# Primed for New Beginnings

2008 **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 the communities we serve.

# Vision for 2010 & 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

Over the past years since its turnaround in 2003 and more specifically in 2008, Philippine National Bank (PNB) has stepped up the bar of achievement in terms of product and service delivery, customer relationships, market coverage, and operating and financial efficiency. These gains make PNB well primed for new and bigger things ahead.

In spite of the challenges posed by the global economic uncertainties, PNB looks at the future with confidence and fresh optimism knowing that the strategic roadmap it has pursued with relentless focus continue to deliver meaningful results and enduring value to its stakeholders.

PNB takes on the future.

**PNB**… **P**rimed for **N**ew **B**eginnings.

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# CONSOLIDATED FINANCIAL HIGHLIGHTS

*(In Thousand Pesos, Except Per Share Amounts)*

| | December 31 | |
|---|---|---|
| | **2008** | 2007 |
| **Results of Operations** | | |
| Gross Income | **17,350,503** | 19,940,996 |
| Total Expenses | **16,230,901** | 18,442,546 |
| Net Income | **1,119,602** | 1,498,450 |
| **Financial Condition** | | |
| Total Assets | **275,421,414** | 239,705,040 |
| Loans and Receivables | **102,401,109** | 76,575,031 |
| Total Liabilities | **246,115,247** | 209,475,922 |
| Deposit Liabilities | **201,272,426** | 178,811,969 |
| Total Equity | **29,306,167** | 30,229,118 |
| **Per Share**[1/] | | |
| Basic/Diluted Earnings Per Share | **1.67** | 2.43 |
| Book Value Per Share | **44.07** | 45.48 |

[1/] *attributable to equity holders of the Parent Company*

# MESSAGE TO SHAREHOLDERS

The year 2008 was characterized by unprecedented turbulence in the global economy as the United States sub-prime mortgage market crisis escalated. The deepening US credit crunch led to the collapse, sell-out or government bailout of the largest and revered US financial institutions. The US financial debacle wrought havoc on other major economies, plunging financial and equities markets worldwide to historically low levels.

The ripple effects of the global economic woes reached the Philippine shore which resulted in the country's economic growth slowing down in 2008. Gross National Product decelerated to 6.1% from the 8.0% posted in 2007. Gross Domestic Product likewise moderated to 4.6%, down from the 30-year historical high of 7.2% in the previous year. The growth in the domestic economy was driven largely by the services sector, primarily real estate which enjoyed buoyant demand from business outsourcing companies and Overseas Filipino Workers. Inflation surged to double-digit levels in the third quarter due to spiraling world oil and food commodity prices, but abated in the latter part of the year. Mirroring the inflationary trend, interest rates crept up until November, and then started to soften as the monetary policy eased to address the slowing economic growth. The heightened risk aversion amid uncertainties in the global financial markets caused the Philippine peso to depreciate by 12.8% from year-ago level to end the year at ₱47.49 to the US dollar.

**"Our 17.6% capital adequacy ratio remained ONE OF THE HIGHEST IN THE INDUSTRY and way above the minimum 10% requirement by the Bangko Sentral ng Pilipinas."**

While the country's financial system was not spared from the impact of the global financial crisis, its effect was not substantial as the local banks' direct exposure to the failed Lehman Brothers was very limited, amounting to less than 1% of total assets. Thus, the Philippine banking industry remained strong, stable, and adequately capitalized. International credit rating agencies such as Fitch Ratings and Standard & Poor's also noted that Asian banks would not likely be downgraded due to their strong financial positions.

Amidst this difficult operating environment, Philippine National Bank (PNB) managed to cap the year with solid and respectable results: a consolidated net income after tax of ₱1.1 billion and total resources of ₱275.4 billion by year-end 2008. Your Bank's performance demonstrated the continuing strength of its business model, underpinned by a firm commitment to strengthen capital base, manage risks prudently, and improve efficiencies in operations. These provided the momentum for PNB to aggressively take on new growth strategies, new markets, and new ventures.

## Robust Financial Strength

Your Bank worked on preserving and further building up its financial standing to improve shareholder value. PNB achieved a robust 14.9% or a ₱35.7 billion increase in total consolidated resources ending with ₱275.4 billion by the end of 2008. This growth exceeded the industry average of 12.6%. Asset build-up was funded by an impressive 12.6% climb in deposits from ₱178.8 billion to ₱201.3 billion. Low cost funds were up by a hefty 16.9% to end with ₱184.1 billion thus providing cheaper sources of funds for deployment. On the other hand, lending activities expanded and registered a growth of 33.7% year-on-year to reach ₱102.4 billion.

In June 2008, PNB raised additional capital of ₱6.0 billion through the offering of Lower Tier 2 (LT2) Subordinated Notes. The issue was highly oversubscribed and was the first-ever Peso-denominated LT2 deal to price below the benchmark. Half of the proceeds was used to redeem LT2 notes callable in February 2009.

Your Bank's 17.6% capital adequacy ratio remained one of the highest in the industry, and was way above the minimum 10% requirement of the Bangko Sentral ng Pilipinas. Consolidated equity stood strong at ₱29.3 billion.

Non-performing loans (NPL), net of those fully covered by allowance for credit losses, were reduced by ₱1.0 billion to ₱8.0 billion. As a result, NPL ratio improved from 10.4% in 2007 to 7.7% in 2008.

# MESSAGE TO SHAREHOLDERS

PNB's net interest income grew significantly by 12.6% to ₱6.6 billion owing to a stable base of accrual income, expansion of the loan portfolio and other earning assets, and the ability to source funds at relatively lower costs. This gain was tempered by the slight dip in net service fees and commissions to ₱2.4 billion; and the 49% reduction in other income to ₱3.2 billion.

Operating expenses, on one hand, were reduced by as much as 17.3% year-on-year to ₱10.2 billion. Your Bank continued to reap gains out of its continuing expense rationalization program which included, among others, branch realignments and manpower productivity measures.

All told, Consolidated Net Income for the year hit ₱1.1 billion, 25.3% lower than 2007's ₱1.5 billion. Pre-tax profits, however, declined by a modest 6.8% to ₱2.0 billion in 2008 vs. ₱2.1 billion in the preceding year. The decline in net income is attributed mainly to losses on the required mark-to-market valuation of contracted cross currency swaps which the Bank intends to hold to maturity. These are purely accounting losses, and not real losses. This practice is governed by accounting standards adhered to by the Bank.

## New Approaches to Valuing Customer Relationships

During the year, PNB continued to deliver product and service solutions attuned to the evolving needs of its clients. A speed to market approach enabled your Bank to have a first mover advantage in several product lines. Parallel to this, marketing and sales processes were further strengthened to harness greater synergy across business and support units. This ushered a fresher approach at valuing client relationships and how best they can be served.

**PNB'S NET INTEREST INCOME GREW SIGNIFICANTLY BY 12.6% to P6.6 billion owing to a stable base of accrual income, expansion of the loan portfolio and other earning assets, and the ability to source funds at relatively lower costs.**

A co-branded PNB and SSS ATM card was piloted for pensioners to facilitate their mandatory annual confirmation by SSS through PNB branches. Close to 74,000 pensioners initially benefited from this arrangement.

To address the demand for investment products, the DREAM Builder Unit Investment Trust Fund (UITF) was rolled out. DREAM Builder is an affordable investment designed to help investors secure their children's future. Aside from its low initial participation and staggered investment contribution, the product comes with a free personal insurance coverage.

PNB invested in Automated Remittance Machines (ARM) to make it more convenient, fast and secure to remit funds from the United States to the Philippines. ARM is again a first in the industry from PNB. Deployment of ARMs in high traffic offsite locations overseas will continue in 2009.

Your Bank worked on deepening relationships with corporate clients by offering a complete suite of products and services. Aside from loans and trade financing, cash management solutions and e-banking services were also offered aggressively to help clients effectively manage their liquidity, disbursement and collection needs.

To reward customers for their continued loyalty, the Bank ran two sales promotions in 2008: a raffle promotion encouraging clients to open or add at least US$200 to their dollar savings accounts; and the "PNB UITF Rewards Program" where investors can earn points from their funds redeemable for PAL Mabuhay Miles.

## New Alliances Fortify Core Business

To tap into new markets and further provide value-added services to PNB's clientele, your Bank forged linkages with strategic partners. Our remittance operations signed up 20 new payout agents in North America, Europe, Middle East and Asia. These partnerships provide OFW customers greater convenience in sending remittances to their beneficiaries wherever they are based. Their services and market coverage create synergies with PNB's overseas network consisting of 105 branches, offices, remittance centers and subsidiaries, by far the most extensive international footprint by any local bank. In the Philippines, 4 new payout partners with strong provincial presence particularly in the Mindanao region were added. Payout outlets now number 4,722 nationwide.

Alliances with home developers, brokers, car dealers and wholesale conduits allowed PNB to reach more potential clients for housing, motor vehicle and multi-purpose loans. These tie-ups complemented the Bank's branch network which remains to be the main acquisition channel for consumer loans. By the end of the year, 230 real estate brokers were accredited and an additional 9 prime developers were added to the Bank's Contract to Sell Financing Program.

**WE CONFIDENTLY LOOK AT THE FUTURE WITH FRESH OPTIMISM knowing that PNB has stepped up the bar of achievement in terms of product and service delivery, customer relationships, market coverage, and operating and financial efficiency.**

Your Bank also continued to strengthen linkages with government financial institutions, bilateral organizations and European and American banks. By serving as conduit of their specialized lending programs, we are able to provide our clients access to other sources of credit at favorable terms to fund their expansion or working capital requirements.

## New Growth Perspective

In 2008, PNB made substantial progress in a major system upgrade designed to improve customer servicing and to support product development initiatives. Your Bank rolled out its new core banking system-Flexcube in 170 domestic and 4 overseas branches. PNB is the first local bank to implement Flexcube, a system extensively used by leading financial institutions in 115 countries worldwide. We expect to fully reap the rewards from this major investment when the rest of the branches are migrated to Flexcube no later than the first quarter of 2009.

In the middle of the year, PNB entered into a plan of merger with Allied Banking Corporation (ABC). This strategic move was approved by shareholders of both banks. With PNB as the surviving entity, the consolidation is expected to transform your Bank into the fourth largest private domestic bank in terms of assets, loan, and branch network.

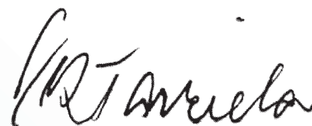
Almost immediately, PNB and ABC worked to fast track the integration process even as final regulatory approvals were sought. The final date of actual merger awaits the completion of ABC's divestment of its 28% equity share in California-based Oceanic Bank. By the end of the year, significant progress has been made in the alignment of products, policies and processes; branch rationalization; and synchronization of IT systems. We integrated both banks' training programs which saw the first run of the combined Branch Officers Development Program (BODP). Email access between banks was likewise put in place. Procurement policies were reviewed for alignment and will soon see both banks operate on a single centralized set-up. Rationalization of both banks' branches and their relative locations will now be jointly reviewed. We even went ahead in interconnecting both banks' ATM systems thus, allowing PNB and ABC clients to use either banks' ATM network free of charge. PNB's Global Operations Sector Head EVP Anthony Q. Chua was seconded to ABC to help out hasten the assimilation process.

## Forward into the Future

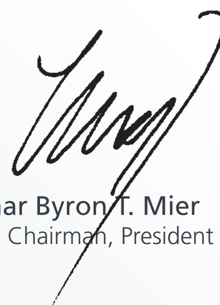
The gains achieved by your Bank in 2008 make it well primed for new and bigger things ahead. In spite of the global economic uncertainties, we confidently look at the future with fresh optimism knowing that PNB has stepped up the bar of achievement in terms of product and service delivery, customer relationships, market coverage, and operating and financial efficiency.

PNB will continue to pursue its strategic roadmap which, by all accounts, has enabled the Bank to deliver meaningful results and enduring value to stakeholders. This roadmap remains anchored on three key strategies: strengthening core businesses; reducing non-performing loans; and improving on operational efficiencies.

We would not have achieved where we stand today without the unwavering loyalty and confidence of our customers and shareholders for which we are profoundly grateful. We also thank all Philnabankers who steadfastly remain committed in pursuing the Bank's vision. Last but not the least, we also extend our sincere appreciation to our Board of Directors for their valuable support and guidance in all our undertakings.



Florencia G. Tarriela
Chairman



Omar Byron T. Mier
Vice Chairman, President and CEO

# Primed Up for Bigger Things

## CORPORATE BANKING

In 2008, PNB stepped up its role as a major lender to the country's priority sectors and key industry players. Aggregate loans to top corporations, government entities, and small and medium enterprises (SMEs) increased by a vigorous 38%. Government accounts posted a 49% growth followed by corporate accounts with 37%.

New account acquisitions, higher line utilization of existing borrowers and the successful revival of specific lending segments with inactive clients accounted for loan growth in the year. Top clients included prime industry movers in telecommunications, power generation, oil, mining, agriculture, infrastructure, fertilizer industries; and various national government agencies, government-owned and controlled corporations and local government units.

The Bank was able to improve further its relationship with corporate clients through trade financing and cash management solutions. Volume of import LCs opened through the Bank grew by 45% while non-LC imports (DP/DA/OA) rose faster by 118%. Overall trade performance grew by 63% due to new customer acquisitions, increase in credit facilities of existing clients and competitive foreign exchange pricing. Various cash management solutions such as corporate internet banking, deposit pick-up, executive checking accounts and e-Collect were offered and availed by new and existing customers.

e-Collect continues to diversify the type of individual payments allowable by the system to go beyond the traditional utility, telecommunications and credit card payments to a wider range of business sectors. Corporate collections now include retail establishments, educational institutions, manufacturing firms, government entities, and financial institutions. Paywise, the Bank's payroll service product, registered a 22% increase in employer enrolment and a growth of 49% in employee coverage.

The existing base product was enhanced to further improve the payroll process cycle which included setting up of alternative channels for data transmission. A variant of Paywise will be launched in early 2009 which will enable companies to significantly automate typical manual components of payroll and human resource management.

During the year, PNB's Corporate Banking Sector established long-term facilities worth US$1.1 billion with 15 foreign banks to deploy PNB's Tier 2 proceeds. Rediscounting loans with BSP surged by 165.7 times from US$75 million to US$12.5 billion.

## RETAIL BANKING

One of the main drivers of PNB's performance in 2008 was the continued growth of its retail banking business. The year saw a 13% growth in low-cost deposits in terms of average daily balance, thus bringing down the Bank's overall cost of funds. Total deposits expanded by 13% to ₱201.3 billion.

These impressive results were mainly achieved by leveraging on the Bank's wide distribution network and well-entrenched relationships with over two million customers, including Overseas Filipino Workers (OFWs). An internal deposit campaign was launched in the second semester of 2008 which brought an estimated ₱8 billion in new funds. This was followed in November 2008 by the "Dagdag Dollars, Dagdag Swerte" raffle promo where tax-free cash prizes totaling US$40,000 is at stake for those who open or add at least US$200 in incremental deposit to their US$ savings accounts.

New initiatives to improve customer service were implemented in 2008. Banking operations were extended by one hour up to 4:00 p.m. in 242 PNB branches nationwide. Saturday banking was likewise piloted in 10 branches. A major development during the year was the conversion of 52% of the Bank's domestic branch network to a new core banking system – Flexcube. Full cut-over of all branches is scheduled to be completed by the first quarter of 2009. The new system is expected to provide a distinct competitive advantage in both client servicing and innovation.

In line with its continuing branch rationalization and modernization program, the Bank relocated 12 branches and upgraded the facilities of 19 branches in 2008. Two of those relocated branches, namely the Alabang Branch in Muntinlupa and Petron Mega Plaza Branch in Makati City, were transformed into model branches which feature spacious interiors and modern amenities that meet customers' needs for convenience and privacy. PNB also established a foreign exchange booth and installed two ATMs at the NAIA Terminal 3 in time for its opening in July

# OPERATIONAL HIGHLIGHTS

2008. PNB was the first bank to be given authority to set up an office in the new terminal.

Continued efforts were also undertaken to re-energize the branches' capability as primary distribution channels for loans and investment products nationwide. Closer collaboration between the branches and other business units of the Bank improved cross-selling of consumer loans, trust products, e-banking services and treasury products. To a great extent, this ushered a new way of valuing customer relationships across the institution.

