receivable from SPV (Note 10)	**682,932**	–	**682,932**	–
NPAs to be sold to SPV (Note 15)	**–**	5,466,310	**–**	5,466,310
	₱13,268,619	₱19,408,961	**₱12,985,441**	₱19,182,541

Below is the breakdown of provision for credit losses by type of loans and receivable for the years ended December 31, 2007 and 2006, respectively.

	Consolidated					
	2007			2006		
	Individual Impairment	**Collective Impairment**	**Total**	Individual Impairment	Collective Impairment	Total
	(In Thousand Pesos)					
Loans receivables	**(₱201,109)**	**₱287,444**	**₱86,335**	₱2,219,175	(₱406,519)	₱1,812,656
Unquoted debt instruments	**–**	**–**	**–**	(555,662)	–	(555,662)
Others	**362,647**	**–**	**362,647**	908,639	–	908,639
	₱161,538	**₱287,444**	**₱448,982**	₱2,572,152	(₱406,519)	₱2,165,633

	Parent Company					
	2007			2006		
	Individual Impairment	Collective Impairment	Total	Individual Impairment	Collective Impairment	Total
	(In Thousand Pesos)					
Loans receivables	(₱229,151)	₱287,444	₱58,293	₱2,173,994	(₱406,519)	₱1,767,475
Unquoted debt instruments	–	–	–	(555,662)	–	(555,662)
Others	361,502	–	361,502	886,274	–	886,274
	₱132,351	₱287,444	₱419,795	₱2,504,606	(₱406,519)	₱2,098,087

A reconciliation of the allowance for impairment losses for loans and receivables by class is as follows:

For the year ended December 31, 2007

	Consolidated							
	Business loans	GOCCs and NGAs	LGUs	Consumers	Fringe Benefits	Unquoted Debt Instruments	Others	Total
	(In Thousand Pesos)							
Balance at beginning of year	₱6,320,199	₱16,585	₱10,955	₱474,492	₱35,003	₱1,782,069	₱4,857,920	₱13,497,223
Provisions during the year	(13,177)	122,458	(807)	(22,536)	397	–	362,647	448,982
Accounts charged off, transfers and others	(280,853)	–	–	(3,296)	2,242	(201,218)	(1,060,639)	(1,543,764)
Accretion of impaired loans	(418,723)	–	–	(14,080)	(2,242)	–	(1,108)	(436,153)
Balance at end of year	₱5,607,446	₱139,043	₱10,148	₱434,580	₱35,400	₱1,580,851	₱4,158,820	₱11,966,288

	Parent Company							
	Business loans	GOCCs and NGAs	LGUs	Consumers	Fringe Benefits	Unquoted Debt Instruments	Others	Total
	(In Thousand Pesos)							
Balance at beginning of year	₱6,225,836	₱16,585	₱10,955	₱397,525	₱35,003	₱1,782,069	₱4,802,830	₱13,270,803
Provisions during the year	(24,007)	122,458	(807)	(39,748)	397	–	361,502	419,795
Accounts charged off, transfers and others	(316,040)	–	–	14,080	2,241	(201,217)	(1,070,399)	(1,571,335)
Accretion of impaired loans	(418,724)	–	–	(14,080)	(2,241)	–	(1,108)	(436,153)
Balance at end of year	₱5,467,065	₱139,043	₱10,148	₱357,777	₱35,400	₱1,580,852	₱4,092,825	₱11,683,110

For the year ended December 31, 2006

	Consolidated							
	Business loans	GOCCs and NGAs	LGUs	Consumers	Fringe Benefits	Unquoted Debt Instruments	Others	Total
	(In Thousand Pesos)							
Balance at beginning of year	₱15,126,938	₱188,337	₱83,663	₱410,873	₱22,332	₱2,291,555	₱6,007,382	₱24,131,080
Provisions during the year	1,967,033	(171,752)	(72,708)	77,412	12,671	(555,662)	908,639	2,165,633
Accounts charged off, transfers and others	(9,855,663)	–	–	(3,525)	2,915	46,176	(2,056,857)	(11,866,954)
Accretion of impaired loans	(918,109)	–	–	(10,268)	(2,915)	–	(1,244)	(932,536)
Balance at end of year	₱6,320,199	₱16,585	₱10,955	₱474,492	₱35,003	₱1,782,069	₱4,857,920	₱13,497,223

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	Parent Company							
	Business loans	GOCCs and NGAs	LGUs	Consumers	Fringe Benefits	Unquoted Debt Instruments	Others	Total
				(In Thousand Pesos)				
Balance at beginning of year	₱15,034,236	₱188,337	₱83,663	₱342,854	₱22,332	₱2,291,555	₱5,973,805	₱23,936,782
Provisions during the year	1,944,593	(171,752)	(72,708)	54,671	12,671	(555,662)	886,274	2,098,087
Accounts charged off, transfers and others	(9,834,884)	–	–	10,268	2,915	46,176	(2,056,005)	(11,831,530)
Accretion of impaired loans	(918,109)	–	–	(10,268)	(2,915)	–	(1,244)	(932,536)
Balance at end of year	₱6,225,836	₱16,585	₱10,955	₱397,525	₱35,003	₱1,782,069	₱4,802,830	₱13,270,803

Below is the movement of allowance for credit losses for AFS investments and NPAs to be sold to SPV for the Group and Parent Company:

	2007		2006	
	AFS investments	**NPAs to be sold to SPV**	AFS investments	NPAs to be sold to SPV
		(In Thousand Pesos)		
Balance at beginning of year	**₱445,428**	**₱5,466,310**	₱122,846	₱–
Provisions during the year	**146,881**	**–**	–	–
Disposals, transfers and others	**27,090**	**(5,466,310)**	322,582	5,466,310
Balance at end of year	**₱619,399**	**₱–**	₱445,428	₱5,466,310

17. Deposit Liabilities

Of the total deposit liabilities of the Parent Company, ₱7.6 billion and ₱7.4 billion as of December 31, 2007 and 2006, respectively, are noninterest-bearing. Remaining deposit liabilities generally earned annual fixed interest rates ranging from 0.50% to 5.14% in 2007 and from 0.50% to 5.13% in 2006 for foreign currency-denominated deposit liabilities, and from 0.50% to 13.94% in 2007 and 2006 for peso-denominated deposit liabilities.

Under existing BSP regulations, non-FCDU deposit liabilities of the Parent Company are subject to liquidity reserves equivalent to 11.00% and statutory reserves equivalent to 10.00%. Available reserves follow:

	2007	2006
	(In Thousand Pesos)	
Cash on hand	**₱3,594,104**	₱4,051,961
Due from BSP	**27,961,521**	12,566,759
Securities held under agreements to resell	**11,200,000**	15,700,000
AFS investments	**3,733,032**	10,383,733
	₱46,488,657	₱42,702,453

As of December 31, 2007 and 2006, the Parent Company was in compliance with such regulations.

Interest expense on deposit liabilities consists of:

	Consolidated			Parent Company		
	2007	2006	2005	**2007**	2006	2005
			(In Thousand Pesos)			
Savings	**₱2,984,817**	₱4,070,575	₱3,734,388	**₱2,984,262**	₱4,088,182	₱3,745,031
Time	**793,549**	987,658	912,103	**790,919**	1,071,120	962,556
Demand	**108,480**	100,243	82,173	**108,480**	100,243	82,173
	₱3,886,846	₱5,158,476	₱4,728,664	**₱3,883,661**	₱5,259,545	₱4,789,760

18. Bills and Acceptances Payable

This account consists of:

	Consolidated		Parent Company	
	2007	2006	**2007**	2006
	(In Thousand Pesos)			
Bills payable to:				
BSP and local banks	**₱2,456,145**	₱2,571,515	**₱1,748,311**	₱2,072,515
Foreign banks	**1,002,912**	1,425,893	**768,099**	1,140,888
PDIC and others	**420,530**	6,548,580	**538,531**	6,738,352
	3,879,587	10,545,988	**3,054,941**	9,951,755
Acceptances outstanding	**419,507**	409,960	**419,507**	409,960
	₱4,299,094	₱10,955,948	**₱3,474,448**	₱10,361,715

As of December 31, 2007, 10.47% and 13.47% of the bills payable of the Group and the Parent Company, respectively, are subject to periodic interest repricing. As of December 31, 2006, 70.31% and 70.70% of the bills payable of the Group and the Parent Company, respectively, are subject to periodic interest repricing. The annual interest rates range from 4.68% to 6.08% for the year ended December 31, 2007 and from 3.70% to 6.19% for the year ended December 31, 2006 for foreign currency-denominated borrowings, and from 2.00% to 12.50% for the year ended December 31, 2007 and from 3.50% to 12.00% for the year ended December 31, 2006 for peso-denominated borrowings for the Group and the Parent Company.

The Parent Company's bills payable to BSP includes the transferred liabilities from Maybank amounting to ₱1.9 billion as of December 31, 2007 and 2006 (see Note 9).