## CONSUMER BANKING

Consumer lending accelerated to new highs in 2008. Aggregate bookings for Sure Wheels Auto Loan, Sure Homes Housing Loan and Sure Funds Multi-Purpose Loan jumped by 145% year-on-year. This was achieved on the strength of improved turnaround times, sales channel expansion and optimization, and an internal sales incentive referral program.

The Bank's Contract-To-Sell (CTS) loan portfolio posted the highest growth in new loans at 337%. Nine big-ticket developers were acquired during the year, and CTS line utilization improved to 51%. Home buyers of accredited developers were offered an affordable solution to their post-dated check requirements through PNB's Special Budget Checking Account which requires a low maintaining balance and comes with one free checkbook. This special offering provides PNB an early headstart when these clients eventually look for mortgage financing.

New releases of Sure Wheels Auto Loan grew by 71% in 2008. About 52% of these new loans were brought in by the Regional Consumer Finance Centers which served the provincial areas. Other acquisition channels like the dealers and direct sales agents also showed marked improvements in contribution.

Sure Homes Housing Loan posted a 78% growth in new business largely due to sales referrals from branches and accredited brokers. A direct mail campaign to PNB depositors and existing borrowers was implemented to encourage new and repeat business. Special discounts and freebies were given to PNB housing loan borrowers acquiring properties from select real estate developers

with whom the Bank had promotional tie-ups. Furthermore, the Bank expanded the coverage of its Own a Philippine Home Loan to Filipinos in Italy. This unique facility allows Filipinos working or residing abroad to acquire a house in the Philippines through a loan for a maximum term of 20 years.

PNB's Sure Funds Multi-Purpose Loan increased by 151% arising from the strategy to focus on wholesale business for corporate clients. As part of its wholistic approach to the OFW market, the Bank also started offering multi-purpose loans in Singapore last year.

## INTERNATIONAL BANKING

The Bank continued to strengthen its franchise in the OFW market despite the challenges brought about by the global economic crisis. PNB's remittance business grew by 10% resulting in a 17% increase in remittance revenues. New remittance products and services, additional strategic alliances with remittance channels here and abroad, and aggressive promotional campaigns sustained the Bank's position as one of the dominant players in the remittance business.

For the third consecutive year, the Bangko Sentral ng Pilipinas (BSP) awarded PNB as the Best Commercial Bank Respondent on OFW Remittances. PNB holds the distinction of being the only bank to be honored with this award from 2005 to 2007, thereby elevating it to the Hall of Fame. The Social Security System likewise cited PNB as the Best Collecting Bank for OFW Remittances in view of its extensive overseas presence, remittance volume handled, and affordable services.

In 2008, PNB provided a new service for OFWs to facilitate their membership and loan payments to the Social Security System and Pag-Ibig Fund through its overseas branches. The Bank also entered into a payment collection arrangement with Bayan Telecommunicatons and Nestle Philippines using PNB's Overseas Bills Payment System for the utility bills and pre-packaged grocery products of OFW beneficiaries, respectively.

The Bank vigorously pursued strategic alliances with domestic and overseas remittance partners. Four new domestic payout partners with an aggregate of 557 branches were signed up: Quezon Capital Rural Bank, RD Cash Padala, Inc., One Network Bank, and Peninsula Rural Bank. With these additional tie-ups, PNB's total payout network expanded to more than 4,700 outlets nationwide. The Bank also forged agreements with 17

# OPERATIONAL HIGHLIGHTS

send-out agents based in Italy, Spain, Israel, Singapore, North America and the Netherlands. Among the notable alliances formed in 2008 were: Singapore Post; Xoom- a worldwide web-based agent; Sunro Change BV in Netherlands; and Ehud Neor of Israel. Another remittance business model implemented in 2008 was typified by the partnership with I-Remit where PNB was tapped to be its distribution agent in the Philippines for funds remitted by its overseas customers.

The Bank also rolled out 26 self-service fund transfer devices known as Automated Remittance Machines (ARM) in strategic offsite locations in the USA. The ARM, a first in the industry, provides 24/7 convenience and security to overseas remitters.

Several promotional activities conducted in the year served to reinforce loyalty amongst PNB's OFW customers. "Pabaon ni Bee" promo rewarded clients with meal coupons from Jollibee for every remittance claimed at any PNB branch in Luzon. PNB RCI in the U.S., PNB RCC in Canada and PNB Paris Branch ran a "Spin-a-Wheel" promo during the Yuletide season which entitled remitters a chance to win remittance fee discount coupons and freebies.

Hand-in-hand with the business initiatives, the Bank implemented major systems upgrade in its overseas branches to improve remittance servicing. PNB Branches in Hong Kong, New York, Los Angeles and Honolulu were migrated to Flexcube. The latest version of the Bank's Integrated Remittance System was likewise rolled out in all overseas offices. This new version includes functionalities which further enhance transaction processing, data management and security.

## E-BANKING

PNB continued to fortify alternative distribution capabilities to provide greater banking convenience to its customers. A total of 52 ATMs were upgraded during the year while 12 ATMs were relocated to more strategic sites. PNB's ATM network reached 396 units at the close of 2008. The high reliability of the Bank's ATM network was again recognized by MegaLink which conferred the Highest Reply Rate Award to PNB.

A major milestone in the year was the interconnection of PNB and Allied Banking Corporation (Allied Bank) ATMs which operate on different platforms. This allowed PNB cardholders to withdraw cash and do balance inquiry on Allied Bank's ATMs and vice-versa free of charge.

The Bank's retail internet banking facility saw a 76% increase in the number of new users. Bills payment transactions alone grew by 150% while other e-banking transactions rose by 80% from previous year's levels. Aggressive marketing campaigns to increase enrollment and usage in tandem with new merchant acquisitions boosted migration to this channel, thereby decongesting the lobbies of PNB branches and partly freeing up time for servicing and cross-selling activities.

## TREASURY

The sub-prime crisis which broke out in 2007 unraveled into a full-blown global financial crisis in 2008. Risk aversion in international financial markets drove credit spreads wider and sent prices of securities down to distressed levels. Despite the difficult environment, Treasury managed to generate modest gains. Prudent investment policies prevented the Bank from incurring huge capital losses. The Bank did not have Collateralized Debt Obligations (CDOs) and had no direct exposure to Lehman Brothers and American International Group, Inc.

The Bank maintained its status as one of the top ten government securities dealers of the Bureau of Treasury through active trading in the interbank market and increased volume of transactions from clients of the Treasury Marketing Group.

In June 2008, the Bank issued P6.0 billion worth of Lower Tier 2 Subordinated Notes. The offering was oversubscribed with orders reaching three times the initial announced deal size of ₱3.0 billion, prompting the

PNB remittances
from abroad credited in
90
seconds
or it's FREE!*

# OPERATIONAL HIGHLIGHTS

# OPERATIONAL HIGHLIGHTS

Bank to increase the issue to ₱6.0 billion. Moreover, PNB's Tier 2 float in 2008 was the first ever peso deal that was priced below the benchmark, thus reflecting investors' confidence in PNB's business fundamentals.

Throughout the year, Treasury was able to maintain optimal liquidity while supporting the higher loan requirements of the Bank's business sectors. Funding costs were reduced despite heavy competition for deposits among local banks.

## TRUST BANKING

During the year, Trust Banking Group continued to provide its retail and corporate investors with innovative products, value added benefits and sound investment advisory services. PNB introduced in October 2008 the PNB Unit Investment Trust Fund (UITF) Rewards Program, the first stand alone incentive program offered in the trust banking industry. Under this promo program, investors in any of PNB's eight UITF products can earn points convertible to PAL Mabuhay Miles which are redeemable for trips to any local or international destination.

PNB launched DREAM Builder, a peso-denominated, intermediate-term bond fund aimed to help investors provide for their child's education or gain start-up capital for small business. The product comes bundled with accidental health, dismemberment and total permanent disablement insurance; and offers the lowest minimum initial participation in the market at ₱5,000 with at least ₱2,000 monthly contribution for a minimum term of 12 months. The existing PUNLA UITF was expanded to be made available not only to OFWs but to their beneficiaries as well. PUNLA UITF requires an affordable minimum initial participation of ₱10,000 or US$1,000.

In the second quarter of 2008, PNB's trust business topped two categories in the Watson Wyatt Philippines' 94th survey on investment performance of retirement funds: the "All Trusteed Funds (Investment Managers Handling Less Than Five Funds)" and the "Trusteed Funds Managed with Full Discretion (Investment Managers Handling Less Than Five Funds)." The survey covered 154 retirement funds of 117 companies with total plan assets of P36.4 billion. This citation affirms the Bank's professional expertise and higher-than-market returns on investments.

## ASSET MANAGEMENT

In 2008, PNB profitably disposed almost ₱2 billion worth of acquired assets largely through regular public auctions in key cities nationwide and accredited brokers. There were also public auctions held jointly with Allied Bank offering attractive payment terms.

To fast track the disposal of low-ticket Real and Other Properties Acquired items or those with maximum appraised value of ₱1 million, the Bank introduced the Pabahay Bonanza program in January 2008. This program generated significant sales during the year.

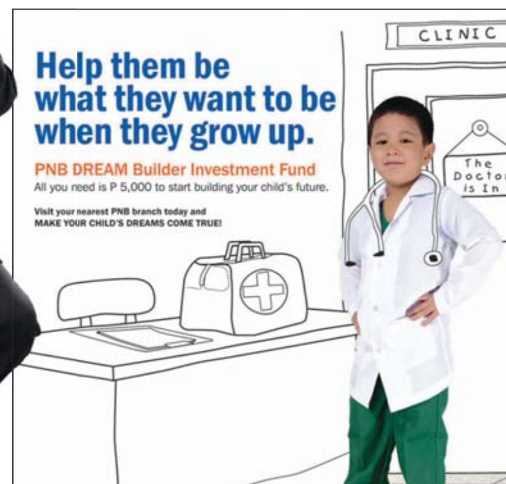
Moreover, PNB was able to secure BSP approval for its joint ventures with Eton Properties Phils., Inc. involving two foreclosed properties of the Bank. These are expected to be on stream in 2009.

## REMEDIAL MANAGEMENT

The Bank continued to make headway in reducing non-performing loans in 2008 through aggressive collection efforts combined with prompt restructuring, foreclosure, corporate rehabilitation, and settlement by dacion of problem accounts.

In the midst of the adverse economic situation prevailing in 2008, the Bank adopted a proactive stance by conducting a portfolio review and stress testing of loan accounts to determine which clients were vulnerable to negative developments. For these cases, necessary safeguards were put in place.

Non-performing loans, net of those which were fully covered by allowance for credit losses, were reduced by more than 10% to ₱8.0 billion as of end-2008.



# CORPORATE SOCIAL RESPONSIBILITY

PNB has always pursued initiatives that further its mission of becoming a good corporate citizen and a partner in nation-building. This commitment is shared across the institution and supported by Philnabankers who willingly contribute their time and resources to empower the less privileged sectors of society. In 2008, the Bank was involved in three major corporate social responsibility (CSR) activities: the PNB-Gawad Kalinga Village, tree planting, and relief to typhoon-stricken communities.

## Community Development

The Bank's flagship CSR program is the PNB-Gawad Kalinga Village. Following its donation of a 1.2-hectare real estate property in Lubao, Pampanga to the Gawad Kalinga Community Development Foundation, Inc. (GK), PNB initiated an internal fund raising campaign in 2008 to finance the development of a self-sustaining community. The funds will be used to provide homes to at least 30 underprivileged families and for the construction of a pre-school and multi-purpose hall. The Bank has committed to provide the funding which is estimated at ₱3.45 million. This is one of the very few GK housing projects wherein both land and development costs are shouldered by a single donor.

Groundbreaking is set for the 1st quarter of 2009. For its part, GK has commenced site planning and beneficiary selection.

## Greening the Environment

PNB commemorated its 92nd anniversary on July 22, 2008 with a nationwide tree planting activity. A total of 92 trees were planted in various locations which included PNB's Head Office in Pasay City and in strategic sites identified by participating PNB branches in Metro Manila, Luzon, Visayas and Mindanao. Chairman Florencia G. Tarriela led the members of the Board of Directors and Senior Management in planting trees at the frontage of the PNB Main Office. The Branches, on the other hand, had a similar localized activity with some valued clients gracing the affair.

## Rebuilding Lives of Calamity Victims

In June 2008, Typhoon Frank wreaked devastation in the Panay Island in the Visayas Region. Many local residents were left homeless by the severity of the calamity which included 59 Philnabankers. Twenty-seven of these PNB employees practically lost their homes and belongings to the typhoon. Forthwith, a fund raising campaign was conducted within the PNB community to provide financial assistance to the affected employees. In addition, the Bank decided to tone down its 92nd anniversary celebration and instead utilized the funds in helping the employees rebuild their lives after the calamity that beset them.

# 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; dealing fairly 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 Commision (SEC) and the self-assessment form adopted by PNB in compliance with the requirements of the 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 has to be reviewed and evaluated by the respective Committees en banc. After that, the Director's self-assessment, 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**

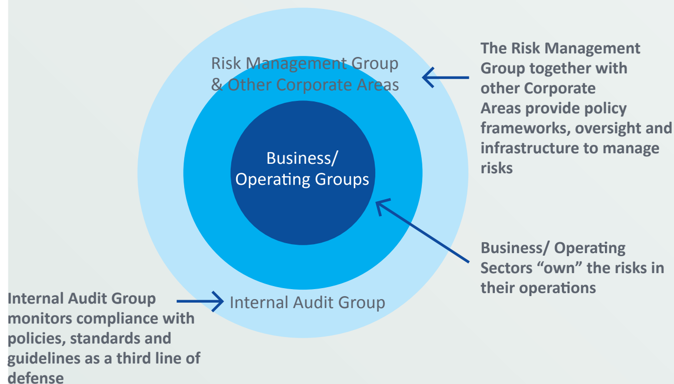
  The Manual was updated on July 28, 2006, September 28, 2007, November 23, 2007, February 22, 2008 and April 25, 2008. Apart from these updates, there are no other plans to change the Manual for the moment.

# DISCLOSURE ON RISK MANAGEMENT

## Overview of the Risk Management Process

Sound risk management is one of the key pillars of support for a strategy of sustainable profitable growth and therefore a core competency at PNB. PNB relies upon a strong risk management framework for several reasons: to ensure that it maintains consistently high standards of risk management, to raise executive management's awareness and understanding of the risks being taken and to encourage optimization of the risk/return ratio. At PNB, the risk management framework resides at all levels within the Bank and its subsidiaries (the Group). The Board of Directors, hereinafter referred to as the Board, is responsible for establishing and maintaining a sound risk management system and is accountable for risks taken within the Bank. Through its various designated committees, the Board provides policy directions, reviews performance and ensures that safe and sound management practices are always adhered to in all of the Bank's engagement and transactions.

The Bank's effective risk management framework provides for **three lines of defense** working in partnership to identify, measure, monitor and manage risks.




In the first line of defense, business / operating units are primarily responsible for risk management. Their assessment, evaluation and measurement of risk need to be an ongoing process integrated with the day-to-day activities of the business. This process includes the implementation of the Group's risk management framework, identification of issues and the implementation of remedial action where required. Business unit management is also accountable for appropriate reporting to the governance bodies within the Group.

The second line of defense consists of the Group and business unit risk management functions which are independent of line management. The Risk Management Committee (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 third line of defense consists of Internal Audit which provides an independent assessment of the adequacy and effectiveness of the overall risk management framework and risk governance structures and reports independently to the Bank Audit and Compliance Committee. In addition, the Corporate Governance Committee (CGC) is responsible for providing oversight to the performance management and the conduct of good governance by the Bank towards its stakeholders: Stockholders, Employees, Clients and the community in general.

External audit has a statutory duty to report its independent opinion on the company's financial statements to the shareholders.

The Bank's Enterprise Risk Management (ERM) framework, which was adopted in 2007, 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.

Under the ERM, the key risks that the Bank faces such as **credit risk, 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.

## Key Achievements in 2008

The past year has presented a number of challenges in implementing the ERM including the involvement in the oversight of the implementation of the core banking system (Flexcube), the incorporation of initial statistical analytics in risk management reporting and finally the volatility of markets for the most part of the year which was triggered by the sub-prime crises and which quickly translated into a tightening of liquidity. The Bank's existing control framework and procedures functioned effectively in the face of the increasing levels of risks and did not require any major changes. Management did, however, stress the importance of enhanced awareness and vigilance at all levels of operations.

- Compliance with Basel II requirements by the Bangko Sentral ng Pilipinas (BSP) is continuously being implemented and enhanced with the quarterly submission of the Capital Adequacy Report to the regulator.
- Group The maintained a conservative stance on the management of market and liquidity risks. Even with

the tightening of credit and liquidity resulting from the global credit crisis, the Bank's liquidity position was never endangered.

- During the market volatility in the second half of the year, the Bank's value-at-risk (VaR) models were continually fine tuned to provide adequate monitoring and control process.
- With the blip in market volatility towards the end of the year, the Bank's tight market risk management process was "stress-tested" and proved that the close coordination among front-office (Treasury), back-office (Operations), and risk management (Risk Management Group) works effectively and ready to provide Senior Management and the Board with immediate reporting and recommendation for subsequent actions.
- Macro analysis of the Bank's credit risk profile on the portfolio level to determine concentration risk and to determine the quality of the loan portfolio per lending unit.

## Focus Areas in 2009

- Ongoing reassessment of the level of risk appetite and the risk management framework across all risk types
- Continued enhancement and strengthening of the risk management standards, practices and systems, with a focus on employing and retaining highly-skilled and qualified staff
- Further development of the Group's capabilities to embed economic capital into all business and risk decision-making processes
- Implementation of automated processes to provide further efficiency particularly in the credit risk management process
- Adoption of the Internal Capital Adequacy Assessment Process (ICAAP) to develop, challenge and review capital management activities across the Group
- Further enhance the analytics capability to move from a static to dynamic risk management processes that will support decision-making
- Continued enhancements of systems and processes to combat financial crimes due to the increase in activities, especially in internet crimes, information security breaches and external attacks on the Bank's financial and information assets
- Conduct of lecture nationwide to promote risk awareness and educate Bank personnel on the risk management process
- Continuous enhancement of the risk identification and evaluation processes through semi-annual conduct of risk and control self-assessment

## 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 mandate. The Bank is compliant with the 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 with 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, ceiling on group exposure, DOSRI ceilings per BSP guidelines, target industry limits, ceiling on unsecured loans, ceiling on contingent exposure, limits on financial institutions, country risk limit, loans to subsidiaries, and treasury risk limits. Moving forward, the Bank intends to augment the existing "simple" computation of the actual annual default probability to determine the true realized default rate based on the historical performance of individual borrower in the portfolio.

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 portfolio. 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 Data Center
- Risk and Control Self-Assessment
- Operational Risk Mapping to Eight Business Lines
- Product 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

*Left to right:*

Florencia G. Tarriela - *Chairman*
Omar Byron T. Mier - *Vice Chairman, President and CEO*
Lucio C. Tan - *Director*
Eric O. Recto - *Director*
Washington Z. SyCip - *Director*
Domingo T. Chua* - *Director*
Gloria L. Tan Climaco** - *Director*

**Director of PNB until 12-31-08; assumed Chairmanship of Allied Bank 01-01-09*
***Elected on 01-01-09*

# BOARD OF DIRECTORS

*Left to right:*
Florido P. Casuela - *Director*
Feliciano L. Miranda, Jr. - *Director*
Jose Ngaw - *Board Advisor*
Renato J. Fernandez - *Corporate Secretary*
Estelito P. Mendoza* - *Director*
Lucio K. Tan, Jr. - *Director*
Carmen G. Huang - *Director*

**Elected 01-01-09*

# SENIOR MANAGEMENT TEAM

*Seated from left:* EVP Carmen G. Huang (Chief Financial Officer & Chief of Staff to the President), Omar Byron T. Mier (President & Chief Executive Officer), and EVP Ma. Elena B. Piccio (Head, Business Development Sector)

*Standing from left:* FSVP Ramon L. Lim (Head, Treasury Sector), EVP Renato A. Castillo (Chief Credit Officer & Head, Remedial Management Sector), EVP Cynthia V. Javier (Head, Global Technology Sector), FSVP Rafael Z. Sison, Jr. (Head, Retail Banking Sector), EVP Jovencio B. Hernandez (Head, Consumer Banking Sector), and EVP Anthony Q. Chua (Head, Global Operations Sector)

*Seated from left:* SVP Carmela A. Pama (Chief Risk Officer & Head, Risk Management Group),
FSVP Cris S. Cabalatungan (Head, Internal Audit Group), FSVP Ma. Elena S. Sarmiento (Trust Officer & Head, Trust Banking Group)

*Standing from left:* SVP Maria Paz D. Lim (Treasurer), FSVP Edgardo T. Nallas (Head, Human Resource Group),
FSVP Isabelita T. Manalastas-Watanabe (Group Head, Europe, Israel & African Continent), FSVP Alvin C. Go (Chief Legal Counsel & Head, Legal Group), SVP Christian Jerome O. Dobles (Head, Asset Management Sector), Rommel R. Garcia (Head, International Banking & Overseas Remittance Sector)

# PRODUCTS AND SERVICES

## DEPOSITS AND RELATED SERVICES

Peso Accounts
- Regular Passbook Savings Account
- Superteller ATM 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
- COMBO Account
- Regular Time Deposit Account
- PNBig Savings Account
- 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
  - Top Dollar Time Deposit Account
  - U.S. Dollar Wealth Multiplier Account
- Euro Accounts
  - Euro Savings Account
  - Euro Time Deposit Account

Cash Management Services
- Collections
  - *e*-Collect
  - Cash Mover
  - Special Arrangements
    - Government Agencies
      - Bureau of Internal Revenue
      - Social Security System
      - Bureau of Customs
      - Philhealth
      - National Home Mortgage Finance Corp.
      - Pag-ibig Fund
    - Financial Institutions
- Disbursements
  - Paywise (Payroll Services)
  - Paywise Plus
  - Executive Check Writer
  - Corporate *e*-Pay
  - PNB Tax *e*-Payment Facility
- *e*-Banking Services
  - Personal Internet Banking
  - Corporate Internet Banking
  - Phone Banking
  - Mobile Banking
  - ATM

Other Services
- Conduit Clearing Arrangement
- Safety Deposit Boxes

## BANCASSURANCE

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

## REMITTANCE SERVICES

Rapid Remit
- Credit to a PNB Account (Peso, U.S. Dollar, Euro)

Credit to Other Banks (Peso, U.S. Dollar)

Credit to Payroll Accounts (Peso, U.S. Dollar)

Global Filipino Card (GFC)

Door-to-Door Delivery
- Cash Delivery
- Check Delivery
- US$ Delivery (selected Metro Manila areas)

Overseas Bills Payment

Cash Pick-Up (Advise and Pay Anywhere)
- Peso Pick-up (Domestic Branches and Authorized

Payout Outlets)
U.S. Dollar Pick-up (Metro Manila Branches only)
Pay Anywhere Around the World

Remittance Channels
Automated Remittance Machine (ARM)
Web Remittance

Other International Services
Cargo Services

## FUND TRANSFER AND RELATED SERVICES

S.W.I.F.T. Transfer
Gross Settlement Real Time (GSRT)
Real Time Gross Settlement (RTGS - Inward) - Peso
Demand Drafts
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

## 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

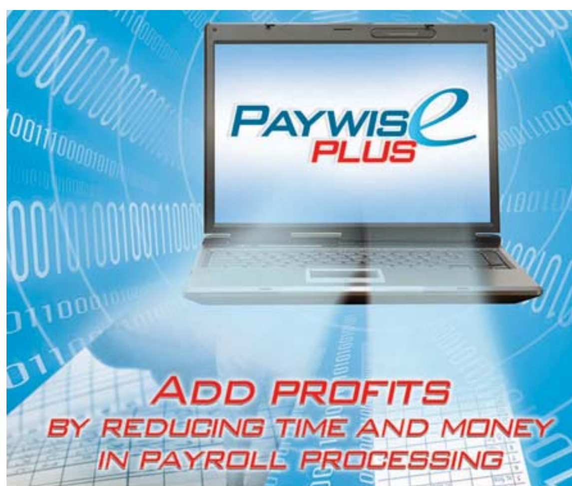
Local Currency
Money Market Transactions
Securities Dealership
Government Securities
Treasury Bills
Fixed Rate Treasury Notes/Bonds
Retail Treasury Bonds
Zero-Coupon Bonds
Local Government Unit Bonds
Commercial Papers

## 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 (Multi-Purpose Loan)
- Sure Wheels (Motor Vehicle Loan)
- Sure Home (Housing Loan)
  - Sure Home Flexi Loan
- Contract to Sell Financing
- Own a Philippine Home Loan
- Global Filipino Auto 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
- PNB DREAM Builder 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 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 of a wide range of production machinery, motor vehicles, and hospital, business and IT-related equipment, etc., chattel mortgage loans, and installment notes discounting. It also arranges 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 extension offices at Nottinghill Gate and Earl's Court in 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 (PNB Capital) 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 for corporate clients, debt and equity syndication and underwriting including assisting clients in pre-IPO reorganizations. PNB Capital also assists in structuring and packaging mergers and acquisitions, securitization transactions and mezzanine financing.

## PNB CORPORATION, GUAM

PNB Corporation, Guam is a wholly-owned subsidiary incorporated in the Territory of Guam. Its main business activity is to provide foreign exchange remittance services to Filipinos in Guam.

## PNB GLOBAL FILIPINO REMITTANCE SPAIN, S.A.

PNB Global Filipino Remittance Spain, S.A. is a wholly-owned subsidiary of PNB which 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 four branches are situated in Shatin, Yuen Long, Tseun Wan and Hung Hom.

## 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 42 money transfer offices in 11 states of the United States of America.

PNB RCI also owns PNBRCI Holding Company, Ltd., which was 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. is doing business as PNB Cargo Services, Inc., 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. Presently, its principal business is to service the remittance requirements of overseas Filipino workers in Italy. It has offices in Rome, Milan and Florence.

## 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 money 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.

# FINANCIAL STATEMENTS

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# 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 financial statements of the Parent Company which comprise the balance sheets as at December 31, 2008 and 2007 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, 2008.

The balance sheet as at December 31, 2008 and the statement of income, statement of changes in equity and statement of cash flows for the year ended December 31, 2008, have been prepared in accordance with Accounting Principles Generally Accepted in the Philippines for banks, except for the deferral of losses from the sale of the non-performing assets (NPA) to the special purpose vehicle (SPV) companies in 2006, 2005 and 2004, non-recognition of allowance for impairment losses as of December 31, 2006 on loans sold to an SPV company in 2007 and the non-consolidation of the accounts of the SPV that acquired the NPA sold in 2007 and 2006 as allowed under the regulatory accounting policies prescribed by the Bangko Sentral ng Pilipinas (BSP) 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.

The balance sheet as at December 31, 2007 and the statements of income, statements of changes in equity and statements of cash flows for the years ended December 31, 2007 and 2006 have been prepared in accordance with Philippine Financial Reporting Standards, except for the deferral of losses from the sale of the NPA to the SPV companies in 2006, 2005 and 2004, non-recognition of allowance for impairment losses as of December 31, 2006 on loans sold to an SPV company in 2007 and the non-consolidation of the accounts of the SPV that acquired the NPA sold in 2007 and 2006 as allowed under the regulatory accounting policies prescribed by the BSP 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 (BOD) 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 BOD and the 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 15th day of April 2009 affiants exhibiting to me their Community Tax Certificates, as follows:

| Names | CTC No. | Date of Issue | Place of Issue |
|---|---|---|---|
| Florencia G. Tarriela | 19142020 | January 5, 2009 | Manila |
| Omar Byron T. Mier | 11246474 | January 20, 2009 | Quezon City |
| Carmen G. Huang | 12384546 | January 26, 2009 | Makati City |

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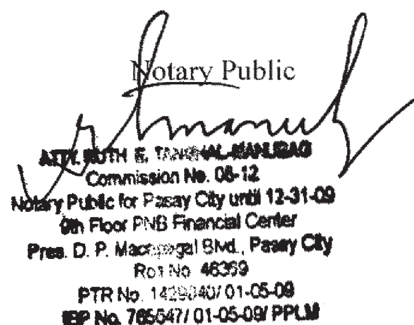

# INDEPENDENT AUDITORS' REPORT

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, 2008 and 2007, 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, 2008, 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 (PFRS). 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 (NPAs), the Parent Company sold certain NPAs 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 NPAs to the SPV companies, representing the allowance for impairment losses specifically provided for the NPAs 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 NPAs 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 ₱7.1 billion and ₱7.7 billion as of December 31, 2008 and 2007, respectively, and net income in 2006 would have been decreased by ₱3.2 billion.

The sale of the NPAs 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 NPAs 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, liabilities and minority interest in equity of consolidated subsidiaries would have been increased by ₱2.3 billion, ₱2.5 billion and ₱21.7 million, respectively, as of December 31, 2008. As of December 31, 2007, total assets, liabilities and minority interest in equity of consolidated subsidiaries would have been increased by ₱2.0 billion, ₱1.9 billion and ₱28.8 million, respectively.

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, 2008 and their financial performance and their cash flows for the year then ended in accordance with accounting principles generally accepted in the Philippines for banks as described in Note 3 to the financial statements except for the effects of the matters discussed in the sixth and seventh paragraphs.

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 their financial performance and their cash flows for the years ended December 31, 2007 and 2006 in accordance with Philippine Financial Reporting Standards, except for the effects of the matters discussed in the sixth and seventh paragraphs.

SYCIP GORRES VELAYO & CO.

Janeth T. Nuñez
Partner
CPA Certificate No. 0111092
SEC PA Control No. A-223-A
Tax Identification No. 900-322-673-00
PTR No. 1566451, January 5, 2009, Makati City