Under the MOA mentioned in Note 2, notes payable to BSP of ₱13.9 billion as of October 28, 2001 was assigned to PDIC. Such assignment increased the Parent Company's total obligation to PDIC to ₱23.9 billion. In October 2001, of the total obligation, (a) ₱10.0 billion was settled thru "dacion en pago" of the Parent Company's assets comprising loans to, and debt securities issued by various government entities, (b) ₱7.8 billion was converted into convertible preferred shares of the Parent Company, and (c) the balance of ₱6.1 billion was converted into a notes payable in ten years with interest of 91-day T-bill rate plus 1.00%.

On October 14, 2006, the Parent Company and PDIC amended the loan and mortgage agreement by way of substitution of collateral at the request of the Parent Company. PDIC has agreed to release its mortgage lien on the real estate properties and in substitution, the Parent Company assigned in favor of PDIC certain government securities with a face value of ₱6.2 billion as of December 31, 2006, (see Note 9). The bills payable to PDIC was settled on June 19, 2007.

Bills payable - others also includes funding from the Development Bank of the Philippines, Land Bank of the Philippines and the Social Security System under which the Parent Company acts as a conduit for certain financing programs of these institutions. Lending to such programs is shown under 'Loans and receivables' (see Note 9).

Interest expense on bills payable and other borrowings consists of:

	Consolidated			Parent Company		
	2007	2006	2005	**2007**	2006	2005
	(In Thousand Pesos)					
Subordinated debt	**₱953,206**	₱663,362	₱380,803	**₱965,723**	₱663,362	₱380,803
Bills payable	**460,571**	636,779	696,920	**410,491**	589,637	673,172
Others	**15,396**	254,074	46,643	**13,326**	252,090	43,473
	₱1,429,173	₱1,554,215	₱1,124,366	**₱1,389,540**	₱1,505,089	₱1,097,448

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19. Accrued Taxes, Interest and Other Expenses

This account consists of:

	Consolidated		Parent Company	
	2007	2006	**2007**	2006
	(In Thousand Pesos)			
Interest	**₱2,053,372**	₱2,575,054	**₱2,046,474**	₱2,579,782
Taxes	**184,426**	114,010	**115,932**	101,177
Others	**2,036,920**	2,210,363	**2,003,759**	2,142,852
	₱4,274,718	₱4,899,427	**₱4,166,165**	₱4,823,811

20. Subordinated Debt

On May 26, 2006 and August 3, 2006, the Parent Company's BOD approved the issuance of unsecured subordinated notes of ₱5.5 billion that qualify as Lower Tier 2 capital. The MB, in its Resolution Nos. 979 dated August 3, 2006 and 874 dated July 6, 2006, approved this issuance subject to the Parent Company's compliance with certain conditions.

Relative to this, on August 10, 2006, the Parent Company issued ₱5.5 billion, 10% subordinated notes (the 2006 Notes) due in 2016.

Among the significant terms and conditions of the issuance of such 2006 Notes are:

(a) Issue price at 100.00% of the principal amount;

(b) The 2006 Notes bear interest at the rate of 10.00% per annum from and including August 10, 2006 to but excluding August 10, 2011. Interest will be payable quarterly in arrears on the 10th of February, May, August and November of each year, commencing on August 10, 2006. Unless the 2006 Notes are previously redeemed, interest from and including August 10, 2011 to but excluding August 10, 2016 will be reset at the equivalent of the five-year Money Market Association of the Philippines 1 Fixed Rate Treasury Notes (MART1 FXTN) as of reset date multiplied by 80.00%, plus a spread of 4.4935% per annum. The stepped-up interest will be payable quarterly in arrears on February, May, August and November of each year, commencing on November 10, 2011;

(c) The 2006 Notes constitute direct, unconditional, unsecured and subordinated obligations of the Parent Company and at all times rank pari passu without preference among themselves and at least equally with all other present and future unsecured and subordinated obligations of the Parent Company;

(d) The Parent Company may redeem the 2006 Notes in whole but not in part at a redemption price equal to 100.00% of the principal amount together with accrued and unpaid interest on the day following the last day of the twentieth (20th) interest period from issue date, subject to the prior consent of the BSP and the compliance by the Bank with the prevailing requirements for the granting by the BSP of its consent thereof. The 2006 Notes may not be redeemed at the option of the noteholders; and

(e) Each noteholder, by accepting the 2006 Notes, irrevocably agrees and acknowledges that: (i) it may not exercise or claim any right of set-off in respect of any amount owed by the Parent Company arising under or in connection with the 2006 Notes; and (ii) it shall, to the fullest extent permitted by applicable law, waive and be deemed to have waived all such rights of set-off.

On December 19, 2003, the Parent Company's BOD approved the raising of Lower Tier 2 capital through the issuance in the local capital market of subordinated notes with maximum principal amount of ₱3.0 billion maturing in 10 years but callable with step-up on August 16, 2009. The notes bear a coupon rate of 12.50% per annum with step-up after five years.

The issuance of the foregoing subordinated notes under the terms approved by the BOD was approved by the MB, in its Resolution No. 06/01-23-04 dated January 22, 2004, subject to the Parent Company's compliance with certain conditions.

Relative to this, on February 16, 2004, the Parent Company issued ₱3.0 billion, 12.50% Subordinated Notes (the 2004 Notes) due in 2014. As discussed in Note 30, on March 2, 2004, the Parent Company swapped the proceeds from the 2004 Notes into USD, which are then invested in USD-denominated interbank placements, Republic of the Philippines (ROP) and US Treasury bonds.

Among the significant terms and conditions of the issuance of such Notes are:

(a) Issue price at 100.00% of the principal amount;

(b) The 2004 Notes bear interest at the rate of 12.50% per annum from and including February 16, 2004 to but excluding February 16, 2009. Interest will be payable semi-annually in arrears on February 16 and August 16 of each year, commencing on August 16, 2004. Unless the Notes are previously redeemed, interest from and including February 16, 2009 to but excluding February 16, 2014 will be reset at 11.23%, the equivalent of the five-year MART1 FXTN as of February 9, 2004, plus a spread of 5.27% per annum. The stepped-up interest will be payable semi-annually in arrears on February 16 and August 16 of each year, commencing on August 16, 2009;

(c) The 2004 Notes constitute direct, unconditional unsecured and subordinated obligations of the Parent Company and at all times rank pari passu without preference among themselves and at least equally with all other present and future unsecured and subordinated obligations of the Parent Company;

(d) The Parent Company may redeem the 2004 Notes in whole but not in part at a redemption price equal to 100.00% of the principal amount together with accrued and unpaid interest on the day following the last day of the tenth interest period from issue date, subject to the prior consent of the BSP. The 2004 Notes may not be redeemed at the option of the noteholders; and

(e) Each noteholder, by accepting the 2004 Notes, irrevocably agrees and acknowledges that: (i) it may not exercise or claim any right of set-off in respect of any amount owed by the Parent Company arising under or in connection with the 2004 Notes; and (ii) it shall to the fullest extent permitted by applicable law, waive and be deemed to have waived all such rights of set-off.

As of December 31, 2007 and 2006, subordinated debt is net of unamortized transaction cost of ₱83.6 million and ₱110.7 million, respectively.

21. Other Liabilities

This account consists of:

	Consolidated		Parent Company	
	2007	2006	**2007**	2006
	(In Thousand Pesos)			
Accounts payable	**₱5,186,627**	₱3,778,795	**₱5,093,465**	₱3,503,276
Bills purchased - contra	**4,159,741**	2,993,225	**4,159,741**	2,993,225
Insurance contract liabilities	**670,671**	637,728	**–**	–
Retirement liability (Note 23)	**579,717**	336,744	**551,234**	283,943
Manager's checks and demand drafts outstanding	**450,396**	1,987,410	**450,396**	1,987,410
Due to other banks	**368,275**	436,387	**301,322**	413,096
Other dormant credits	**340,692**	307,266	**340,692**	307,266
Deposits on lease contracts	**223,919**	203,621	**–**	–
Deferred credits	**223,794**	102,810	**223,794**	102,625
Withholding tax payable	**127,866**	130,390	**123,989**	127,844
Due to BSP	**122,818**	114,312	**122,818**	114,312
Derivative liability	**67,612**	6,633	**67,612**	6,633
Margin deposits and cash letters of credit	**35,684**	506,282	**35,684**	506,282
Miscellaneous	**1,115,905**	1,260,823	**489,508**	735,925
	₱13,673,717	₱12,802,426	**₱11,960,255**	₱11,081,837

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22. Equity

Capital stock as of December 31, 2007 and 2006 consists of (in thousand pesos except for par value and number of shares):

	2007		2006		2005	
	Shares	Amount	Shares	Amount	Shares	Amount
Preferred - ₱40 par value						
Authorized	195,175,444		195,175,444		195,175,444	
Issued and outstanding						
Balance at beginning of the year	54,357,751	₱2,174,310	54,357,751	₱2,174,310	195,175,444	₱7,807,018
Conversion to common stock	54,357,751	2,174,310	–	–	140,817,693	5,632,708
Balance at end of the year	–	–	54,357,751	2,174,310	54,357,751	2,174,310
Common - P40 par value						
Authorized	1,054,824,557		1,054,824,557		1,054,824,557	
Issued and outstanding						
Balance at beginning of the year	518,888,165	20,755,527	518,888,165	20,755,527	378,070,472	15,122,819
Conversion from preferred stock	54,357,751	2,174,310	–	–	140,817,693	5,632,708
Additional issuance	89,000,000	3,560,000	–	–	–	–
	662,245,916	26,489,837	518,888,165	20,755,527	518,888,165	20,755,527
		₱26,489,837		₱22,929,837		₱22,929,837

As discussed in Note 1, the Parent Company completed its Tier 1 follow-on equity offering in August 2007 where it raised ₱5.1 billion, net of issuance cost of ₱199.5 million in Tier 1 capital. Together with the sale of 89 million primary shares, 71.8 million secondary shares owned by the NG thru PDIC and DOF were sold to the public thus paving for a complete exit of the NG from the Parent Company.