March 31, 2009

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

# BALANCE SHEETS

*(Amounts In Thousand Pesos)*

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | As of December 31 | | | |
| | **2008** | 2007 | **2008** | 2007 |
| **ASSETS** | | | | |
| **Cash and Other Cash Items** (Note 17) | **₱6,436,406** | ₱4,773,212 | **₱6,326,528** | ₱4,732,004 |
| **Due from Bangko Sentral ng Pilipinas** (Notes 17 and 34) | **20,056,705** | 27,961,521 | **19,840,705** | 27,961,521 |
| **Due from Other Banks** | **6,669,184** | 3,962,000 | **6,082,326** | 2,859,908 |
| **Interbank Loans Receivable** | **12,859,095** | 13,197,201 | **12,818,778** | 12,824,611 |
| **Securities Held Under Agreements to Resell** (Note 17) | **5,600,000** | 11,200,000 | **5,600,000** | 11,200,000 |
| **Financial Assets at Fair Value Through Profit or Loss** (Note 8) | **11,052,293** | 3,215,235 | **11,042,856** | 3,194,086 |
| **Available-for-Sale Investments** (Notes 11 and 17) | **14,589,537** | 44,821,522 | **13,390,840** | 43,961,027 |
| **Loans and Receivables** (Notes 9 and 29) | **102,401,109** | 76,575,031 | **96,395,893** | 73,162,024 |
| **Receivable from Special Purpose Vehicle** (Note 10) | **719,292** | 726,095 | **719,292** | 726,095 |
| **Held-to-Maturity Investments** (Notes 11 and 17) | **44,150,080** | 446,054 | **44,054,218** | 362,795 |
| **Property and Equipment** (Note 12) | | | | |
| At cost | **758,083** | 821,810 | **638,969** | 714,513 |
| At appraised value | **15,952,829** | 15,681,869 | **15,952,829** | 15,681,869 |
| **Investments in Subsidiaries and an Associate** (Notes 2 and 13) | **5,061** | 665,123 | **4,508,461** | 5,381,139 |
| **Investment Properties** (Notes 2, 14, 25 and 30) | **23,453,926** | 24,799,602 | **23,377,850** | 24,723,885 |
| **Deferred Tax Assets** (Note 26) | **1,736,589** | 1,857,109 | **1,692,278** | 1,798,662 |
| **Other Assets** (Note 15) | **8,981,225** | 9,001,656 | **8,727,963** | 8,842,847 |
| **TOTAL ASSETS** | **₱275,421,414** | ₱239,705,040 | **₱271,169,786** | ₱238,126,986 |
| **LIABILITIES AND EQUITY** | | | | |
| **LIABILITIES** | | | | |
| **Deposit Liabilities** (Note 17) | | | | |
| Demand | **₱22,742,300** | ₱20,167,642 | **₱23,013,773** | ₱19,952,002 |
| Savings | **161,343,347** | 137,315,472 | **161,196,424** | 137,295,678 |
| Time | **17,186,779** | 21,328,855 | **17,911,001** | 23,642,993 |
| | **201,272,426** | 178,811,969 | **202,121,198** | 180,890,673 |
| **Financial Liabilities at Fair Value Through Profit or Loss** (Note 18) | **6,952,831** | 67,612 | **6,952,831** | 67,612 |
| **Bills and Acceptances Payable** (Notes 2 and 19) | **12,630,134** | 4,299,094 | **11,468,828** | 3,474,448 |
| **Accrued Taxes, Interest and Other Expenses** (Note 20) | **4,362,928** | 4,274,718 | **4,207,580** | 4,166,165 |
| **Subordinated Debt** (Note 21) | **8,445,674** | 8,416,424 | **8,445,674** | 8,416,424 |
| **Other Liabilities** (Note 22) | **12,451,254** | 13,606,105 | **10,157,684** | 11,892,643 |
| **TOTAL LIABILITIES** | **246,115,247** | 209,475,922 | **243,353,795** | 208,907,965 |
| **EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT COMPANY** | | | | |
| Capital Stock (Notes 2 and 23) | **26,489,837** | 26,489,837 | **26,489,837** | 26,489,837 |
| Capital Paid in Excess of Par Value (Notes 2 and 13) | **2,037,272** | 2,037,272 | **2,037,272** | 2,037,272 |
| Surplus Reserves (Notes 2 and 28) | **539,377** | 532,136 | **539,377** | 532,136 |
| Deficit (Notes 2 and 9) | **(1,054,790)** | (1,547,162) | **(2,951,133)** | (3,079,723) |
| Revaluation Increment on Land and Buildings (Notes 2 and 12) | **2,729,147** | 2,471,113 | **2,729,147** | 2,471,113 |
| Accumulated Translation Adjustment (Notes 2, 3 and 13) | **(373,760)** | (724,360) | **144,086** | – |
| Net Unrealized Gain (Loss) on Available-for-sale Investments (Note 11) | **(1,175,238)** | 832,131 | **(1,172,595)** | 768,386 |
| Share in Equity Adjustments of An Associate (Note 13) | **–** | 36,221 | **–** | – |
| Parent Company Shares Held by a Subsidiary | **(4,740)** | (5,323) | **–** | – |
| | **29,187,105** | 30,121,865 | **27,815,991** | 29,219,021 |
| **MINORITY INTEREST** | **119,062** | 107,253 | **–** | – |
| **TOTAL EQUITY** | **29,306,167** | 30,229,118 | **27,815,991** | 29,219,021 |
| **TOTAL LIABILITIES AND EQUITY** | **₱275,421,414** | ₱239,705,040 | **₱271,169,786** | ₱238,126,986 |

*See accompanying Notes to Financial Statements.*

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

# STATEMENTS OF INCOME

*(Amounts in Thousand Pesos, Except Earnings Per Share Amounts)*

| | Consolidated | | | Parent Company | | |
|---|---|---|---|---|---|---|
| | Years Ended December 31 | | | | | |
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| **INTEREST INCOME ON** | | | | | | |
| Loans and receivables (Notes 9 and 29) | **₱6,163,655** | ₱5,342,153 | ₱6,040,528 | **₱5,901,958** | ₱5,155,348 | ₱5,855,038 |
| Trading and investment securities (Notes 8 and 11) | **4,116,030** | 3,753,985 | 4,224,835 | **4,078,628** | 3,668,371 | 4,053,146 |
| Interbank loans receivable | **286,740** | 848,798 | 1,106,984 | **286,740** | 848,798 | 1,106,984 |
| Deposits with banks and others | **1,092,454** | 1,248,680 | 684,855 | **999,921** | 1,041,836 | 640,566 |
| | **11,658,879** | 11,193,616 | 12,057,202 | **11,267,247** | 10,714,353 | 11,655,734 |
| **INTEREST EXPENSE ON** | | | | | | |
| Deposit liabilities (Note 17) | **3,448,392** | 3,886,846 | 5,158,476 | **3,506,878** | 3,883,661 | 5,259,545 |
| Bills payable and other borrowings (Notes 19 and 21) | **1,591,607** | 1,429,173 | 1,554,215 | **1,524,026** | 1,389,540 | 1,505,089 |
| | **5,039,999** | 5,316,019 | 6,712,691 | **5,030,904** | 5,273,201 | 6,764,634 |
| **NET INTEREST INCOME** | **6,618,880** | 5,877,597 | 5,344,511 | **6,236,343** | 5,441,152 | 4,891,100 |
| Service fees and commission income (Note 27) | **2,502,486** | 2,481,237 | 2,767,462 | **1,766,373** | 1,558,623 | 1,796,203 |
| Service fees and commission expense | **149,441** | 107,116 | 102,479 | **107,638** | 108,807 | 92,280 |
| **NET SERVICE FEES AND COMMISSION INCOME** | **2,353,045** | 2,374,121 | 2,664,983 | **1,658,735** | 1,449,816 | 1,703,923 |
| Trading and investment securities gains (losses) - net (Notes 8 and 11) | **(918,325)** | 1,088,442 | 2,071,623 | **(937,827)** | 1,027,911 | 2,047,021 |
| Foreign exchange gains - net | **2,541,278** | 869,680 | 1,076,607 | **2,049,683** | 510,317 | 630,806 |
| Miscellaneous (Notes 25 and 27) | **1,568,655** | 4,308,021 | 2,153,786 | **1,537,825** | 4,294,522 | 2,250,650 |
| **TOTAL OPERATING INCOME** | **12,163,533** | 14,517,861 | 13,311,510 | **10,544,759** | 12,723,718 | 11,523,500 |
| **OTHER EXPENSES** | | | | | | |
| Compensation and fringe benefits (Notes 24 and 29) | **3,488,171** | 3,641,425 | 3,201,890 | **2,818,567** | 3,013,436 | 2,480,783 |
| Provision for impairment and credit losses (Note 16) | **964,064** | 3,280,875 | 2,802,283 | **1,243,031** | 3,251,687 | 2,734,736 |
| Depreciation and amortization (Note 12) | **828,959** | 1,150,314 | 1,111,364 | **783,015** | 1,118,285 | 1,066,999 |
| Taxes and licenses (Note 26) | **1,100,601** | 953,079 | 1,123,155 | **1,068,542** | 923,946 | 1,099,523 |
| Occupancy and equipment-related costs (Note 25) | **808,126** | 807,233 | 832,172 | **591,515** | 644,706 | 672,435 |
| Miscellaneous (Notes 26 and 27) | **3,007,606** | 2,497,234 | 2,534,237 | **2,548,527** | 1,969,366 | 2,004,369 |
| **TOTAL OPERATING EXPENSES** | **10,197,527** | 12,330,160 | 11,605,101 | **9,053,197** | 10,921,426 | 10,058,845 |
| **INCOME BEFORE SHARE IN NET INCOME OF AN ASSOCIATE AND INCOME TAX** | **1,966,006** | 2,187,701 | 1,706,409 | **1,491,562** | 1,802,292 | 1,464,655 |
| **SHARE IN NET INCOME (LOSS) OF AN ASSOCIATE (Note 13)** | **(2,471)** | (79,739) | 46,299 | **–** | – | – |
| **INCOME BEFORE INCOME TAX** | **1,963,535** | 2,107,962 | 1,752,708 | **1,491,562** | 1,802,292 | 1,464,655 |
| **PROVISION FOR INCOME TAX** (Note 26) | **843,932** | 609,512 | 932,679 | **747,550** | 467,181 | 758,874 |
| **NET INCOME** | **₱1,119,603** | ₱1,498,450 | ₱820,029 | **₱744,012** | ₱1,335,111 | ₱705,781 |
| **ATTRIBUTABLE TO:** | | | | | | |
| **Equity Holders of the Parent Company** (Note 32) | **₱1,107,794** | ₱1,490,157 | ₱814,435 | | | |
| **Minority Interest** | **11,809** | 8,293 | 5,594 | | | |
| | **₱1,119,603** | ₱1,498,450 | P820,029 | | | |
| Basic/Diluted Earnings Per Share Attributable to Equity Holders of the Parent Company (Note 32) | **₱1.67** | ₱2.43 | ₱1.42 | | | |

*See accompanying Notes to Financial Statements.*

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

# STATEMENTS OF CHANGES IN EQUITY

*(Amounts in Thousand Pesos)*

For the Year Ended December 31, 2008

**Consolidated**

| | Attributable to Equity Holders of the Parent Company | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Capital Stock** (Notes 2 and 23) | **Capital Paid in Excess of Par Value** (Note 2 and 13) | **Surplus Reserves** (Notes 2 and 28) | **Deficit** (Notes 2 and 9) | **Revaluation Increment on Land and Buildings** (Notes 2 and 12) | **Accumulated Translation Adjustment** (Notes 2, 3 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, 2008** | **₱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** |
| Unrealized loss on available-for-sale (AFS) investments recognized directly in equity | – | – | – | – | – | – | (1,516,787) | – | – | (1,516,787) | – | (1,516,787) |
| Amounts realized in profit or loss | – | – | – | – | – | – | (490,582) | (36,221) | – | (526,803) | – | (526,803) |
| Amortization of deferred losses (Note 9) | – | – | – | (608,181) | – | – | – | – | – | (608,181) | – | (608,181) |
| Revaluation increment during the year | – | – | – | – | 258,034 | – | – | – | – | 258,034 | – | 258,034 |
| Translation adjustment for the year | – | – | – | – | – | 350,600 | – | – | – | 350,600 | – | 350,600 |
| Sale of treasury shares | – | – | – | – | – | – | – | – | 583 | 583 | – | 583 |
| Total income and expenses recognized directly in equity | – | – | – | (608,181) | 258,034 | 350,600 | (2,007,369) | (36,221) | 583 | (2,042,554) | – | (2,042,554) |
| Net income for the year | – | – | – | 1,107,794 | – | – | – | – | – | 1,107,794 | 11,809 | 1,119,603 |
| Total income and expenses for the year | – | – | – | 499,613 | 258,034 | 350,600 | (2,007,369) | (36,221) | 583 | (934,760) | 11,809 | (922,951) |
| Transfer to surplus reserves (Note 28) | – | – | 7,241 | (7,241) | – | – | – | – | – | – | – | – |
| **Balance at December 31, 2008** | **₱26,489,837** | **₱2,037,272** | **₱539,377** | **(₱1,054,790)** | **₱2,729,147** | **(₱373,760)** | **(₱1,175,238)** | **₱–** | **(₱4,740)** | **₱29,187,105** | **₱119,062** | **₱29,306,167** |

**Parent Company**

| | **Capital Stock** (Notes 2 and 23) | **Capital Paid in Excess of Par Value** (Notes 2 and 13) | **Surplus Reserves** (Notes 2 and 28) | **Deficit** (Notes 2 and 28) | **Revaluation Increment on Land and Buildings** (Notes 2 and 12) | **Accumulated Translation Adjustment** (Note 3) | **Net Unrealized Gain (Loss) on AFS Investments** (Note 11) | **Total Equity** |
|---|---|---|---|---|---|---|---|---|
| **Balance at January 1, 2008** | **₱26,489,837** | **₱2,037,272** | **₱532,136** | **(₱3,079,723)** | **₱2,471,113** | **₱–** | **₱768,386** | **₱29,219,021** |
| Unrealized loss on AFS investments recognized directly in equity | – | – | – | – | – | – | (1,478,603) | (1,478,603) |
| Amounts realized in profit or loss | – | – | – | – | – | – | (462,378) | (462,378) |
| Amortization of deferred losses (Note 9) | – | – | – | (608,181) | – | – | – | (608,181) |
| Revaluation increment during the year | – | – | – | – | 258,034 | – | – | 258,034 |
| Translation adjustment for the year | – | – | – | – | – | 144,086 | – | 144,086 |
| Total income and expenses recognized directly in equity | – | – | – | (608,181) | 258,034 | 144,086 | (1,940,981) | (2,147,042) |
| Net income for the year | – | – | – | 744,012 | – | – | – | 744,012 |
| Total income and expenses for the year | – | – | – | 135,831 | 258,034 | 144,086 | (1,940,981) | (1,403,030) |
| Transfer to surplus reserves (Note 28) | – | – | 7,241 | (7,241) | – | – | – | – |
| **Balance at December 31, 2008** | **₱26,489,837** | **₱2,037,272** | **₱539,377** | **(₱2,951,133)** | **₱2,729,147** | **₱144,086** | **(₱1,172,595)** | **₱27,815,991** |

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

# STATEMENTS OF CHANGES IN EQUITY

*(Amounts in Thousand Pesos)*

For the Year Ended December 31, 2007

Consolidated

| | Attributable to Equity Holders of the Parent Company | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Capital Stock (Notes 2 and 23) | Capital Paid in Excess of Par Value (Note 2 and 13) | Surplus Reserves (Notes 2 and 28) | Deficit (Notes 2 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 23) | Capital Paid in Excess of Par Value (Note 2 and 13) | Surplus Reserves (Notes 2 and 28) | Deficit (Notes 2 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

*(Amounts in Thousand Pesos)*

For the Year Ended December 31, 2006

| | Consolidated | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Attributable to Equity Holders of the Parent Company | | | | | | | | | | | |
| | Capital Stock (Notes 2 and 23) | Capital Paid in Excess of Par Value (Note 2 and 13) | Surplus Reserves (Notes 2 and 28) | Deficit (Notes 2 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 and 13) | Surplus Reserves (Notes 2 and 28) | 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 28) | – | – | 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 |