The Parent Company shares are listed in the PSE.

The preferred shares have the following features:

(a) Non-voting, non-cumulative, fully participating in dividends with the common shares;

(b) Convertible, at any time at the option of the holder who is qualified to own and hold common shares;

(c) With mandatory and automatic conversion into common shares upon the sale of such preferred shares to any person other than the NG or any GOCC's; and

(d) With rights to subscribe to additional new preferred shares with all of the features described above.

The additional issuance of 89.0 million common shares was approved by the BOD on March 23, 2007.

Capital Management

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

The Parent Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Parent Company may adjust the amount of dividend payment to shareholders, return capital structure, or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

Regulatory Qualifying Capital

Under existing BSP regulations, the determination of the Parent Company's compliance with regulatory requirements and ratios is based on the amount of the Parent Company's "unimpaired capital" (regulatory net worth) reported to the BSP, which is determined on the basis of regulatory policies, which differ from PFRS in some respects. In addition, the risk-based capital ratio of a bank, expressed as a percentage of qualifying capital to risk-weighted assets, should not be less than 10.00% for both solo basis (head office and branches) and consolidated basis (parent bank and subsidiaries engaged in financial allied undertakings but excluding insurance companies). Qualifying capital and risk-weighted assets are computed based on BSP regulations.

The regulatory Gross Qualifying Capital of the Parent Company consists of Tier 1 (core) and Tier 2 (supplementary) capital. Tier 1 capital comprises share capital, retained earnings (including current year profit) and minority interest less required deductions such as deferred income tax and unsecured credit accommodations to directors, officers, stockholders and related interests (DOSRI). Tier 2 capital includes unsecured subordinated debts, revaluation reserves and general loan loss provision. Certain items are deducted from the regulatory Gross Qualifying Capital, such as but not limited to equity investments in unconsolidated subsidiary banks and other financial allied undertakings, but excluding insurance companies (for solo basis); investments in debt capital instruments of unconsolidated subsidiary banks (for solo basis); and equity investments in subsidiary insurance companies and subsidiary non-financial allied undertakings; and reciprocal investments in equity of other banks/enterprises.

Risk-weighted assets are determined by assigning defined risk weights to amounts of on-balance sheet exposures and to the credit equivalent amounts of off-balance sheet exposures. Certain items are deducted from risk-weighted assets, such as the excess of general loan loss provision over the amount permitted to be included in Tier 2 capital. The risk weights vary from 0% to 150% depending on the type of exposure, with the risk weights of off-balance sheet exposures being subjected further to credit conversion factors. Below is a summary of exposure types and their corresponding risk weights:

Risk weight	Exposure/Asset type*
0%	Cash on hand; all peso denominated exposures to the PNG and BSP, exposures to Multilateral Development Banks (MDB), Bank for International Settlements (BIS), International Monetary Fund (IMF), European Central Bank (ECB) and the European Community (EC)
20%	COCI, claims guaranteed by Philippine/foreign incorporated banks/quasi-banks with the highest credit quality; and exposures as enumerated in standardized credit risk weight below
50%	Housing loans fully secured by first mortgage on residential property; and exposures as enumerated in standardized credit risk weight below
75%	MSME qualified portfolio
100%	All other assets excluding those deducted from capital (e.g., deferred income tax and equity investments), financial assets held for trading, securitization exposures, unsecured DOSRI and accumulated market gains/(losses) on available for sale debt securities; defaulted housing loans exposures
150%	All defaulted exposures (except defaulted housing loan exposures and below B- rating exposures in standardized credit risk weight enumerated below

** Not all inclusive*

STANDARDIZED CREDIT RISK WEIGHTS								
Credit Assessment	AAA	AA+ to AA	A+ to A-	BBB+ to BBB-	BB+ to BB	B+ to B-	Below B-	Unrated
Sovereigns	0%	0%	20%	50%	100%	100%	150%	100%
MDBs	0%	20%	50%	50%	100%	100%	150%	100%
Banks	20%	20%	50%	50%	100%	100%	150%	100%
Interbank call loans	20%							
Local government units	20%	20%	50%	50%	100%	100%	150%	100%
Government Corporations	20%	20%	50%	100%	100%	150%	150%	100%
Corporates	20%	20%	50%	100%	100%	150%	150%	100%
Housing loans	50%							
MSME qualified portfolio	75%							
Defaulted exposures								
Housing loans	100%							
Others	150%							
ROPA	150%							
All other assets	100%							

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With respect to off-balance sheet exposures, the exposure amount is multiplied by a credit conversion factor (CCF), ranging from 0% to 100%, to arrive at the credit equivalent amount, before the risk weight factor is multiplied to arrive at the risk-weighted exposure. Direct credit substitutes (e.g., guarantees) have a CCF of 100%, while items not involving credit risk has a CCF of 0%.

In the case of derivatives, the credit equivalent amount (against which the risk weight factor is multiplied to arrive at the risk-weighted exposure) is generally the sum of the current credit exposure or replacement cost (the positive fair value or zero if the fair value is negative or zero) and an estimate of the potential future credit exposure or add-on. The add-on ranges from 0% - 1.5% for interest rate-related, 1% - 7.5% for exchange rate-related, and 6.0% to 10.0% for equity contract depending on the residual maturity of the contract. The credit equivalent amount shall be treated like any on-balance sheet asset, and shall be assigned the appropriate risk weight, i.e. according to the third part credit assessment of the counterpart exposure.

As discussed in Note 2, the BSP approved the booking of additional appraisal increment of ₱431.8 million in 2001 on properties and recognition of the same in determining the capital adequacy ratio, and booking of translation adjustment of ₱1.6 billion in 2001 representing the increase in peso value of the investment in foreign subsidiaries for purposes of the quasi-reorganization and rehabilitation of the Parent Company provided that the same shall be excluded for dividend purposes. As of December 31, 2007 and 2006, the Group was in compliance with the CAR.

The CAR of the Group as reported to the BSP as of December 31, 2007 and 2006 are shown in the table below.

	2007		2006	
	Actual 1/	Required	Actual 2/	Required
	(Amounts in Million Pesos)			
Tier 1 capital	₱22,706.8		₱16,644.0	
Tier 2 capital	10,345.0		9,317.7	
Gross qualifying capital	33,051.8		25,961.7	
Less required deductions	0.4		0.5	
Total qualifying capital	₱33,051.4	₱17,365.50	₱25,961.2	₱13,263.4
Risk weighted assets	₱173,655.2		₱132,633.8	
Tier 1 capital ratio	13.08%		12.55%	
Total capital ratio	19.03%		19.57%	

1/ Data are based on consolidated CAR combined credit, market and operational risks (BSP Cir. No. 538).

2/ Data are based on consolidated CAR for credit risks (BSP Cir. No. 280).

The BSP, under BSP Circular 538 dated August 4, 2006, has issued the prescribed guidelines implementing the revised risk-based capital adequacy framework for the Philippine banking system to conform to Basel II recommendations. The new BSP guidelines took effect on July 1, 2007.

The increase in the regulatory qualifying capital in 2007 is mainly due to the additional issuance of Tier 1 follow-on equity offering in August 2007.

Financial Performance

The following basic ratios measure the financial performance for the years ended December 31, 2007 and 2006 of the Group and the Parent Company:

	Consolidated		Parent Company	
	2007	2006	2007	2006
	(Amounts in Million Pesos)			
Return on average equity (a/b)	5.45%	3.44%	5.09%	3.17%
a.) Net income	₱1,498	₱820	₱1,335	₱706
b.) Average total equity	27,493	23,833	26,242	22,280
Return on average assets (c/d)	0.62%	0.35%	0.56%	0.30%
c.) Net income	₱1,498	₱820	₱1,335	₱706
d.) Average total assets	241,588	233,065	239,890	231,550
Net interest margin on average earning assets (e/f)	3.75%	3.77%	3.59%	3.59%
e.) Net interest income	₱5,878	₱5,345	₱5,441	₱4,891
f.) Average interest earning assets	156,567	141,691	151,744	136,406

Note: Average balances were determined as the sum of beginning and ending balances of the respective balance sheet accounts as of the end of the year divided by two (2).