*See accompanying Notes to Financial Statements.*

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

# STATEMENTS OF CASH FLOWS

*(Amounts in Thousand Pesos)*

| | Consolidated | | | Parent Company | | |
|---|---|---|---|---|---|---|
| | Years Ended December 31 | | | | | |
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | | | |
| Income before income tax | **₱1,963,535** | ₱2,107,962 | ₱1,752,708 | **₱1,491,562** | ₱1,802,292 | ₱1,464,655 |
| Adjustments for: | | | | | | |
| Provision for impairment and credit losses (Note 16) | **964,064** | 3,280,875 | 2,802,283 | **1,243,031** | 3,251,687 | 2,734,736 |
| Depreciation and amortization (Notes 12 and 14) | **828,959** | 1,150,314 | 1,111,364 | **783,015** | 1,118,285 | 1,066,999 |
| Share in net loss (income) of an associate (Note 13) | **2,471** | 79,739 | (46,299) | **–** | – | – |
| Amortization of transaction costs | **29,250** | 27,127 | 16,095 | **29,250** | 27,127 | 16,095 |
| Amortization of software cost (Note 15) | **64,221** | 57,286 | 30,540 | **59,349** | 55,537 | 29,140 |
| Amortization of premium (discount) | **40,101** | (75,219) | (13,205) | **42,522** | (20,964) | 13,096 |
| Realized trading gain on available-for-sale (AFS) investments (Note 11) | **(490,582)** | (1,032,205) | (1,024,925) | **(462,378)** | (1,031,780) | (1,024,476) |
| Loss (gain) on mark-to-market of embedded derivatives (Note 11) | **367,072** | (103,367) | (929,503) | **367,072** | (103,367) | (929,503) |
| Loss on mark-to-market of financial liability designated at fair value through profit or loss (Note 11) | **1,004,261** | – | – | **1,004,261** | – | – |
| Net gain on sale or exchange of assets (Note 27) | **(808,862)** | (3,410,352) | (1,317,083) | **(807,765)** | (3,409,364) | (1,317,083) |
| Changes in operating assets and liabilities: | | | | | | |
| Decrease (increase) in amounts of: | | | | | | |
| Financial assets at fair value through profit or loss (FVPL) | **(9,763,439)** | (1,973,963) | 1,102,791 | **(9,775,151)** | (2,188,386) | 1,115,259 |
| Loans and receivables | **(28,330,115)** | 4,991,986 | (9,400,615) | **(25,705,533)** | 6,304,496 | (9,295,614) |
| Other assets | **(2,246)** | 510,413 | (4,833,661) | **(195,728)** | 596,692 | (4,791,652) |
| Increase (decrease) in amounts of: | | | | | | |
| Deposit liabilities | **22,460,457** | (2,855,723) | 13,840,915 | **21,230,525** | (2,842,291) | 13,637,084 |
| Financial liabilities at FVPL | **6,000,000** | – | – | **6,000,000** | – | – |
| Accrued taxes, interest and other expenses | **(22,670)** | (671,058) | 181,986 | **(74,041)** | (672,401) | 233,195 |
| Other liabilities | **(1,273,892)** | 269,439 | 1,138,920 | **(1,854,001)** | 878,418 | 785,851 |
| Net cash generated from (used in) operations | **(6,967,415)** | 2,353,254 | 4,412,941 | **(6,624,010)** | 3,765,981 | 3,737,782 |
| Income taxes paid | **(733,052)** | (547,457) | (949,905) | **(632,094)** | (465,110) | (772,981) |
| Dividends received (Note 13) | **–** | 3,605 | 9,012 | **23,651** | – | 7,147 |
| Net cash provided by (used in) operating activities | **(7,700,467)** | 1,809,402 | 3,472,048 | **(7,232,453)** | 3,300,871 | 2,971,948 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | | | |
| Proceeds from sale of: | | | | | | |
| AFS investments | **754,000,210** | 146,371,960 | 147,467,060 | **754,000,210** | 146,215,730 | 145,161,445 |
| Investment properties | **3,796,946** | 2,399,763 | 6,316,502 | **3,798,830** | 2,397,286 | 6,315,196 |
| Property and equipment | **–** | 217,196 | 339,912 | **–** | 216,345 | 333,833 |
| Collection of interbank loans receivables | **–** | 3,151,961 | 420,276,297 | **–** | 3,151,961 | 420,276,297 |
| Proceeds from maturity of held-to-maturity investments | **90,184,081** | – | 3,763,003 | **90,366,943** | – | 3,658,545 |
| Proceeds from disposal of an investment in associate | **499,814** | – | – | **499,814** | – | – |
| Proceeds from placements with the Bangko Sentral ng Pilipinas (BSP) | **12,700,000** | – | – | **12,700,00** | – | – |
| Placements with the BSP | **(8,900,000)** | (12,700,000) | – | **(8,900,000)** | (12,700,000) | – |
| Acquisition of: | | | | | | |
| AFS investments | **(768,052,499)** | (146,303,119) | (149,101,658) | **(767,665,686)** | (147,422,095) | (146,971,081) |
| Held-to-maturity investments | **(90,013,822)** | (54,942) | (37,350) | **(90,184,081)** | – | – |
| Property and equipment (Note 12) | **(202,863)** | (547,187) | (518,174) | **(172,680)** | (473,370) | (496,642) |
| Software cost (Note 15) | **(196,844)** | (249,146) | (54,285) | **(196,844)** | (249,146) | (54,285) |
| Additional interbank loans receivables | **–** | – | (423,428,258) | **–** | – | (423,428,258) |
| Additional investments in subsidiaries | **(118,140)** | – | – | **(118,140)** | – | (40,498) |
| Net cash provided by (used in) investing activities | **(6,303,117)** | (7,713,514) | 5,023,049 | **(5,871,634)** | (8,863,289) | 4,754,552 |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | | | | |
| Proceeds from: | | | | | | |
| Bills and acceptances payable | **784,770,532** | 556,934 | 12,356,184 | **795,902,700** | 556,934 | 11,381,465 |
| Settlement of bills and acceptances payable (Note 2) | **(776,439,492)** | (7,213,788) | (14,546,110) | **(787,908,320)** | (7,444,201) | (13,463,033) |
| Issuance of common shares (Note 23) | **–** | 5,051,527 | – | – | 5,051,527 | – |
| Issuance of subordinated debt (Note 21) | **–** | – | 5,500,000 | **–** | – | 5,500,000 |
| Net cash provided by (used in) financing activities | **8,331,040** | (1,605,327) | 3,310,074 | **7,994,380** | (1,835,740) | 3,418,432 |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | **(5,672,544)** | (7,509,439) | 11,805,171 | **(5,109,707)** | (7,398,158) | 11,144,932 |
| **CASH AND CASH EQUIVALENTS AT BEGINNING 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 34) | **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 |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | | | | | | |
| Cash and other cash items | **6,436,406** | 4,773,212 | 4,820,155 | **6,326,528** | 4,732,004 | 4,753,539 |
| Due from BSP (Note 34) | **11,156,705** | 15,261,521 | 12,566,759 | **10,940,705** | 15,261,521 | 12,566,759 |
| Due from other banks | **6,669,184** | 3,962,000 | 3,555,603 | **6,082,326** | 2,859,908 | 2,314,288 |
| Interbank loans receivable (Note 34) | **12,859,095** | 13,197,201 | 19,260,856 | **12,818,778** | 12,824,611 | 18,941,576 |
| Securities held under agreements to resell | **5,600,000** | 11,200,000 | 15,700,000 | **5,600,000** | 11,200,000 | 15,700,000 |
| | **₱42,721,390** | ₱48,393,934 | ₱55,903,373 | **₱41,768,337** | ₱46,878,044 | ₱54,276,162 |
| **OPERATIONAL CASH FLOWS FROM INTEREST AND DIVIDENDS** | | | | | | |
| Interest paid | **₱4,839,332** | ₱5,837,700 | ₱7,109,859 | **₱4,824,072** | ₱5,806,509 | ₱7,148,539 |
| Interest received | **10,667,513** | 11,187,821 | 12,118,812 | **10,283,755** | 10,206,429 | 11,705,491 |
| Dividends received | **–** | 3,605 | 9,012 | **23,651** | 20,532 | 191,949 |

*See accompanying Notes to Financial Statements*

## 1. Corporate Information

Philippine National Bank (the Parent Company) was established in the Philippines 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) through 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, 2008 and 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.

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 33 overseas branches and offices as of December 31, 2008 and 324 domestic and 32 overseas branches and offices as of December 31, 2007. The Parent Company's international subsidiaries have a network of 73 offices as of December 31, 2008 and 2007 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 31, 2009.

## 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 determining the Parent Company's capital adequacy ratio (CAR); 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:

| | |
|---|---:|
| 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 borrowing 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 19). 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 23, the Parent Company completed its Tier 1 follow-on equity offering in August 2007 raising about ₱5.1 billion in Tier 1 capital, net of issuance cost of ₱199.5 million.

## 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) and available-for-sale (AFS) investments, that are measured at fair value and land and building that are measured at appraised value.

The financial statements of the Parent Company reflect the accounts maintained in the Regular Banking Unit (RBU) and Foreign Currency Deposit Unit (FCDU).

The functional currency of RBU and FCDU is Philippine pesos and United States Dollar (USD), respectively. For financial reporting purposes, FCDU accounts and foreign currency-denominated accounts in the RBU are translated into their equivalents in Philippine pesos (see accounting policy on Foreign currency translation). The financial statements individually prepared for these units are combined and inter-unit accounts are eliminated.

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. The respective functional currencies of the subsidiaries are presented under 'Basis of Consolidation'.

Statement of Compliance

In 2008, the financial statements of the Group and of the Parent Company have been prepared in accordance with the accounting principles generally accepted in the Philippines for banks (Philippine GAAP for banks), particularly the reclassification as permitted by the BSP for prudential regulation and the SEC for financial reporting purposes, of certain investments of the Parent Company in Republic of the Philippines (ROP) credit-linked notes from AFS investments to held-to-maturity (HTM) investments and the related embedded derivatives previously bifurcated and classified as financial assets at FVPL to HTM investments as discussed in Note 11. Other than the aforementioned reclassification, and the deferral of the losses on sale of the non-performing assets (NPAs) to special purpose vehicle (SPV) as discussed in Note 9 and non-consolidation of the SPV as discussed in Note 10 which were allowed separately by the BSP, the financial statements of the Group and of the Parent Company have been prepared in compliance with Philippine Financial Reporting Standards (PFRS).

In 2007 and 2006, the financial statements of the Group and of the Parent Company have been prepared in compliance with PFRS, except for the deferral of losses on sale of NPAs to SPV as discussed in Note 9 and the non-consolidation of the SPV as discussed in Note 10.

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 | Functional Currency |
|---|---|---|---|---|
| PNB Capital and Investment Corporation (PNB Capital) | Financial Markets | Philippines | 100.00 | Philippine Peso (Php) |
| PNB Forex, Inc. | - do - | - do - | 100.00 | Php |
| PNB Holdings Corporation (PNB Holdings) | - do - | - do - | 100.00 | Php |
| PNB Securities, Inc. (PNB Securities) | Securities Brokerage | - do - | 100.00 | Php |
| PNB Corporation - Guam | Financial Markets | Guam | 100.00 | USD |
| PNB International Investments Corporation (PNB IIC) | - do - | USA | 100.00 | USD |
| PNB Europe PLC | - do - | United Kingdom | 100.00 | Great Britain Pounds (GBP) |
| PNB International Finance Limited (PNB IFL) | - do - | Hong Kong | 100.00 | Hong Kong Dollar (HKD) |
| PNB Global Filipino Remittance Spain (PNB GFRS) | - do - | Spain | 100.00 | Euro |
| PNB Austria Financial Services GmbH (PNB Austria) | - do - | Austria | 100.00 | Euro |
| PNB Italy SpA | - do - | Italy | 100.00 | Euro |
| PNB Remittance Center, Ltd. | Services | Hong Kong | 100.00 | HKD |
| Tanzanite Investments (SPV-AMC), Inc. | Others | Philippines | 100.00 | Php |
| Tau Portfolio Investments (SPV-AMC), Inc. | - do - | - do - | 100.00 | Php |
| Omicron Asset Portfolio (SPV-AMC), Inc. | - do - | - do - | 100.00 | Php |
| Japan - PNB Leasing and Finance Corporation (Japan-PNB Leasing) | Financial Markets | - do - | 60.00 | Php |

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 NPAs 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, 2008 and 2007.

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, amendments to Philippine Accounting Standards (PAS) and Philippine Interpretations which became effective in 2008.

Amendments to PAS 39 and PFRS 7, *Reclassification of Financial Assets*
The Group adopted the amendments to PAS 39 and PFRS 7 which allow reclassifications of certain financial instruments held-for-trading to either HTM investments, loans and receivables or AFS investments categories, as well as certain instruments from AFS investments to loans and receivables. On September 11, 2008, the Parent Company reclassified certain financial instruments from the FVPL and AFS investments category to HTM investments. The adoption of the amendments to PAS 39 and PFRS 7 did not result in the restatement of prior year's financial statements. The related disclosures are included in Note 11.

Philippine Interpretation IFRIC 11, *PFRS 2 Group and Treasury Share Transactions*
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, the adoption of this Interpretation has no impact on its financial statements.

Philippine Interpretation IFRIC 12, *Service Concession Arrangements*
This Interpretation covers contractual arrangements arising from private entities providing public services. This Interpretation is not relevant to the Group.

Philippine Interpretation IFRIC 14, *PAS 19, The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*
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. As the Group's defined benefit schemes are currently in deficit, the Interpretation had no impact on its financial statements.

**Significant Accounting Policies**

Foreign Currency Translation
*Transactions and balances*
The books of accounts of the RBU are maintained in Philippine pesos, while those of the FCDU are maintained in USD.

As at reporting date, foreign currency-denominated monetary assets and liabilities in the RBU are translated in Philippine peso 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 of the RBU 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.

*FCDU and Overseas subsidiaries*
As at the reporting date, the assets and liabilities of the FCDU and overseas subsidiaries are translated into the Parent Company's presentation currency (the Philippine peso) at the closing rate prevailing at the balance sheet date, and their income and expenses are translated at average rate for the year. Exchange differences arising on translation are taken directly to a separate component of equity under 'Accumulated translation adjustment'. 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.

Prior to 2008, FCDU's functional currency was Philippine peso. In 2008, in compliance with the requirements of BSP Circular No. 601, management formalized its determination of the FCDU's functional currency. Based on management's assessment, the FCDU's functional currency is USD. Under PAS 21, *The Effect of Changes in Foreign Exchange Rates*, change in functional currency is applied prospectively. Foreign exchange difference credited to 'Accumulated translation adjustment' in 2008 amounted to ₱144.1 million. Translation adjustments of prior years are no longer restated since the amount is not material to the financial statements of the Group and of the Parent Company.

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

*Reclassification of financial assets*
The Group may choose to reclassify a non-derivative trading financial asset out of the held-for-trading category if the financial asset is no longer held for purposes of selling it in the near term and only in rare circumstances arising from a single event that is unusual and highly unlikely to recur in the near term. In addition, the Group may choose to reclassify financial assets that would meet the definition of loans and receivables out of the held-for-trading or AFS investments categories if the Group has the intention and ability to hold these financial assets for the foreseeable future or until maturity at the date of reclassification.

The Group may also reclassify certain AFS investments to HTM investments when there is a change of intention and the Group has the ability to hold the financial instruments to maturity.

Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortized cost as applicable, and no reversals of fair value gains or losses recorded before reclassification date are subsequently made. Effective interest rates for financial assets reclassified to loans and receivables and HTM categories are determined at the reclassification date. Further increases in estimates of cash flows adjust effective interest rates prospectively. As of December 31, 2008, the Bank has reclassified some of its financial assets at FVPL and AFS investments to HTM investments (see Note 11).

*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 ask 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' difference*
Where the transaction price in a non-active market is different from the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Group recognizes the difference between the transaction price and fair value (a 'Day 1' difference) in the statement of income in 'Trading and investment securities gains (losses) - 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' difference 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 (losses) - 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 2008 and 2007, 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 loans 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 receivables; call options in certain long-term debt, and foreign-currency derivatives in debt instruments, purchase orders and service agreements. Except as discussed in Note 11, 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, 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 (losses) - net'. Interest earned or incurred is recorded in 'Interest income' or 'Interest 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 (losses) - net'. Interest earned or incurred is recorded in 'Interest income' or 'Interest 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 and notes receivables financed by Japan – PNB Leasing. 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 in the statement of 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 (loss) on AFS investments' in the equity section of the balance sheet.

When the security is disposed of, the cumulative gain or loss previously recognized in equity is recognized as 'Trading and investment securities gains (losses) - 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 not qualified as and not designated at FVPL 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 has expired. 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.

*Financial assets at amortized cost*
For loans and receivables, HTM investments, 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 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.

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.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of such credit risk characteristics as industry, collateral type, past-due status and term. Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with changes in related observable data from period to period (such 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. Future interest income is based on the reduced carrying amount and is accrued based on the rate of interest used to discount future cash flows for the purpose of measuring impairment loss. Such accrual is recorded as part of 'Interest income' in the statement of income. If 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.

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 has expired.

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.

*Service fees 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.

*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 balance sheet. The unearned discount is taken up to income over the installment terms and is computed using the effective interest method.

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

*Trading and investment securities gains (losses) - net*
Trading and investment securities gains (losses) - net includes results arising from trading activities and all gains and losses from changes in fair value of financial assets and financial liabilities at FVPL and gains and losses from disposal of AFS investments.

*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'.

*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.

Unearned discounts which are amortized over the term of the note or lease using the effective interest method consist of:

- Transaction and finance fees on finance leases and loans and receivables financed with long-term maturities; and
- Excess of the aggregate lease rentals plus the estimated terminal value of the leased equipment over its cost.

*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.

Cash and Cash Equivalents
For purposes of reporting cash flows, cash and cash equivalents include cash and other cash items (COCI), amounts due from BSP and other banks, 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.

Receivable from SPV
Receivable 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.

Investments in Subsidiaries and an Associate
*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.

Under the equity method, investment in an associate is carried in the consolidated 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 consolidated 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. 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 period 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 the date of execution of certificate of sale.

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 period of retirement or disposal.

Expenditures incurred after the investment properties have been put into operations, such as repairs and maintenance costs, are normally charged against income in the period 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 against the statement of income (see accounting policy on Impairment of Property and Equipment, Investment Properties and Intangible Assets).