23. Retirement Plan

The Parent Company has separate funded noncontributory defined benefit retirement plans covering substantially all its officers and regular employees. Under these retirement plans, all covered officers and employees are entitled to cash benefits after satisfying certain age and service requirements.

The Parent Company's annual contribution to the retirement plan consists of a payment covering the current service cost, amortization of the unfunded actuarial accrued liability and interest on such unfunded actuarial liability. The retirement plan provides a retirement benefit equal to one hundred and twelve percent (112.00%) of plan salary per month for every year of credit service.

The following table shows the actuarial assumptions as of January 1, 2007 and 2006 used in determining the retirement benefit obligation of the Parent Company:

	2007	2006
Expected rate of return on plan assets	7%	10%
Discount rate	7%	14%
Salary rate increase	8%	8%

As of December 31, 2007, the discount rate used in determining the retirement obligation is 10%.

The overall expected rate of return on plan assets is determined based on the market prices prevailing on that date applicable to the period over which the obligation is to be settled.

An actuarial valuation was made on December 31, 2007.

The amount of liability recognized in the Parent Company balance sheets (included under Other liabilities) is as follows (in thousand pesos):

	2007	2006
Present value of defined benefit obligation	₱1,648,256	₱1,986,807
Fair value of plan assets	958,856	945,053
	689,400	1,041,754
Unrecognized actuarial gains	(138,166)	(757,811)
Retirement liability	₱551,234	₱283,943

The amounts included in Compensation and fringe benefits in the Parent Company statement of income are as follows (in thousand pesos):

	2007	2006	2005
Current service cost	₱157,093	₱68,859	₱60,403
Interest cost	139,077	108,597	93,425
Expected return on plan assets	(66,154)	(71,032)	(67,733)
Net actuarial gains recognized during the year	37,275	(2,305)	(2,399)
	₱267,291	₱104,119	₱83,696

The actual return on plan assets amounted to ₱98.4 million, ₱289.9 million and ₱78.5 million in 2007, 2006 and 2005, respectively.

The movements in the retirement liability recognized in the Parent Company balance sheet follow (in thousand pesos):

	2007	2006
Balance at beginning of year	₱283,943	₱179,824
Retirement expense	267,291	104,119
Balance at end of year	₱551,234	₱283,943

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Changes in the present value of the defined benefit obligation are as follows (in thousand pesos):

	2007	2006
Defined benefit obligation at beginning of year	₱1,986,807	₱775,689
Interest cost	139,077	108,597
Current service cost	157,093	68,859
Benefits paid	(84,555)	(55,168)
Actuarial loss (gain)	(550,166)	1,088,830
Defined benefit obligation at end of year	₱1,648,256	₱1,986,807

Changes in the fair value of the plan assets are as follows (in thousand pesos):

	2007	2006
Fair value of plan assets at beginning of year	₱945,053	₱710,317
Expected return	66,154	71,032
Benefits paid	(84,555)	(55,168)
Actuarial gain	32,204	218,872
Fair value of plan assets at end of year	₱958,856	₱945,053

The fair value of the plan assets as of December 31, 2007 and 2006 includes the fair value of the investments in the Parent Company shares of stocks amounting to ₱391.7 million and ₱344.7 million, respectively.

The Parent Company believes that the plan has enough funds to pay any retiring employee. Accordingly, it does not expect to contribute to the plan in 2008.

The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:

	2007	2006
Parent Company's own common shares	41%	37%
Government securities	23	53
Receivables from related parties	12	10
Equity securities and others	24	–
	100%	100%

Information on the Parent Company's pension plan (in thousand pesos) are as follows:

	2007	2006
Present value of the defined benefit obligation	₱1,648,256	₱1,986,807
Fair value of plan assets	958,856	945,053
Deficit in plan assets	689,400	1,041,754
Experience adjustments arising on plan liabilities	86,992	52,968
Experience adjustments arising on plan assets	32,204	218,872

As of December 31, 2007 and 2006, the net retirement liability (asset) included in Miscellaneous liabilities and assets, respectively, of certain subsidiaries of the Group follows (in thousand pesos):

	PNB Europe	PNB Capital	PNB Securities	Japan-PNB	PNB Gen
December 31, 2006	50,893	(1,597)	95	1,813	(7,836)
December 31, 2007	**25,784**	**(1,597)**	**196**	**2,504**	**(6,628)**

Retirement expense of the Group charged to operations, included in Compensation and fringe benefits in the statements of income amounted to ₱273.7 million, ₱107.9 million and ₱92.4 million in 2007, 2006 and 2005, respectively.

24. Leases

The Parent Company leases the premises occupied by majority of its branches (about 41.59% of the branch sites are Parent Company-owned). Some of its subsidiaries also lease the premises occupied by their Head Offices and most of their branches. The lease contracts are for periods ranging from 1 to 25 years and are renewable at the Group's option under certain terms and conditions. Various lease contracts include escalation clauses, most of which bear an annual rent increase of 10%.

Rent expense charged against current operations (included in 'Occupancy and equipment-related costs' in the statements of income) amounted to ₱393.0 million in 2007, ₱346.3 million in 2006 and ₱383.2 million in 2005 for the Group, of which ₱247.3 million in 2007, ₱247.6 million in 2006 and ₱274.7 million in 2005 pertain to the Parent Company.

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

	Consolidated		Parent Company	
	2007	2006	**2007**	2006
	(In Thousand Pesos)			
Within one year	**₱157,777**	₱246,298	**₱121,020**	₱150,358
Beyond one year but not more than five years	**288,145**	498,531	**261,452**	348,704
Beyond more than five years	**31,302**	90,483	**31,302**	51,689
	₱477,224	₱835,312	**₱413,774**	₱550,751

The Parent Company has entered into commercial property leases on its investment property. These non-cancelable leases have remaining lease terms of between two and five years. Some leases include escalation clauses (such as 5% per year). In 2007, 2006 and 2005, total rent income (included under 'Miscellaneous income') amounted to ₱196.3 million, ₱209.9 million and ₱172.2 million, respectively, for the Group and ₱192.1 million, ₱207.5 million and ₱171.04 million, respectively, for the Parent Company.

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

	2007	2006
	(In Thousand Pesos)	
Within one year	**₱9,882**	₱30,587
Beyond one year but not more than five years	**27,715**	6,290
	₱37,597	₱36,877

25. Income and Other Taxes

Under Philippine tax laws, the Parent Company and certain subsidiaries are subject to percentage and other taxes (presented as Taxes and Licenses in the statements of income) as well as income taxes. Percentage and other taxes paid consist principally of gross receipts tax and documentary stamp tax.

Income taxes include the corporate income tax, discussed below, and final taxes paid which represents final withholding tax on gross interest income from government securities and other deposit substitutes and income from the FCDU transactions. These income taxes, as well as the deferred tax benefits and provisions, are presented as 'Provision for income tax' in the statements of income.

RA No. 9337, *An Act Amending National Internal Revenue Code*, provides that the RCIT rate shall be 35.00% until December 31, 2008. Starting January 1, 2009, the RCIT rate shall be 30.00%. Interest expense allowed as a deductible expense is reduced by 42.00% starting November 1, 2005 until December 31, 2008. Starting January 1, 2009, interest expense allowed as a deductible expense shall be reduced by 33.00% of interest income subjected to final tax.

An MCIT of 2% on modified gross income is computed and compared with the RCIT. Any excess of MCIT over the RCIT is deferred and can be used as a tax credit against future income tax liability for the next three years. In addition, NOLCO is allowed as a deduction from taxable income in the next three years from the period of incurrence for the Parent Company and certain subsidiaries.

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FCDU offshore income (income from non-residents) is tax-exempt while gross onshore income (income from residents) is generally subject to 10% income tax. In addition, interest income on deposit placement with other FCDUs and offshore banking units (OBUs) is taxed at 7.50%. RA No. 9294, which became effective in May 2004, provides that the income derived by the FCDU from foreign currency transactions with non-residents, OBUs, local commercial banks including branches of foreign banks is tax-exempt while interest income on foreign currency loans from residents other than OBUs or other depository banks under the expanded system is subject to 10.00% income tax.