*Software costs*

Software costs, included in 'Other assets', 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 property and equipment, investment properties and intangible assets with finite useful lives 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 against 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.

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. 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 retirement 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 measurement of a defined benefit asset is limited to the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan plus unrecognized gains and losses. The economic benefit available as a refund is measured as the amount of the surplus at the balance sheet date that the Parent Company and certain subsidiaries have a right to receive as a refund, less any associated costs. If there is no minimum funding requirement, the economic benefit available as a reduction in future contributions is measured as the lower of:

a) the surplus in the plan; and
b) the present value of the future service cost, i.e., excluding any part of the future cost that will be borne by employees, for each year over the shorter of the expected life of the plan and the expected life of the entity.

Under the terms of the Parent Company's and certain subsidiaries' retirement plans, there are no minimum funding requirements.

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. When 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. When 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
*Current tax*
Current tax assets and liabilities for the current periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the balance sheet date.

*Deferred tax*
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 are 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.

Parent Company Shares Held by a Subsidiary
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 period attributable to common shareholders by the weighted average number of common shares outstanding during the period after giving retroactive effect to stock dividends declared and stock rights exercised during the period, 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 period adjusted for the effects of any 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 BOD of the Parent Company and subsidiaries. Dividends for the period that are approved after the balance sheet date are dealt with as an event after the balance sheet date.

Debt Issue Costs
Issuance, underwriting and other related expenses incurred in connection with the issuance of debt instruments (other than debt instruments designated at FVPL) are deferred and amortized over the terms of the instruments using the effective interest method. Unamortized debt issuance costs are netted against the related carrying value of the debt instruments in the balance sheet.

Equity Issuance Cost
Issuance, underwriting and other related expenses incurred in connection with the issuance of equity securities are treated as reduction of the capital account.

Borrowing Costs
Borrowing costs are recognized as expense in the year in which these costs are incurred.

Events After the Balance Sheet Date
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. Refer to Note 7 for detailed disclosure on Segment Information.

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 standards and interpretations which are not yet effective for the year ended December 31, 2008. Except as otherwise indicated, the Group does not expect the adoption of these new and amended standards and interpretations to have significant impact on its financial statements.

*Effective in 2009*
Amendment to PAS 1, *Presentation of Financial Statements - Amendment on Statement of Comprehensive Income*
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 of comprehensive income. Owners are defined as holders of instruments classified as equity.

In addition, the amendment to PAS 1 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 has yet to assess the impact of this amendment on the financial statements.

PAS 23, *(Revised) Borrowing Cost*
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.

Amendments to PAS 27, *Consolidated and Separate Financial Statements - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*
Amendments to PAS 27 prescribe changes in respect of the holding companies separate financial statements including (a) the deletion of 'cost method', making the distinction between pre- and post-acquisition profits no longer required; and (b) in cases of reorganizations where a new parent is inserted above an existing parent of the group (subject to meeting specific requirements), the cost of the subsidiary is the previous carrying amount of its share of equity items in the subsidiary rather than its fair value. All dividends will be recognized in profit or loss. However, the payment of such dividends requires the entity to consider whether there is an indicator of impairment.

PAS 32, *Financial Instruments: Presentation and PAS 1, Puttable Financial Instruments and Obligations Arising on Liquidation*
The standards have been amended to allow a limited scope exception for puttable financial instruments to be classified as equity if they fulfill a number of specified criteria.

PFRS 1, *First-time Adoption of PFRS - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*
The amended PFRS 1 allows an entity, in its separate financial statements, to determine the cost of investments in subsidiaries, jointly controlled entities or associates (in its opening PFRS financial statements) as one of the following amounts: a) cost determined in accordance with PAS 27; b) at the fair value of the investment at the date of transition to PFRS, determined in accordance with PAS 39; or c) previous carrying amount (as determined under generally accepted accounting principles) of the investment at the date of transition to PFRS.

PFRS 2, *Share-based Payment - Vesting Conditions and Cancellations Combinations*
This Standard has been amended to clarify the definition of vesting conditions and to prescribe the accounting treatment of an award that is effectively cancelled because a non-vesting condition is not satisfied.

PFRS 8, *Operating Segments*
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.

Philippine Interpretation IFRIC 13, *Customer Loyalty Programmes*
This Interpretation addresses the accounting by an entity that grants award credits to its customers. The Group will apply paragraph 13 of PAS 18, *Revenue*, and account for award credits as a separately identifiable component of the sales transaction in which they are granted.

Philippine Interpretation IFRIC 16, *Hedges of a Net Investment in a Foreign Operation*
This Interpretation provides guidance on identifying the foreign currency risk arising from its net investments in foreign operations and wishes to qualify for hedge accounting in accordance with PAS 39.

Improvements to PFRSs
In May 2008, the International Accounting Standards Board issued its first omnibus of amendments to certain standards, primarily with a view to removing inconsistencies and clarifying wording. There are the separate transitional provisions for each standard:

PFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*
When a subsidiary is held for sale, all of its assets and liabilities will be classified as held for sale under PFRS 5, even when the entity retains a non-controlling interest in the subsidiary after the sale.

PAS 1, *Presentation of Financial Statements*
Assets and liabilities classified as held for trading are not automatically classified as current in the balance sheet.

PAS 16, *Property, Plant and Equipment*
The amendment replaces the term 'net selling price' with 'fair value less costs to sell', to be consistent with PFRS 5 and PAS 36, *Impairment of Assets*.

Items of property and equipment held for rental that are routinely sold in the ordinary course of business after rental, are transferred to inventory when rental ceases and they are held for sale. Proceeds of such sales are subsequently shown as revenue. Cash payments on initial recognition of such items, the cash receipts from rents and subsequent sales are all shown as cash flows from operating activities.

PAS 19, *Employee Benefits*
The definition of 'past service costs' is revised to include reductions in benefits related to past services ('negative past service costs') and to exclude reductions in benefits related to future services that arise from plan amendments. Amendments to plans that result in a reduction in benefits related to future services are accounted for as a curtailment. The definition of 'return on plan assets' is revised to exclude plan administration costs if they have already been included in the actuarial assumptions used to measure the defined benefit obligation.

The definition of ' short-term' and 'other long-term' employee benefits is revised to focus on the point in time at which the liability is due to be settled.

The reference to the recognition of contingent liabilities is deleted to ensure consistency with PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

PAS 20, *Accounting for Government Grants and Disclosures of Government Assistance*
Loans granted with no or low interest rates will not be exempt from the requirement to impute interest. The difference between the amount received and the discounted amount is accounted for as a government grant.

PAS 23, *Borrowing Costs*
The definition of borrowing costs is revised to consolidate the types of items that are considered components of 'borrowing costs', i.e., components of the interest expense calculated using the effective interest rate method.

PAS 28, *Investment in Associates*
If an associate is accounted for at fair value in accordance with PAS 39, only the requirement of PAS 28 to disclose the nature and extent of any significant restrictions on the ability of the associate to transfer funds to the entity in the form of cash or repayment of loans applies.

An investment in an associate is a single asset for the purpose of conducting the impairment test. Therefore, any impairment test is not separately allocated to the goodwill included in the investment balance.

PAS 31, *Interest in Joint Ventures*
If a joint venture is accounted for at fair value, in accordance with PAS 39, only the requirements of PAS 31 to disclose the commitments of the venturer and the joint venture, as well as summary financial information about the assets, liabilities, income and expense will apply.

PAS 36, *Impairment of Assets*
When discounted cash flows are used to estimate 'fair value less cost to sell' additional disclosure is required about the discount rate, consistent with disclosures required when the discounted cash flows are used to estimate 'value in use'.

PAS 38, *Intangible Assets*
Expenditure on advertising and promotional activities is recognized as an expense when the Group either has the right to access the goods or has received the services. Advertising and promotional activities now specifically include mail order catalogues. References to there being rarely are deleted, if ever, persuasive evidence to support an amortization method for finite life intangible assets that results in a lower amount of accumulated amortization than under the straight-line method, thereby effectively allowing the use of the unit of production method.

PAS 39, *Financial Instruments: Recognition and Measurement*
Changes in circumstances relating to derivatives - specifically derivatives designated or de-designated as hedging instruments after initial recognition - are not reclassifications.

When financial assets are reclassified as a result of an insurance company changing its accounting policy in accordance with paragraph 45 of PFRS 4, *Insurance Contracts*, this is a change in circumstance, not a reclassification.

The reference to a 'segment' when determining whether an instrument qualifies as a hedge is removed.

The revised effective interest rate (rather than the original effective interest rate) is required to be used when re-measuring a debt instrument on the cessation of fair value hedge accounting.

PAS 40, *Investment Property*
The scope (and the scope of PAS 16) is revised to include property that is being constructed or developed for future use as an investment property. Where an entity is unable to determine the fair value of an investment property under construction, but expects to be able to determine its fair value on completion, the investment under construction will be measured at cost until such time as fair value can be determined or construction is complete.

*Effective in 2010*
Revised PFRS 3, *Business Combinations* and PAS 27, *Consolidated and Separate Financial Statements*
The revised PFRS 3 introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs, and future reported results. The revised PAS 27 requires, among others, that (a) change in ownership interests of a subsidiary (that do not result in loss of control) will be accounted for as an equity transaction and will have no impact on goodwill nor will it give rise to a gain or loss; (b) losses incurred by the subsidiary will be allocated between the controlling and non-controlling interests (previously referred to as 'minority interests'); even if the losses exceed the non-controlling equity investment in the subsidiary; and (c) on loss of control of a subsidiary, any retained interest will be remeasured to fair value and this will impact the gain or loss recognized on disposal. The changes introduced by the revised PFRS 3 must be applied prospectively, while changes introduced by revised PAS 27 must be applied retrospectively with a few exceptions. The change will affect future acquisitions and transactions with non-controlling interests.

Amendment to PAS 39, *Financial Instruments: Recognition and Measurement - Eligible Hedged Items*
This amendment addresses only the designation of a one-sided risk in a hedged item, and the designation of inflation as a hedged risk or portion in particular situations. The amendment clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as a hedged item.

Philippine Interpretation IFRIC - 17, *Distribution of Non-cash Assets to Owners*
This Interpretation covers accounting for two types of non-reciprocal distributions of assets by an entity to its owners acting in their capacity as owners.

The two types of distribution are:
a. distributions of non-cash assets (e.g., items of property and equipment, businesses as defined in PFRS 3, ownership interests in another entity or disposal groups as defined in PFRS 5); and
b. distributions that give owners a choice of receiving either non-cash assets or a cash alternative.

This Interpretation addresses only the accounting by an entity that makes a non-cash asset distribution. It does not address the accounting by shareholders who receive such a distribution.

Philippine Interpretation IFRIC - 18, *Transfers of Assets from Customers*
This Interpretation covers accounting for transfers of items of property and equipment by entities that receive such transfers from their customers. Agreements within the scope of this Interpretation are agreements in which an entity receives from a customer an item of property and equipment that

the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services, or to do both. This Interpretation also applies to agreements in which an entity receives cash from a customer when that amount of cash must be used only to construct or acquire an item of property, plant and equipment and the entity must then use the item of property and equipment either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services, or to do both.

*Effective in 2012*
Philippine Interpretation IFRIC 15, Agreement for Construction of Real Estate
This interpretation covers accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. This interpretation requires that revenue on construction of real estate be recognized only upon completion, except when such contract qualifies as construction contract to be accounted for under PAS 11, *Construction Contracts*, or involves rendering of services in which case revenue is recognized based on stage of completion. Contracts involving provision of services with the construction materials and where the risks and rewards of ownership are transferred to the buyer on a continuous basis, will also be accounted for based on stage of completion.

## 4. Significant Accounting Judgments and Estimates

The preparation of the financial statements in compliance 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 properties. The Group has determined, based on an evaluation of the terms and conditions of the lease agreements, that it retains all the significant risks and rewards of ownership of these properties and so accounts for these leases as operating leases.

*Finance leases*
Japan-PNB Leasing has entered into finance leases. The Group has determined that it transfers all the significant risks and rewards of ownership of these properties which are leased out on finance 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.

*(e) Embedded derivatives*
Except as discussed in Note 11, where a hybrid instrument is not classified as financial assets at FVPL, the Group evaluates whether the embedded derivative should be bifurcated and accounted for separately. This includes assessing whether the embedded derivative has a close economic relationship to the host contract.

*(f) Contingencies*
The Group is currently involved in legal proceedings. The estimate of the probable cost for the resolution of claims has been developed in consultation with the aid of the outside legal counsel handling the Group's defense in this matter and is based upon an analysis of potential results. Management does not believe that the outcome of this matter will affect the results of operations. It is probable, however, that future results of operations could be materially affected by changes in the estimates or in the effectiveness of the strategies relating to this proceeding (see Note 30).

*(g) Functional currency*
PAS 21 requires management to use its judgment to determine the entity's functional currency such that it most faithfully represents the economic effects of the underlying transactions, events and conditions that are relevant to the entity. In making this judgment, the Group considers the following:

a) the currency that mainly influences prices for financial instruments and services (this will often be the currency in which prices for its financial instruments and services are denominated and settled);

b) the currency in which funds from financing activities are generated; and
c) the currency in which receipts from operating activities are usually retained.

Estimates

*(a) Credit 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, 2008 and 2007, allowance for credit losses on loans and receivables amounted to ₱12.4 billion and ₱12.0 billion, respectively, for the Group and ₱12.2 billion and ₱11.7 billion, respectively, for the Parent Company. As of December 31, 2008 and 2007, loans and receivables are carried at ₱102.4 billion and ₱76.6 billion, respectively, for the Group and ₱96.4 billion and ₱73.2 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 31 for information on the fair values of these instruments.

*(c) Valuation of unquoted AFS 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 price from observable current market transactions in the same instrument or from other available observable market data. Unquoted AFS equity securities of the Parent Company amounted to ₱384.1 million and ₱350.3 million as of December 31, 2008 and 2007, respectively. Unquoted AFS equity securities of the Group amounted to ₱384.1 million and ₱352.8 million as of December 31, 2008 and 2007, respectively, (see Note 11).

*(d) Impairment of AFS debt investments*

The Group reviews its debt investments classified as AFS investments at each balance sheet date to assess whether they are impaired. This requires similar judgment as applied to the individual assessment of loans and receivables.

As of December 31, 2008 and 2007, no impairment losses were provided on AFS debt investments. Refer to Note 11 for the information on the carrying amounts of these investments.

*(e) 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 12 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.

As of December 31, 2008 and 2007, the allowance for credit losses of equity investments amounted to ₱623.6 million and ₱619.4 million, respectively for the Group and the Parent. Refer to Note 11 for the information on the carrying amounts of these investments.

*(f) Recognition of deferred income taxes*

Deferred tax assets are recognized for all unused tax losses and temporary differences to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable 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 26, recognized net deferred tax assets as of December 31, 2008 and 2007 amounted to ₱1.7 billion and ₱1.8 billion, respectively, for the Group and the Parent Company. As of December 31, 2008 and 2007 deferred tax assets on the unused tax losses and other temporary differences amounting to ₱28.7 billion and ₱29.6 billion, respectively, for the Group and ₱28.6 billion and ₱29.5 billion, respectively, for the Parent Company, were not recognized.

(g) *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.

As of December 31, 2008 and 2007, the present value of the defined benefit obligation of the Parent Company amounted to ₱1.2 billion and ₱1.6 billion, respectively (see Note 24).

(h) *Revaluation of property and equipment*
The Group measures land and buildings at revalued amounts with changes in fair value being recognized in equity. The Group engaged independent valuation specialists to determine the fair value of land and buildings as of December 31, 2008.

As of December 31, 2008 and 2007, the appraised value of land and buildings amounted to ₱17.5 billion and ₱17.6 billion, respectively, for the Group and the Parent Company.

(i) *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, 2008, the carrying value of the property and equipment and investment properties amounted to ₱16.7 billion and ₱23.5 billion, respectively, for the Group and ₱16.6 billion and ₱23.4 billion, respectively, for the Parent Company. 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 (see Notes 12 and 14).

As of December 31, 2008 and 2007, the allowance for impairment losses on the investment properties amounted to ₱5.5 billion and ₱6.4 billion, respectively, for the Group and the Parent Company. The Group and the Parent Company did not recognize any allowance for impairment losses on property and equipment as of December 31, 2008 and 2007 (see Note 16).

(j) *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, 2008, the carrying value of depreciable property and equipment and investment properties amounted to ₱5.7 billion and ₱3.6 billion, respectively, for the Group and ₱5.6 billion and ₱3.6 billion, respectively, for the Parent Company. As of December 31, 2007, the carrying value of depreciable property and equipment and investment properties amounted to ₱5.6 billion and ₱4.1 billion, respectively, for the Group and ₱5.4 billion and ₱4.1 billion, respectively, for the Parent Company (see Notes 12 and 14).

## 5. Financial Risk Management Objectives and Policies

Introduction
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.

2008 was a year in which risk management emerged as having a critical though unfulfilled role in the global financial market. The banking industry was faced with new challenges in all risk categories that translate to a need for more improvements in managing risks.

The sub-prime crisis that materialized in the US real estate sector triggered the global financial turbulence that is now felt by first-world countries. The consequential credit risk has initiated a massive snowballing effect that is gradually spreading to other asset classes. Pessimistic projections in the industry point to these effects gaining a foothold in the Philippine economic topography. This led to the recognition of the need for a more effective group-wide risk controlling framework in the Group.

The Parent Company monitors processes associated with the following overall risk categories:
- Credit Risk
- Market
- Liquidity Risk
- Operational Risk
- Information Security and Technology Risk

Further, the Group is also cognizant of the need to address various other risks through the primary divisions presented above. The following are also taken into consideration as part of the overall Enterprise Risk Management (ERM) Framework:
- Counterparty Risk
- Business Risk
- Strategic Risk
- Compliance Risk
- Legal Risk
- Risks arising from the Parent Company's shareholdings and equity interests

Managing the level of these risks as provided for by the Group's ERM framework is critical to its continuing profitability. The Risk Management Committee (RMC) of the Parent Company's BOD determines the risk policy and approves the principles of risk management, establishment of limits for all relevant risks, and the risk control procedures. The RMC of the Parent Company is also responsible for the risk management of the Group.

Enterprise Risk Management Framework
The ERM framework adopted by the Parent Company is consistent with the following approach:
1. Identify the risk
2. Measure the risk
3. Control the risk
4. Monitor the risk

The approach enumerated above gives rise to the five stages of activity, described as a closed loop process, which allows a consistent and iterative approach to risk management. The process consists, as stated above of five fundamental activity stages, as follows:
1. Understanding the Business Context
   It is imperative that an understanding of the business operation be established. In some cases, business goals are neither obvious nor explicitly stated. This provides impetus for ensuring a thorough understanding of how management views and addresses risk.

2. Identify the business risks
   The identification of risks helps to clarify and quantify the possibility that certain events will directly impact business goals. The severity of business risks are normally expressed in financial metrics that have impacts upon direct financial loss, damage to reputation, violation of regulatory constraints, and exposure to liability.

3. Synthesize and prioritize the risks
   A number of risks will be apparent in any business activity. It is in the risk prioritization process that the Parent Company is able to take into account which business goals are the most important, which goals are immediately threatened, and how likely the risks are to manifest themselves in such a way as to impact the business.

4. Define the risk mitigation strategy
   It is in this stage that a coherent strategy for mitigating the risks in a cost effective way is created. This is the stage where policies and procedures are established and implemented to help ensure that the selected responses are uniformly and effectively carried out across the Group.

5. Keep track of the results of the strategy
   With the ERM in place, the Risk Management Group (RMG), Internal Audit Group (IAG), the Compliance Office, together with the oversight of the RMC, Board Audit and Compliance Committee (BACC), and Corporate Governance (CorpGov) Committees, constantly monitor the management of risk as defined in stage 4 above. This is accomplished via a continuous reporting system supported by the Parent Company's Management Information System (MIS) Group.

Upon reaching stage 5, the loop is closed by continuing on back to stage 2, unless any major changes have been identified in the way business is conducted, in which case, a repeat of the entire process, from stage 1 becomes necessary.

Risk Responsibilities
1. Establishing the RMC of the Parent Company's BOD is in conformity with the regulations of the BSP. The RMC hears the recommendation for the Group's potential risk exposure, and endorses these identified risks and the corresponding risk management process, to the BOD.

   Likewise, the Group's risk profile is monitored against this appetite. In this way, the fulfilment of the risk management functions of the BOD has been delegated to and assumed by the RMC, which is currently made up of five (5) directors. It is the RMC that is primarily responsible for the execution of the ERM framework.

   The RMC meets monthly to be apprised by the heads of the various risk-taking offices on the current risk situations faced by the Parent Company. Through these meetings, the RMC evaluates the adequacy and effectiveness of risk management policies, the suitability of limits, the adequacy of provisions, and the overall adequacy of capital in relation to the level and form of risks assumed.

2. The Parent Company has established a risk management function that is independent of the business line by setting up the RMG. The RMG is composed of divisions addressing the primary risk categories identified above, to wit:

    - Credit Risk Management
    - Market and Liquidity Risk Management
    - Operations Risk Management
    - Information Security and Technology Risk Management

The RMG provides the legwork for the RMC in its role of formulating the risk management strategy, the management of regulatory capital, the development and maintenance of the internal risk management framework, and the definition of the governing risk management principles. The mandate of the RMG involves:

- The implementation of the risk management framework of identifying, measuring, controlling and monitoring the various risk taking activities of the Group, inherent in all financial institutions;
- Provide services to the risk-taking units and personnel in the implementation of risk mitigation strategies; and
- Establish recommended limits based on the results of its analysis of exposures.

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 and approving authorities;
- 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 CAR report;
- Monitoring of breaches in regulatory and internal limits;
- Credit Risk Management Dashboard;
- Diversification; and
- Active loan portfolio management undertaken to determine the quality of the loan portfolio and identify the following:
    a. portfolio growth
    b. movement of loan portfolio (cash releases and cash collection for the month)
    c. loss rate
    d. recovery rate
    e. trend of nonperforming loans (NPLs)
    f. concentration risk (per classified account, per industry, clean exposure, large exposure, contingent exposure, currency, security, facility, demographic, etc)
    g. Internal Risk Rating System for corporate accounts
    h. Credit Scoring for retail accounts

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 letters of credit (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, as discussed under *Collateral and other credit enhancement*, 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. Clear escalation process and override procedures are in place, whereby any excess in limits are covered by appropriate approving authority to regularize and monitor breaches in 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.

*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, 2008 and 2007, without considering the effects of collateral, credit enhancements and other credit risk mitigation techniques (in million pesos):

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| COCI and due from BSP (excluding cash on hand) | **₱20,792** | ₱28,020 | **₱20,791** | ₱28,017 |
| Due from other banks | **6,669** | 3,962 | **6,082** | 2,860 |
| Interbank loans receivable | **12,859** | 13,197 | **12,819** | 12,825 |
| Securities held under agreements to resell | **5,600** | 11,200 | **5,600** | 11,200 |
| Financial assets at FVPL: | | | | |
| Held-for-trading: | | | | |
| Government securities | **3,905** | 1,963 | **3,905** | 1,963 |
| Derivative assets | **1,372** | 1,173 | **1,372** | 1,173 |
| Equity securities | **65** | 79 | **56** | 58 |
| Designated at FVPL: | | | | |
| Private debt | **5,710** | – | **5,710** | – |
| | **11,052** | 3,215 | **11,043** | 3,194 |
| Loans and receivables: | | | | |
| Loans receivables*: | | | | |
| Business loans | **48,472** | 36,640 | **43,860** | 35,300 |
| GOCCs and NGAs | **20,574** | 11,304 | **20,574** | 11,304 |
| Consumers | **6,992** | 3,954 | **6,825** | 3,719 |
| LGUs | **5,610** | 5,312 | **5,610** | 5,312 |
| Fringe benefits | **773** | 859 | **770** | 859 |
| Unquoted debt securities | **9,011** | 8,304 | **9,011** | 8,304 |
| Other receivable | **10,969** | 10,202 | **9,746** | 8,364 |
| | **102,401** | 76,575 | **96,396** | 73,162 |
| Receivable from SPV | **719** | 726 | **719** | 726 |
| AFS investments: | | | | |
| Government securities | **10,884** | 32,310 | **10,093** | 31,712 |
| Other debt securities | **3,137** | 11,768 | **2,858** | 11,585 |
| Unquoted equity securities | **384** | 353 | **384** | 350 |
| Quoted equity securities | **184** | 391 | **56** | 314 |
| | **14,589** | 44,822 | **13,391** | 43,961 |
| HTM investments: | | | | |
| Government securities | **37,434** | 446 | **37,338** | 363 |
| Other debt securities | **6,716** | – | **6,716** | – |
| | **44,150** | 446 | **44,054** | 363 |
| Miscellaneous COCI | **1** | 165 | **1** | 165 |
| Commitments | **8,818** | 10,220 | **8,818** | 9,942 |
| | **₱227,650** | ₱192,548 | **₱219,714** | ₱186,415 |

*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 23). The limit to group exposure is 100% of the single borrower's limit (SBL) for loan accounts with 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 (in million pesos):

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Philippines | **₱218,874** | ₱164,462 | **₱214,196** | ₱159,806 |
| USA and Canada | **4,659** | 3,863 | **2,147** | 2,761 |
| Asia (excluding the Philippines) | **3,718** | 6,876 | **3,367** | 6,874 |
| United Kingdom | **374** | 2,666 | **–** | 2,666 |
| Other European Union Countries | **21** | 14,681 | **–** | 14,308 |
| Middle East | **4** | – | **4** | – |
| Total | **₱227,650** | ₱192,548 | **₱219,714** | ₱186,415 |

c. Concentration by Industry

The tables below show the industry sector analysis of the Group's and Parent Company's financial assets as of December 31, 2008 and 2007 at amounts before taking into account the fair value of the loan collateral held or other credit enhancements (in million pesos).

| | Consolidated | | |
|---|---|---|---|
| | 2008 | | |
| | Gross Maximum Exposure | | Fair Market Value |
| | Amount | % | of Collateral |
| **Loans and Receivables** | | | |
| Loans receivables: | | | |
| Primary target industry: | | | |
| Wholesale and retail | **₱22,885** | **27.76** | **₱14,971** |
| Manufacturing | **12,236** | **14.85** | **17,315** |
| Electricity, gas and water | **7,830** | **9.50** | **17,607** |
| Transport, storage and communication | **7,824** | **9.49** | **23,031** |
| Public administration and defense | **6,375** | **7.73** | **11,705** |
| Financial intermediaries | **4,836** | **5.87** | **16,439** |
| Agriculture, hunting and forestry | **2,729** | **3.31** | **2,354** |
| Secondary target industry: | | | |
| Real estate, renting and business | | | |
| Activities | **3,684** | **4.47** | **6,865** |
| Construction | **1,778** | **2.16** | **4,630** |
| Others* | **12,244** | **14.86** | **44,321** |
| | **82,421** | **100.00** | **159,238** |
| Unquoted debt securities: | | | |
| Manufacturing | **4,661** | **51.73** | **–** |
| Government | **3,763** | **41.76** | **–** |
| Financial intermediaries | **231** | **2.56** | **–** |
| Real estate, renting and business activities | **356** | **3.95** | **–** |
| | **9,011** | **100.00** | **–** |
| Other receivables | **10,969** | | **–** |
| | **102,401** | | **159,238** |
| **Trading and Financial Investment Securities** | | | |
| Government | **52,223** | **74.83** | **–** |
| Financial intermediaries | **14,349** | **20.56** | **–** |
| Real estate, renting and business activities | **265** | **0.38** | **–** |
| Manufacturing | **75** | **0.11** | **–** |
| Electricity, gas and water | **17** | **0.02** | **–** |
| Others | **2,862** | **4.10** | **–** |
| | **69,791** | **100.00** | **–** |
| **Other Financial Assets** | | | |
| Government | **25,657** | **46.26** | **–** |
| Financial intermediaries | **20,263** | **36.54** | **–** |
| Others | **9,538** | **17.20** | **–** |
| | **55,458** | **100.00** | **–** |
| | **₱227,650** | | **₱159,238** |

| | Consolidated | | |
|---|---|---|---|
| | 2007 | | |
| | Gross Maximum Exposure | | Fair Market Value |
| | Amount | % | of Collateral |
| **Loans and Receivables** | | | |
| Loans receivables: | | | |
| Primary target industry: | | | |
| Manufacturing | ₱8,644 | 14.89 | ₱9,581 |
| Wholesale and retail | 8,455 | 14.56 | 13,105 |
| Electricity, gas and water | 7,646 | 13.17 | 13,052 |
| Agriculture, hunting and forestry | 7,468 | 12.86 | 2,515 |
| Transport, storage and communications | 4,718 | 8.12 | 3,074 |
| Financial intermediaries | 5,868 | 10.11 | 13,840 |
| Public administration and defense | 2,352 | 4.05 | 1,371 |
| Secondary target industry: | | | |
| Real estate, renting and business activities | 7,176 | 12.36 | 17,094 |
| Construction | 1,619 | 2.79 | 4,325 |
| Others* | 4,123 | 7.09 | 31,226 |
| | 58,069 | 100.00 | 109,183 |
| Unquoted debt securities: | | | |
| Manufacturing | 5,223 | 62.89 | – |
| Government | 1,505 | 18.12 | – |
| Real estate, renting and business activities | 1,308 | 15.76 | – |
| Financial intermediaries | 268 | 3.23 | – |
| | 8,304 | 100.00 | – |
| Other receivables | 10,202 | | 2,626 |
| | 76,575 | | 111,809 |
| **Trading and Financial Investment Securities** | | | |
| Government | 34,719 | 71.61 | – |
| Financial intermediaries | 12,0472 | 4.85 | – |
| Electricity, gas and water | 823 | 1.70 | – |
| Real estate, renting and business activities | 255 | 0.52 | – |
| Manufacturing | 67 | 0.14 | – |
| Others | 572 | 1.18 | – |
| | 48,483 | 100.00 | – |
| **Other Financial Assets** | | | |
| Government | 42,302 | 62.68 | 11,200 |
| Financial intermediaries | 14,242 | 21.10 | – |
| Others | 10,946 | 16.22 | – |
| | 67,490 | 100.00 | 11,200 |
| | ₱192,548 | | ₱123,009 |

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

| | **Parent Company** | | |
|---|---|---|---|
| | **2008** | | |
| | **Gross Maximum Exposure** | | **Fair Market Value** |
| | **Amount** | **%** | **of Collateral** |
| **Loans and Receivables** | | | |
| Loans receivables: | | | |
| Primary target industry: | | | |
| Wholesale and retail | **₱22,413** | **28.87** | **₱14,591** |
| Manufacturing | **11,554** | **14.88** | **17,315** |
| Electricity, gas and water | **7,777** | **10.02** | **17,607** |
| Transport, storage and communication | **6,862** | **8.84** | **21,785** |
| Public administration and defense | **6,375** | **8.21** | **11,705** |
| Financial intermediaries | **4,824** | **6.21** | **16,431** |
| Agriculture, hunting and forestry | **2,708** | **3.49** | **2,354** |
| Secondary target industry: | | | |
| Real estate, renting and business activities | **3,424** | **4.41** | **6,815** |
| Construction | **1,769** | **2.28** | **4,630** |
| Others* | **9,933** | **12.79** | **44,320** |
| | **77,639** | **100.00** | **157,553** |