Provision for income tax consists of:

	Consolidated			Parent Company		
	2007	2006	2005	2007	2006	2005
	(In Thousand Pesos)					
Current	₱617,873	₱728,113	₱712,602	₱479,865	₱538,852	₱552,654
Deferred	(8,361)	204,566	1,179,124	(12,684)	220,022	1,179,124
	₱609,512	₱932,679	₱1,891,726	₱467,181	₱758,874	₱1,731,778

Net deferred tax assets of the Group are included in the following accounts in the balance sheet:

	2007	2006
	(In Thousand Pesos)	
Deferred tax asset	₱1,857,109	₱1,847,258
Other liabilities	29,121	10,439
	₱1,827,988	₱1,836,819

The components of net deferred tax assets are as follows:

	Consolidated		Parent Company	
	2007	2006	2007	2006
	(In Thousand Pesos)			
Deferred tax asset on:				
Allowance for impairment losses	₱3,261,154	₱3,291,831	₱3,253,106	₱3,254,691
NOLCO and others	124,044	105,012	–	–
	3,385,198	3,396,843	3,253,106	3,254,691
Deferred tax liability on:				
Revaluation increment on land and buildings	859,117	882,352	859,117	882,352
Unrealized trading gains on derivatives	352,743	325,744	352,743	325,744
Unrealized gain on AFS investments	60,442	43,250	41,417	33,104
Others	284,908	308,678	201,167	219,200
	1,557,210	1,560,024	1,454,444	1,460,400
	₱1,827,988	₱1,836,819	₱1,798,662	₱1,794,291

Deferred tax charged (credited) directly to equity during the year is as follows:

	Consolidated		Parent Company	
	2007	2006	2007	2006
	(In Thousand Pesos)			
Unrealized gain on AFS investments	₱17,192	(₱63,551)	₱8,313	(₱65,008)
Revaluation increment on land and buildings	–	424,634	–	424,634
Others	–	224,995	–	224,995
	₱17,192	₱586,078	₱8,313	₱584,621

Based on the five-year financial forecast prepared by management and duly approved by the Executive Committee of the BOD, the Parent Company's deferred tax assets of ₱1.8 billion and ₱2.6 billion as of December 31, 2007 and 2006, respectively, is expected to be realized from its taxable profits within the next three to five years. The Parent Company and certain subsidiaries did not recognize deferred tax assets on the following temporary differences:

	Consolidated		Parent Company	
	2007	2006	**2007**	2006
	(In Thousand Pesos)			
Investment properties:				
Allowance for impairment losses	**₱6,419,716**	₱4,134,211	**₱6,419,716**	₱4,134,211
Accumulated depreciation	**2,632,265**	2,268,266	**2,632,265**	2,268,266
Fair value adjustment	**(8,985,005)**	(6,063,609)	**(8,985,005)**	(6,063,609)
	66,976	338,868	**66,976**	338,868
Allowance for impairment losses on loans and receivables	**479,819**	8,251,435	**429,248**	8,165,093
NOLCO	**27,097,239**	20,874,427	**27,080,071**	20,851,059
MCIT	**76,178**	55,983	**75,761**	54,911
Others	**1,888,586**	1,468,379	**1,887,711**	1,396,488
	₱29,608,798	₱30,989,092	**₱29,539,767**	₱30,806,419

Details of the Group's NOLCO follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousand Pesos)		
1992 to 1999	₱12,121	₱6,324	₱5,797	2002 to 2009
2004	1,700,948	1,700,948	–	2007
2005	7,029,130	–	7,029,130	2008 to 2010
2006	11,473,748	–	11,473,748	2009 to 2011
2007	8,618,816	–	8,618,816	2010 to 2012
	₱28,834,763	₱1,707,272	₱27,127,491	

The Group's NOLCO of ₱11.5 billion in 2006 and ₱7.0 billion in 2005 includes the Parent Company's loss on sale of NPAs to SPV companies amounting to ₱9.6 billion in 2006 and P5.4 billion in 2005 which can be claimed as deductions from taxable income for a period of five consecutive taxable years immediately following the year of sale.

The Group's NOLCO includes net operating losses of PNB Corporation - Guam from 1992 to 1999 amounting to ₱12.1 million recognized based on applicable tax laws similar to those of USA. Guam's NOLCO matures 10 years from the date such NOLCO was incurred.

Details of the Group's MCIT follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousand Pesos)		
2004	₱16,428	₱16,428	₱–	2007
2005	25,510	–	25,510	2008
2006	14,045	–	14,045	2009
2007	36,623	–	36,623	2010
	₱92,606	₱16,428	₱76,178	

Details of the Parent Company's NOLCO follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousand Pesos)		
2004	₱1,689,030	₱1,689,030	₱–	2007
2005	7,029,130	–	7,029,130	2008 to 2010
2006	11,432,125	–	11,432,125	2009 to 2011
2007	8,618,816	–	8,618,816	2010 to 2012
	₱28,769,101	₱1,689,030	₱27,080,071	

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Details of the Parent Company's MCIT follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousand Pesos)		
2004	₱15,773	₱15,773	₱–	2007
2005	25,510	–	25,510	2008
2006	13,628	–	13,628	2009
2007	36,623	–	36,623	2010
	₱91,534	₱15,773	₱75,761	

The reconciliation between the statutory income tax rate to effective income tax rate follows:

	Consolidated			Parent Company		
	2007	2006	2005	**2007**	2006	2005
Statutory income tax rate	**35.00%**	35.00%	32.50%	**35.00%**	35.00%	32.50%
Tax effects of:						
Net unrecognized deferred tax assets	**33.04**	39.52	76.27	**38.57**	41.13	96.82
Non-deductible expenses	**11.14**	10.76	10.38	**10.63**	12.74	13.19
FCDU income before tax	**(15.18)**	(16.12)	(25.35)	**(17.75)**	(19.28)	(32.21)
Tax-exempt income	**(8.55)**	(12.01)	(12.38)	**(8.39)**	(14.37)	(15.73)
Tax-paid income	**(24.88)**	(3.94)	(6.96)	**(32.14)**	(3.41)	(7.23)
Others - net	**(1.66)**	–	0.63	**–**	–	–
Effective income tax rate	**28.91%**	53.21%	75.09%	**25.92%**	51.81%	87.34%

Revenue Regulations (RR) No. 10-2002 defines expenses to be classified as entertainment, amusement and recreation expenses (EARE) and set a limit for the amount that is deductible for tax purposes. EARE are limited to 1.00% of net revenues for sellers of services. EARE charged against current operations (included in 'Miscellaneous expense') amounted to ₱130.8 million in 2007, ₱117.0 million in 2006 and ₱116.1 million in 2005 for the Group and ₱126.3 million in 2007, ₱111.7 million in 2006 and ₱110.1 million in 2005 (see Note 26).

26. Income and Expenses

Service fees and commission income consists of:

	Consolidated			Parent Company		
	2007	2006	2005	**2007**	2006	2005
			(In Thousand Pesos)			
Remittance	**₱1,021,760**	₱1,142,124	₱1,199,920	**₱355,984**	₱366,878	₱345,135
Deposit-related	**891,322**	928,936	1,099,468	**891,322**	928,936	1,099,468
Credit-related	**196,775**	250,339	354,418	**188,675**	241,646	345,629
Trust fees	**106,685**	238,828	202,160	**106,685**	238,828	202,160
Miscellaneous	**264,695**	207,235	58,465	**15,957**	19,915	15,790
	₱2,481,237	₱2,767,462	₱2,914,431	**₱1,558,623**	₱1,796,203	₱2,008,182

Miscellaneous income consists of:

	Consolidated			Parent Company		
	2007	2006	2005	**2007**	2006	2005
			(In Thousand Pesos)			
Net gain on sale or exchange of assets	**₱3,410,352**	₱1,317,083	₱372,542	**₱3,409,364**	₱1,317,083	₱372,542
Rental (Notes 28)	**196,295**	209,918	172,200	**192,129**	207,535	171,038
Others	**701,374**	626,785	783,579	**693,029**	726,032	604,951
	₱4,308,021	₱2,153,786	₱1,328,321	**₱4,294,522**	₱2,250,650	₱1,148,531

Miscellaneous expenses consist of:

	Consolidated			Parent Company		
	2007	2006	2005	**2007**	2006	2005
			(In Thousand Pesos)			
Insurance	**₱410,623**	₱383,333	₱424,245	**₱408,685**	₱379,922	₱422,380
Security, clerical, messengerial	**279,418**	316,232	–	**276,986**	310,232	–
Foreclosure	**219,777**	187,135	247,888	**219,777**	187,135	247,888
Transportation and travel	**138,944**	133,742	123,917	**127,783**	127,498	118,064
Representation and entertainment	**130,754**	117,710	116,099	**126,312**	111,655	110,100
Stationery and supplies used	**124,441**	132,958	120,076	**121,178**	126,179	119,632
Management and professional fees	**122,935**	152,895	358,683	**80,647**	110,229	243,251
Promotional	**121,481**	156,325	153,910	**121,475**	146,331	152,192
Others	**948,861**	953,907	1,097,713	**486,523**	505,188	601,528
	₱2,497,234	₱2,534,237	₱2,642,531	**P1,969,366**	₱2,004,369	₱2,015,035

Miscellaneous - others include information technology-related expenses, postage, telephone and telegraph, repairs and maintenances, EARE and litigation expenses.

27. Trust Operations

Securities and other properties held by the Parent Company in fiduciary or agency capacities for its customers are not included in the accompanying balance sheet since these are not assets of the Parent Company. Such assets held in trust were carried at a value of ₱22.4 billion and ₱14.1 billion as of December 31, 2007 and 2006, respectively (see Note 29). In connection with the trust functions of the Parent Company, government securities amounting to ₱232.4 million and ₱157.9 million (included under 'AFS investments' and 'HTM investments') as of December 31, 2007 and 2006, respectively, are deposited with the BSP in compliance with trust regulations.

In compliance with existing banking regulations, the Parent Company transferred from deficit to surplus reserves of ₱19.9 million in 2007, ₱17.1 million in 2006 and ₱13.4 million in 2005, corresponding to the 10.00% of the net income realized from its trust, investment management and other fiduciary business until such related surplus reserve constitutes 20.00% of its regulatory capital.

28. Related Party Transactions

In the ordinary course of business, the Parent Company has loans and other transactions with its subsidiaries and affiliates, and with certain DOSRI. Under the Parent Company's policy, these loans and other transactions are made substantially on the same terms as with other individuals and businesses of comparable risks. The amount of direct credit accommodations to each of the Parent Company's DOSRI, 70.00% of which must be secured, should not exceed the amount of their respective deposits and book value of their respective investments in the Parent Company. In the aggregate, DOSRI loans generally should not exceed the Parent Company's equity or 15% of the Parent Company's total loan portfolio, whichever is lower. As of December 31, 2007 and 2006, the Parent Company was in compliance with such regulations.

The information relating to the DOSRI loans of the Group follows (amounts in thousand pesos):

	2007	2006
Total outstanding DOSRI loans		
Inclusive of loans extended to NG and GOCCs	**₱2,410,629**	₱12,574,264
Exclusive of loans extended to NG and GOCCs	**2,410,629**	2,473,406
Percent of DOSRI loans to total loans		
Inclusive of loans extended to NG and GOCCs	**3.71%**	20.85%
Exclusive of loans extended to NG and GOCCs	**3.71%**	4.10%
Percent of unsecured DOSRI loans to total DOSRI loans		
Inclusive of loans extended to NG and GOCCs	**3.32%**	0.75%
Exclusive of loans extended to NG and GOCCs	**3.32%**	3.82%
Percent of past due DOSRI loans to total DOSRI loans	**1.21%**	1.23%
Percent of nonperforming DOSRI loans to total DOSRI loans	**–**	–

As discussed in Note 2, in August 2007, the Parent Company completed its Tier 1 follow-on equity offering where it raised about P5.0 billion in Tier 1 capital. Together with the sale of 89 million primary shares, 71.8 million secondary shares owned by the NG thru PDIC and DOF were sold to the public thus paving for a complete exit of the government from the Parent Company. Accordingly, DOSRI as of December 31, 2007 no longer includes loans to NG and GOCCs as they are no longer considered related parties.

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In accordance with existing BSP regulations, the reported DOSRI performing loans exclude loans extended to certain borrowers before these borrowers became DOSRI.

As of December 31, 2006, the information relating to Parent Company's receivables and other accommodations to government units follows (in thousand pesos):

NG/GOCCs with NG guaranty	₱7,628,955
GOCCs	2,471,903
	₱10,100,858

In the computation of the allowed DOSRI loans (the lower of the Parent Company's equity or 15% of the Parent Company's total portfolio), the receivables from NG and GOCCs with NG guaranty are not included.

The Parent Company has lease agreements with some of its subsidiaries. In 2005, the lease agreement was amended to indicate the share of the subsidiaries in the maintenance of the building in lieu of rental payments. The income related to these agreements amounting to ₱4.8 million in 2007 and 2006 and ₱4.7 million in 2005 is included in 'Miscellaneous income' in the statement of income.

On January 31, 2007, BSP Circular No. 560 was issued providing the rules and regulations that govern loans, other credit accommodations and guarantees granted to subsidiaries and affiliates of banks and quasi-banks. Under the said Circular, total outstanding exposures to each of the bank's subsidiaries and affiliates shall not exceed 10% of bank's net worth, the unsecured portion of which shall not exceed 5% of such networth. Further, the total outstanding exposures to subsidiaries and affiliates shall not exceed 20% of the networth of the lending bank. BSP Circular No. 560 is effective on February 15, 2007.

The significant account balances with respect to related parties included in the financial statements (after appropriate eliminations have been made) follow:

	2007		2006	
Related Party	Loans Receivable	Interest Income	Loans Receivable	Interest Income
	(In Thousand Pesos)			
Fortune Tobacco Corporation (FTC)	**₱1,500,000**	**₱100,132**	₱1,500,000	₱125,962
Asia Brewery Inc. (ABI)	**500,000**	**33,425**	500,000	43,667
Asian Institute of Management (AIM)	**134,782**	**14,277**	144,854	15,313
Philippine Airlines (PAL)	**–**	**–**	6,497	–
Others	**275,847**	**60,120**	322,055	12,072
	₱2,410,629	**₱207,954**	₱2,473,406	₱197,014

FTC, ABI and PAL are also owned by LTG. The Parent Company and AIM have common directors which the BSP considered as related parties.

Other related party transactions represent real estate and other loans granted to the officers of the Group.

The compensation of the key management personnel follows:

	Consolidated			Parent Company		
	2007	2006	2005	**2007**	2006	2005
	(In Thousand Pesos)					
Short term employee benefits	**₱144,732**	₱109,213	₱101,522	**₱49,036**	₱48,296	₱46,059
Post-employment benefits	**8,937**	4,843	6,002	**6,486**	2,527	3,781
	₱153,669	₱114,056	₱107,524	**₱55,522**	₱50,823	₱49,840

29. Commitments and Contingent Liabilities

In the normal course of business, the Group makes various commitments and incurs certain contingent liabilities that are not presented in the financial statements including several suits and claims remain unsettled. No specific disclosures on such unsettled assets and claims are made because any such specific disclosures would prejudice the Group's position with the other parties with whom it is in dispute. Such exemption from disclosures is allowed under PAS 37, Provisions, Contingent Liabilities and Contingent Assets. The Group and its legal counsel believe that any losses arising from these contingencies which are not specifically provided for will not have a material adverse effect on the financial statements.

In November 1994, the BSP, Maybank and the Parent Company executed a Memorandum of Agreement (MA) providing for the settlement of Maybank's ₱3.0 billion liabilities to the BSP. Under this MA, the Parent Company is jointly and severally liable with Maybank for the full compliance and satisfaction of the terms and conditions therein. The MA provides for the creation of an escrow fund to be administered by the BSP where all collections from conveyed assets and certain annual guaranteed payments required under the MA are to be deposited.

Relative to the sale of the Parent Company's 60% interest in Maybank, the Parent Company has requested the BSP to consider the revision of the terms of the MA to, among others, (a) delete the provision on the annual guaranteed payments in consideration of an immediate payment by the Parent Company of an agreed amount, and (b) exclude Maybank as a party to the MA. On May 7, 1997, the BSP approved the Parent Company's request to amend the terms of the MA, subject to the following conditions among others:

a) The Parent Company shall remit ₱150.0 million to the escrow account out of the proceeds from sale;

b) The Parent Company shall remit to the escrow account an amount equivalent to 50% of any profit that may be realized by the Parent Company on account of the sale; and

c) If the amount in the escrow account has not reached the total of ₱3.0 billion by June 30, 2013, the difference shall be paid by the Parent Company by way of a debit to its regular account with the BSP.

On November 28, 1997, the Parent Company remitted ₱150.0 million in compliance with item (a). The Parent Company anticipates that the payment of ₱150.0 million to the BSP together with the existing balance of the funds in escrow as of that date will allow the escrow account to reach the required ₱3.0 billion earlier than programmed. This has effectively released the Parent Company from any further payments under the MA.

The Parent Company's remaining investment in Maybank was sold on June 29, 2000. The sale was approved by the BSP on August 16, 2000.

On August 17, 2007, the Parent Company and the BSP amended certain provisions of the MA as follows:

1. The Parent Company will no longer act as the collecting agent for the BSP on the conveyed assets (Asset Pool 1);
2. The Parent Company will no longer remit the amount collected from the Asset Pool 1 to the escrow account;
3. BSP will revert to the Parent Company all the Asset Pool 1 accounts categorized as sugar and sugar-related accounts; and
4. The Parent Company will submit to BSP acceptable collaterals with an appraised value of at least ₱300.0 million as substitute for the sugar-related loans under Asset Pool 1.

On the same date, the Parent Company executed a real estate mortgage for various real estate properties with an aggregate fair value of ₱300.0 million in favor of the BSP.

As of December 31, 2007 and 2006, the total trust assets of the escrow account maintained with the BSP amounted to ₱2.2 billion and ₱2.0 billion, respectively. Average yield during the year ranged from 7.19% to 14.17%. Management expects that the value of the escrow account and the collection from the asset Pool 1 by 2013 will be more than adequate to cover the ₱3.0 billion liability due the BSP.

BSP Reporting
The following is a summary of various commitments, contingent assets and contingent liabilities at their equivalent peso contractual amounts:

	Consolidated		Parent Company	
	2007	2006	**2007**	2006
	(In Thousand Pesos)			
Trust department accounts	**₱22,435,217**	₱14,130,582	**₱22,435,217**	₱14,130,582
Deficiency claims receivable	**7,667,406**	12,772,446	**7,667,406**	12,763,100
Unused commercial letters of credit	**4,986,755**	6,962,819	**4,986,755**	6,962,819
Confirmed export letters of credit	**2,750,714**	2,733,999	**2,750,714**	2,733,999
Inward bills for collection	**1,576,187**	6,533,310	**1,576,187**	6,533,310
Outstanding guarantees issued	**582,795**	351,967	**304,794**	101,967
Outward bills for collection	**164,860**	152,738	**164,770**	152,738
Other contingent accounts	**123,874**	55,608	**117,819**	52,561
Items held as collateral	**597**	3,779	**597**	3,779

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

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30. Derivative Financial Instruments

The table below shows the fair values of derivative financial instruments entered into by the Parent Company, recorded as derivative assets or derivative liabilities, together with the notional amounts. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding as of December 31, 2007 and 2006 and are not indicative of either market risk or credit risk (amounts in thousands, except average forward rate).

	2007			
	Assets	Liabilities	Average Forward Rate	Notional Amount*
Freestanding derivatives:				
Currency forwards				
BUY:				
USD	₱405	₱4,393	41.42	27,639
EUR	279	–	41.90	353
JPY	–	5,727	111.61	1,000,000
Others	151	–	–	686
SELL:				
USD	86,019	11,777	41.66	153,965
EUR	410	4,262	1.45	10,300
Others	175	938	–	420,154
Cross currency swaps	971,533	–	56.34	53,253
Embedded derivatives:				
Currency forwards	51,325	–	–	3,823
Credit default swaps	63,000	40,515	–	171,700
	₱1,173,297	₱67,612		

* The notional amounts pertain to the original currency except for the 'Others' and the Embedded derivatives, which represent the equivalent US$ amounts.

	2006			
	Assets	Liabilities	Average Forward Rate	Notional Amount*
Freestanding derivatives:				
Currency forwards				
BUY:				
USD	₱267	₱–	49.00	2,855
JPY	–	5,160	117.40	1,130,000
CAD	61	–	1.16	1,500
Others	87	486	–	2,698
SELL:				
USD	74,442	510	49.34	163,000
EUR	1,216	289	1.32	5,900
JPY	68	–	117.42	15,000
Others	1,676	188	–	6,492
Cross currency swaps	768,367	–	56.34	53,253
Embedded derivatives:				
Currency forwards	8,101	–	–	446
Credit default swaps	106,782	–	–	121,700
	₱961,067	₱6,633		

The notional amounts pertain to the original currency except for the 'Others' and the Embedded derivatives, which represent the equivalent US$ amounts.

On March 2, 2004, the Parent Company entered into a cross currency swap agreement with a counterparty bank in which the proceeds from the Notes were swapped for USD. The USD amounts were then invested by the Parent Company in ROP and US Treasury bonds. Under the swap agreement, the Parent Company is committed to sell USD and buy PHP in 2009 at a specified exchange rate. On a semi-annual basis, the Parent Company pays 5.66% on the USD leg and receives 12.50% on the PHP leg. The aggregate notional amount of the cross currency swap is US$53.3 million or ₱3.0 billion while its positive fair value amounted to ₱971.5 million and ₱768.4 million as of December 31, 2007 and 2006, respectively.

The Parent Company enters into certain financial and non-financial contracts that contain embedded derivatives which are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at FVPL. Such derivatives include conversion options in convertible debt instruments, credit default swaps and foreign-currency derivatives in structured notes and deposits, call and put options in investment securities and loans and receivables, bond-linked deposits, and foreign currency derivatives on non-financial contracts such as purchase orders and service agreements.

Embedded derivatives that have been bifurcated are credit derivatives in structured notes and interbank receivables with a notional reference of US$171.7 million and US$121.7 million with a positive fair value of ₱63.0 million and ₱106.8 million as of December 31, 2007 and 2006, respectively, and currency forwards in purchase and service contracts with a notional reference of US$3.8 million and US$0.4 million with positive fair value of ₱51.3 million and ₱8.1 million as of December 31, 2007 and 2006, respectively.

31. Earnings Per Share

The earnings per share of the Group, attributable to equity holders of the Parent Company, are calculated as follows:

		2007	2006	2005
a)	Net income attributable to equity holders of the Parent Company (in thousand pesos)	₱1,490,157	₱814,435	₱620,921
	Less income attributable to convertible preferred stocks classified as equity (in thousand pesos)	82,427	77,228	160,565
b)	Net income attributable to common shareholders	₱1,407,730	₱737,207	₱460,356
c)	Weighted average number of common shares for basic earnings per share	578,620,561	518,888,165	425,009,703
d)	Effect of dilution:			
	Convertible preferred shares	31,708,688	54,357,751	148,236,213
e)	Adjusted weighted average number of common shares for diluted earnings per share	610,329,249	573,245,916	573,245,916
f)	Basic earnings per share (b/c)	₱2.43	₱1.42	₱1.08
g)	Diluted earnings per share (a/e)	2.43	1.42	1.08

32. Maturity Profile of Assets and Liabilities

The following table shows an analysis of assets and liabilities of the Group and Parent Company analyzed according to whether they are expected to be recovered or settled within one year and beyond one year from balance sheet date (amounts in thousand pesos):

	Consolidated					
	2007			2006		
	Less than Twelve Months	Over Twelve Months	Total	Less than Twelve Months	Over Twelve Months	Total
Financial Assets						
Cash and other cash items	₱4,773,212	₱–	₱4,773,212	₱4,820,155	₱–	₱4,820,155
Due from BSP	27,961,521	–	27,961,521	12,566,759	–	12,566,759
Due from other banks	3,962,000	–	3,962,000	3,555,603	–	3,555,603
Interbank loans receivable	13,197,201	–	13,197,201	22,412,817	–	22,412,817
Securities held under agreements to resell	11,200,000	–	11,200,000	15,700,000	–	15,700,000
Financial assets at FVPL	3,215,235	–	3,215,235	1,137,835	–	1,137,835
Loans receivables - gross (Note 9)	28,096,152	36,692,303	64,788,455	38,175,846	24,012,107	62,187,953
Unquoted debt securities classified as loans (Note 9)	8,842,266	1,042,982	9,885,248	11,208,371	10,093,353	21,301,724
Other receivables - gross (Note 9)	9,382,111	4,978,469	14,360,580	11,826,731	2,316,895	14,143,626
Receivables from SPV	–	726,095	726,095	–	1,361,074	1,361,074
AFS investments - gross (Note 11)	6,404,732	39,036,189	45,440,921	14,113,947	29,156,291	43,270,238
HTM investments	83,259	362,795	446,054	–	1,554,368	1,554,368
	117,117,689	82,838,833	199,956,522	135,518,064	68,494,088	204,012,152

(Forward)

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

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	Consolidated					
	2007			2006		
	Less than Twelve Months	Over Twelve Months	Total	Less than Twelve Months	Over Twelve Months	Total
Nonfinancial Assets						
Property and equipment - net						
At cost	₱–	₱821,810	₱821,810	₱–	₱730,181	₱730,181
At appraised value	–	15,681,869	15,681,869	–	15,846,819	15,846,819
Investments in subsidiaries and an associate	–	665,123	665,123	–	801,838	801,838
Investment properties - net	–	24,799,602	24,799,602	–	24,882,076	24,882,076
Other assets - gross (Note 15)*	993,632	9,897,398	10,891,030	10,513,395	7,152,938	17,666,333
	993,632	51,865,802	52,859,434	10,513,395	49,413,852	59,927,247
Less: Allowance for impairment and credit losses (Note 16)	–	(12,617,953)	(12,617,953)	–	(19,924,473)	(19,924,473)
Unearned and other deferred income (Note 9)	(74,069)	(418,894)	(492,963)	–	(543,861)	(543,861)
	(74,069)	(13,036,847)	(13,110,916)	–	(20,468,334)	(20,468,334)
	₱118,037,252	₱121,667,788	₱239,705,040	₱146,031,459	₱97,439,606	₱243,471,065

* - includes prepaid expenses, intangibles (software), deferred tax assets

	Consolidated					
	2007			2006		
	Less than Twelve Months	Over Twelve Months	Total	Less than Twelve Months	Over Twelve Months	Total
Financial Liabilities						
Deposit liabilities	₱170,218,809	₱8,593,160	₱178,811,969	₱171,498,944	₱10,168,748	₱181,667,692
Bills and acceptances payable	2,566,945	1,732,149	4,299,094	4,197,881	6,758,067	10,955,948
Subordinated debt	–	8,416,424	8,416,424	–	8,389,297	8,389,297
Accounts payable	5,186,627	–	5,186,627	4,129,444	–	4,129,444
Bills purchased - contra	4,159,741	–	4,159,741	2,993,225	–	2,993,225
Managers' checks and demand drafts outstanding	450,396	–	450,396	1,987,410	–	1,987,410
Marginal deposits	35,684	–	35,684	506,282	–	506,282
Due to other banks	368,275	–	368,275	436,387	–	436,387
Due to BSP	122,818	–	122,818	114,312	–	114,312
Derivative liabilities	67,612	–	67,612	6,633	–	6,633
Accrued interest payable	491,025	1,562,347	2,053,372	1,019,524	1,555,530	2,575,054
	183,667,932	20,304,080	203,972,012	186,890,042	26,871,642	213,761,684
Nonfinancial Liabilities						
Accrued taxes and other expenses	1,405,411	815,935	2,221,346	1,695,266	629,107	2,324,373
Other liabilities**	2,536,436	746,128	3,282,564	2,628,733	–	2,628,733
	3,941,847	1,562,063	5,503,910	4,323,999	629,107	4,953,106
	₱187,609,779	₱21,866,143	₱209,475,922	₱191,214,041	₱27,500,749	₱218,714,790

** - income tax payable, withholding taxes payable, and other tax payable

	Parent Company					
	2007			2006		
	Less than Twelve Months	Over Twelve Months	Total	Less than Twelve Months	Over Twelve Months	Total
Financial Assets						
Cash and other cash items	₱4,732,004	₱–	₱4,732,004	₱4,753,539	₱–	₱4,753,539
Due from BSP	27,961,521	–	27,961,521	12,566,759	–	12,566,759
Due from other banks	2,859,908	–	2,859,908	2,314,288	–	2,314,288
Interbank loans receivable	12,824,611	–	12,824,611	22,093,537	–	22,093,537
Securities held under agreements to resell	11,200,000	–	11,200,000	15,700,000	–	15,700,000
Financial assets at FVPL	3,194,086	–	3,194,086	1,109,137	–	1,109,137
Loans receivables - gross (Note 9)	27,085,816	35,771,769	62,857,585	37,581,739	22,714,738	60,296,477

(Forward)

	Parent Company					
	2007			2006		
	Less than Twelve Months	Over Twelve Months	Total	Less than Twelve Months	Over Twelve Months	Total
Unquoted debt securities classified as loans (Note 9)	₱8,878,376	₱1,006,872	₱9,885,248	₱11,208,371	₱10,093,353	₱21,301,724
Other receivables - gross (Note 9)	7,578,733	4,878,293	12,457,026	10,439,857	3,129,465	13,569,322
Receivables from SPV	–	726,095	726,095	–	1,361,074	1,361,074
AFS investments - gross (Note 11)	6,186,893	38,393,533	44,580,426	12,111,477	29,156,290	41,267,767
HTM investments	–	362,795	362,795	–	1,420,044	1,420,044
	112,501,948	81,139,357	193,641,305	129,878,704	67,874,964	197,753,668
Nonfinancial Assets						
Property and equipment - net						
At cost	–	714,513	714,513	–	663,916	663,916
At appraised value	–	15,681,869	15,681,869	–	15,846,819	15,846,819
Investments in subsidiaries and an associate - gross (Note 13)	–	5,381,139	5,381,139	–	5,439,520	5,439,520
Investment properties - net	–	24,723,885	24,723,885	–	24,803,748	24,803,748
Other assets – gross (Note 15)*	776,110	9,897,398	10,673,508	9,165,640	8,108,454	17,274,094
	776,110	56,398,804	57,174,914	9,165,640	54,862,457	64,028,097
Less: Allowance for impairment and credit losses (Note 16)	–	(12,334,508)	(12,334,508)	–	(19,696,132)	(19,696,132)
Unearned and other deferred income (Note 9)	–	(354,725)	(354,725)	–	(431,438)	(431,438)
	–	(12,689,233)	(12,689,233)	–	(20,127,570)	(20,127,570)
	₱113,278,058	₱124,848,928	₱238,126,986	₱139,044,344	₱102,609,851	₱241,654,195

* - includes prepaid expenses, intangibles (software) and deferred tax assets - net

	Parent Company					
	2007			2006		
	Less than Twelve Months	Over Twelve Months	Total	Less than Twelve Months	Over Twelve Months	Total
Financial Liabilities						
Deposit liabilities	₱172,297,515	₱8,593,158	₱180,890,673	₱173,564,214	₱10,168,750	₱183,732,964
Bills and acceptances payable	1,844,935	1,629,513	3,474,448	3,603,647	6,758,068	10,361,715
Subordinated debt	–	8,416,424	8,416,424	–	8,389,297	8,389,297
Accounts payable	5,093,465	–	5,093,465	3,503,276	–	3,503,276
Bills purchased - contra	4,159,741	–	4,159,741	2,993,225	–	2,993,225
Managers' checks and demand drafts outstanding	450,396	–	450,396	1,987,410	–	1,987,410
Marginal deposits	35,684	–	35,684	506,282	–	506,282
Due to other banks	301,322	–	301,322	413,096	–	413,096
Due to BSP	122,818	–	122,818	114,312	–	114,312
Derivative liabilities	67,612	–	67,612	6,633	–	6,633
Accrued interest payable	491,025	1,555,449	2,046,474	1,024,318	1,555,464	2,579,782
	184,864,513	20,194,544	205,059,057	187,716,413	26,871,579	214,587,992
Nonfinancial Liabilities						
Accrued interest and other expenses	1,336,917	782,774	2,119,691	1,598,945	645,083	2,244,028
Other liabilities**	1,011,573	717,644	1,729,217	–	1,557,604	1,557,604
	2,348,490	1,500,418	3,848,908	1,598,945	2,202,687	3,801,632
	₱187,213,003	₱21,694,962	₱208,907,965	₱189,315,358	₱29,074,266	₱218,389,624

** - includes income tax payable, withholding taxes payable, and other tax payable

33. Notes to Statements of Cash Flows

The amounts of due from BSP and interbank loans receivable which have original maturities of more than three months are as follows:

	2007	2006
	(Amounts in Thousand Pesos)	
Due from BSP	₱12,700,000	₱–
Interbank loans and receivables	–	3,151,961

Management DIRECTORY

ASSET MANAGEMENT SECTOR
9th Floor PNB Financial Center

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First Vice Presidents
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Florencio C. Lat
Nixon S. Ngo

Vice Presidents
Aquilino B. Mangahas
Ma. Consolacion E. Pingol

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Nestor C. Del Carmen, Jr.
Leonardo F. Dimaranan
Antonio A. Lim
Therese A. Ong
Tene O. Paraiso
Eranio Q. Pascual
Ponciano D. Quinio

BUSINESS DEVELOPMENT SECTOR
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Senior Assistant Vice Presidents
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Marie Grace Nina P. Marcelo

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2nd Floor PNB Financial Center

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First Vice President
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Vice President
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Senior Assistant Vice Presidents
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Dante G. Cruz
Renato M. Estrada
Amy Lee M. Gotianse
Mary Anne Claire D. Nery

Assistant Vice Presidents
Modette Ines V. Carino
Susan R. Cervantes
Noel R. Godoy
Teresita M. Paradero

CORPORATE PLANNING & RESEARCH DIVISION
9th Floor PNB Financial Center

First Vice President
Emeline C. Centeno

Senior Assistant Vice President
Remedios D. Nisce

FACILITIES ADMINISTRATION GROUP
2nd Floor PNB Financial Center

First Vice President
Augusto B. Dimayuga

Assistant Vice Presidents
Nilo J. Nava
Ferdinand R. Balcueva

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10th / 7th Floors PNB Financial Center

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Carmen G. Huang

Senior Vice Presidents
Ligaya R. Gagolinan
Maria Paz D. Lim
Marlyn M. Pabrua

First Vice Presidents
Marilyn A. Asuncion
Udela C. Salvo

Vice Presidents
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Renato S. Del Mundo

Senior Assistant Vice Presidents
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Julian B. Soriano
Ginina C. Trazo

Assistant Vice Presidents
Limwel M. Caparros
Virgilio C. Fabularum
Judah Ben-Hur C. Relativo

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The 2007 Annual Report is published by **Philippine National Bank.**
Concept and design by **OP Communications, Inc.**
Photography by **Noby Cabañero**

A copy of this report may be downloaded from www.pnb.com.ph

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