*(Forward)*

| | Parent Company | | |
|---|---|---|---|
| | 2008 | | |
| | Gross Maximum Exposure | | Fair Market Value |
| | Amount | % | of Collateral |
| Unquoted debt securities: | | | |
| Manufacturing | **₱4,661** | **51.73** | **₱–** |
| Government | **3,763** | **41.76** | **–** |
| Financial intermediaries | **231** | **2.56** | **–** |
| Real estate, renting and business activities | **356** | **3.95** | **–** |
| | **9,011** | **100.00** | **–** |
| Other receivables | **9,746** | | **–** |
| | **96,396** | | **157,553** |
| **Trading and Financial Investment Securities** | | | |
| Government | **51,336** | **74.96** | **–** |
| Financial intermediaries | **14,900** | **21.75** | **–** |
| Real estate, renting and business activities | **217** | **0.32** | **–** |
| Manufacturing | **75** | **0.11** | **–** |
| Electricity, gas and water | **17** | **0.02** | **–** |
| Others | **1,943** | **2.84** | **–** |
| | **68,488** | **100.00** | **–** |
| **Other Financial Assets** | | | |
| Government | **25,441** | **46.40** | **–** |
| Financial intermediaries | **19,853** | **36.21** | **–** |
| Others | **9,536** | **17.39** | **–** |
| | **54,830** | **100.00** | **–** |
| | **₱219,714** | | **₱157,553** |

| | Parent Company | | |
|---|---|---|---|
| | 2007 | | |
| | Gross Maximum Exposure | | Fair Market Value |
| | Amount | % | of Collateral |
| **Loans and Receivables** | | | |
| Loans receivables: | | | |
| Primary target industry: | | | |
| Electricity, gas and water | ₱8,636 | 15.29 | ₱13,052 |
| Wholesale and retail | 8,299 | 14.69 | 13,105 |
| Agriculture, hunting and forestry | 7,445 | 13.18 | 2,515 |
| Manufacturing | 7,417 | 13.13 | 9,581 |
| Financial intermediaries | 5,845 | 10.35 | 13,832 |
| Transport, storage and communications | 4,416 | 7.82 | 3,074 |
| Public administration and defense | 2,352 | 4.16 | 1,371 |
| Secondary target industry: | | | |
| Real estate, renting and business activities | 7,167 | 12.69 | 17,094 |
| Construction | 1,610 | 2.85 | 4,325 |
| Others* | 3,307 | 5.84 | 31,045 |
| | 56,494 | 100.00 | 108,994 |
| Unquoted debt securities: | | | |
| Manufacturing | 5,223 | 62.89 | – |
| Government | 1,505 | 18.12 | – |
| Real estate, renting and business activities | 1,308 | 15.76 | – |
| Financial intermediaries | 268 | 3.23 | – |
| | 8,304 | 100.00 | – |
| Other receivables | 8,364 | | 2,626 |
| | 73,162 | | 111,620 |
| **Trading and Financial Investment Securities** | | | |
| Government | 34,038 | 71.63 | – |
| Financial intermediaries | 11,996 | 25.25 | – |
| Electricity, gas and water | 823 | 1.73 | – |
| Real estate, renting and business activities | 206 | 0.43 | – |
| Manufacturing | 67 | 0.14 | – |
| Others | 388 | 0.82 | – |
| | 47,518 | 100.00 | – |

*(Forward)*

| | Parent Company | | |
|---|---|---|---|
| | 2007 | | |
| | Gross Maximum Exposure | | Fair Market Value |
| | Amount | % | of Collateral |
| **Other Financial Assets** | | | |
| Government | ₱42,300 | 64.35 | ₱11,200 |
| Financial intermediaries | 12,767 | 19.42 | – |
| Others | 10,668 | 16.23 | – |
| | 65,735 | 100.00 | 11,200 |
| | ₱186,415 | | ₱122,820 |

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

The internal limit of the Parent Company based on the Philippine Standard Industry Classification (PSIC) sub-industry is 12%, 10% and 7% for each sub-industry within each of the primary, secondary and non-target industry, respectively, versus total loan portfolio.

*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 the collateral and requests additional collateral in accordance with the underlying agreement. The existing market value of the collateral is considered during the review of the adequacy of the allowance for credit losses. Generally, collateral is not held over loans and advances to banks except for reverse repurchase agreements. The Group is not permitted to sell or repledge the collateral in the absence of default by the owner of the collateral.

*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 CRR System 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 Pre-Approval Review Unit of Credit Policies 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 CRRs of the Parent Company's business loans receivables are defined below:

*CRR 1 - Excellent*
Loans receivables rated as excellent include borrowers which are significant in size, with long and successful history of operations, an industry leader, with ready access to all equity and debt markets and have proven its strong debt service capacity.

*CRR 2 - Super Prime*
Loans receivables rated as super prime include borrowers whose ability to service all debt and meet financial obligations remains unquestioned.

*CRR 3 - Prime*
Under normal economic conditions, borrowers in this rating have good access to public market to raise funds and face no major uncertainties which could impair repayment.

*CRR 4 - Very Good*
Loans receivables rated as very good include borrowers whose ability to service all debts and meet financial obligations remain unquestioned, but current adverse economic conditions or changing circumstances have minimal impact on payment of obligations.

*CRR 5 - Good*
Loans receivables rated as good include borrowers with good operating history and solid management, but payment capacity could be vulnerable to adverse business, financial or economic conditions.

*CRR 6 - Satisfactory*
These are loans receivables to borrowers whose ability to service all debt and meet financial obligations remains unquestioned, but with somewhat lesser capacity than in CRR 5 accounts.

*CRR 7 - Average*
These are loans receivables to borrowers having ability to repay the loan in the normal course of business activity, although may not be strong enough to sustain a major setback.

*CRR 8 - Fair*
These are loans receivables to borrowers possessing the characteristics of borrowers rated as CRR7 with slightly lesser quality in financial strength, earnings, performance and/or outlook.

*CRR 9 - Marginal*
These are performing loans receivables to borrowers not qualified as CRRs 1-8. The borrower is able to withstand normal business cycles, although any prolonged unfavorable economic and/or market period would create an immediate deterioration beyond acceptable levels.

*CRR 10 - Watchlist*
This rating includes borrower where the credit exposure is not at risk of loss at the moment but the performance of the borrower has weakened and, unless present trends are reversed, could eventually lead to losses.

*CRR 11 - Special Mention*
These are loans that have potential weaknesses that deserve management's close attention. These potential weaknesses, if left uncorrected, may affect the repayment of the loan and thus increase credit risk to the Parent Company.

*CRR 12 - Substandard*
These are loans or portions thereof which appear to involve a substantial and unreasonable degree of risk to the Parent Company because of unfavorable record or unsatisfactory characteristics.

*CRR 13 - Doubtful*
These are loans or portions thereof which have the weaknesses inherent in those classified as CRR 12 with the added characteristics that existing facts, conditions and values make collection or liquidation in full highly improbable and in which substantial loss is probable.

*CRR 14 - Loss*
These are loans or portions thereof which are considered uncollectible or worthless.

Borrowers not required to be rated are GOCCs, LGUs and those accounts with asset size below ₱15.0 million (in compliance with BSP Circular 439). The Parent Company is using the Credit Scoring for evaluating the small business loans. Credit scoring details the financial capability of the borrower to pay for any future obligation.

GOCCs and LGUs are rated using the "means and purpose" test whereby borrowers have to pass the two major parameters, namely:

- "Means" test - the borrower must have resources or revenues of its own sufficient to service its debt obligations.
- "Purpose" test - the loan must be obtained for a purpose consistent with the borrower's general business.

LGU loans are backed-up by assignment of Internal Revenue Allotment. Consumer loans are covered by mortgages in residential properties and vehicles financed. Fringe benefit loans are repaid through automatic salary deductions and exposure is secured by mortgage on house or vehicles financed.

The table below shows the Parent Company's loans receivables, gross of allowance for credit losses and unearned and other deferred income, for each CRR and the related unsecured exposure as of December 31, 2008 and 2007 (in million pesos).

| | **2008** | | | |
|---|---|---|---|---|
| | **Neither Past Due nor Individually Impaired** | **Past Due or Individually Impaired** | **Total** | **Unsecured Share of Exposure** |
| **Risk Rating Class** | | | | |
| Business Loans | | | | |
| 1 - Excellent | **₱3,206** | **₱–** | **₱3,206** | **₱498** |
| 2 - Super Prime | **8,347** | **–** | **8,347** | **5,910** |
| 3 - Prime | **5,662** | **–** | **5,662** | **2,333** |
| 4 - Very Good | **3,911** | **–** | **3,911** | **1,122** |
| 5 - Good | **4,957** | **–** | **4,957** | **1,276** |
| 6 - Satisfactory | **3,063** | **64** | **3,127** | **960** |
| 7 - Average | **3,988** | **3** | **3,991** | **1,055** |
| 8 - Fair | **856** | **18** | **874** | **290** |

*(Forward)*

| | 2008 | | | |
|---|---|---|---|---|
| | **Neither Past Due nor Individually Impaired** | **Past Due or Individually Impaired** | **Total** | **Unsecured Share of Exposure** |
| 9 - Marginal | **₱465** | **₱46** | **₱511** | **₱100** |
| 10 - Watchlist | **2,950** | **59** | **3,009** | **2,473** |
| 11 - Special Mention | **473** | **802** | **1,275** | **111** |
| 12 - Substandard | **1,665** | **834** | **2,499** | **848** |
| 13 - Doubtful | **–** | **2,273** | **2,273** | **540** |
| 14 - Loss | **–** | **3,847** | **3,847** | **2,048** |
| | **39,543** | **7,946** | **47,489** | **19,564** |
| **Unrated** | | | | |
| Business Loans | **3,612** | **1,040** | **4,652** | **1,268** |
| GOCCs and NGAs | **18,244** | **–** | **18,244** | **–** |
| LGUs | **5,429** | **224** | **5,653** | **–** |
| Consumers | **6,160** | **836** | **6,996** | **3,315** |
| Fringe Benefits | **747** | **61** | **808** | **–** |
| | **34,192** | **2,161** | **36,353** | **3,472** |
| | **₱73,735** | **₱10,107** | **₱83,842** | **₱23,036** |

| | 2007 | | | |
|---|---|---|---|---|
| | Neither Past Due nor Individually Impaired | Past Due or Individually Impaired | Total | Unsecured Share of Exposure |
| **Risk Rating Class** | | | | |
| Business Loans | | | | |
| 1 - Excellent | ₱4,622 | ₱– | ₱4,622 | ₱4,162 |
| 2 - Super Prime | 1,316 | – | 1,316 | 1,086 |
| 3 - Prime | 4,043 | – | 4,043 | 2,980 |
| 4 - Very Good | 7,166 | – | 7,166 | 4,874 |
| 5 - Good | 1,380 | – | 1,380 | 1,205 |
| 6 - Satisfactory | 1,315 | – | 1,315 | 1,022 |
| 7 - Average | 5,452 | – | 5,452 | 4,866 |
| 8 - Fair | 660 | 2 | 662 | 357 |
| 9 - Marginal | 572 | – | 572 | 180 |
| 10 - Watchlist | 381 | 2 | 383 | 212 |
| 11 - Special Mention | 856 | 803 | 1,659 | 224 |
| 12 - Substandard | 2,075 | 886 | 2,961 | 1,731 |
| 13 - Doubtful | – | 5,000 | 5,000 | 1,561 |
| 14 - Loss | – | 1,538 | 1,538 | 984 |
| | 29,838 | 8,231 | 38,069 | 25,444 |
| **Unrated** | | | | |
| Business Loans | 1,002 | 2,051 | 3,053 | 1,578 |
| GOCCs and NGAs | 11,401 | 42 | 11,443 | – |
| LGUs | 5,059 | 263 | 5,322 | – |
| Consumers | 3,233 | 844 | 4,077 | – |
| Fringe Benefits | 800 | 94 | 894 | – |
| | 21,495 | 3,294 | 24,789 | 1,578 |
| | ₱51,333 | ₱11,525 | ₱62,858 | ₱27,022 |

The 'Individually Impaired' category amounting to ₱7.6 billion and ₱10.1 billion as of December 31, 2008 and 2007, respectively, includes restructured loans receivables of the Parent Company shown below (in million pesos):

| | **2008** | 2007 |
|---|---|---|
| Business loans | **₱3,055** | ₱4,277 |
| Consumers | **3** | 5 |
| | **₱3,058** | ₱4,282 |

Under PFRS 7, a financial asset is past due when a counterparty has failed to make a payment when contractually due. As of December 31, 2008 and 2007, the total past due loans but not impaired amounted to ₱2.1 billion and ₱1.4 billion, respectively, which are fully covered by collaterals with total appraised value of ₱2.1 billion and ₱9.9 billion, respectively. The table below shows the aging analysis of past due but not impaired loans receivables per class of the Parent Company as of December 31, 2008 and 2007 (in million pesos).

| | **2008** | | | |
|---|---|---|---|---|
| | **Less than 30 days** | **31 to 90 days** | **91 to 180 days** | **Total** |
| | | (In Million Pesos) | | |
| Business loans | **₱111** | **₱96** | **₱1,462** | **₱1,669** |
| Consumers | **57** | **137** | **1,746** | **1,940** |
| Fringe benefits | **–** | **1** | **18** | **19** |
| LGUs | **–** | **–** | **16** | **16** |
| Total | **₱168** | **₱234** | **₱3,242** | **₱3,644** |

| | 2007 | | | |
|---|---|---|---|---|
| | 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 |

Below are the financial assets of the Parent Company, excluding loans receivables, which are monitored using external ratings (in million pesos).

| | **2008** | | | | | |
|---|---|---|---|---|---|---|
| | **Rated** | | | | | |
| | **Aaa to Aa3** | **A1 to A3** | **Baa1 and below** | **Subtotal** | **Unrated** | **Total** |
| COCI and due from BSP [1/] (excluding cash on hand) | **₱–** | **₱–** | **₱–** | **₱–** | **₱20,791** | **₱20,791** |
| Due from other banks | **3,151** | **1,141** | **410** | **4,702** | **1,380** | **6,082** |
| Interbank loans receivables | **11,291** | **379** | **514** | **12,184** | **635** | **12,819** |
| Securities held under agreements to resell[2/] | **–** | **–** | **–** | **–** | **5,600** | **5,600** |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | **–** | **–** | **3,267** | **3,267** | **638** | **3,905** |
| Derivative assets[3/] | **6** | **2** | **130** | **138** | **1,234** | **1,372** |
| Equity securities | **–** | **–** | **–** | **–** | **56** | **56** |
| Designated at FVPL: | | | | | | |
| Private debt | **2,754** | **–** | **2,956** | **5,710** | **–** | **5,710** |
| Loans and receivables: | | | | | | |
| Unquoted debt securities[4/] | **–** | **–** | **3,972** | **3,972** | **7,197** | **11,169** |
| Others[5/] | **–** | **–** | **–** | **–** | **13,806** | **13,806** |
| Receivable from SPV[6/] | **–** | **–** | **–** | **–** | **719** | **719** |
| AFS investments: | | | | | | |
| Government securities | **–** | **–** | **8,045** | **8,045** | **2,048** | **10,093** |
| Other debt securities | **1,129** | **–** | **1,129** | **2,258** | **600** | **2,858** |
| Equity securities | **–** | **–** | **–** | **–** | **440** | **440** |
| HTM investments: | | | | | | |
| Government securities | **–** | **–** | **36,971** | **36,971** | **367** | **37,338** |
| Banks | **3,873** | **–** | **2,843** | **6,716** | **–** | **6,716** |
| Miscellaneous COCI | **–** | **–** | **–** | **–** | **1** | **1** |

| | 2007 | | | | | |
|---|---|---|---|---|---|---|
| | Rated | | | | | |
| | Aaa to Aa3 | A1 to A3 | Baa1 to Ba3 | Subtotal | Unrated | Total |
| COCI and due from BSP [1/] (excluding cash on hand) | ₱– | ₱– | ₱– | ₱– | ₱28,017 | ₱28,017 |
| Due from other banks | 2,424 | 158 | 24 | 2,606 | 254 | 2,860 |
| Interbank loans receivables | 10,430 | 1,958 | 97 | 12,485 | 340 | 12,825 |
| Securities held under agreements to resell[2/] | – | – | – | – | 11,200 | 11,200 |
| Financial assets at FVPL: | | | | | | |
| Government securities | 132 | – | 1,831 | 1,963 | – | 1,963 |
| Derivative assets[3/] | – | – | – | – | 1,173 | 1,173 |
| Equity securities | – | – | – | – | 58 | 58 |
| Loans and receivables: | | | | | | |
| Unquoted debt securities[4/] | – | – | – | – | 8,304 | 8,304 |
| Others[5/] | – | – | – | – | 8,364 | 8,364 |
| Receivable from SPV[6/] | – | – | – | – | 726 | 726 |
| AFS investments: | | | | | | |
| Government securities | 541 | – | 30,653 | 31,194 | 518 | 31,712 |
| Other debt securities | 8,527 | 1,954 | 259 | 10,740 | 845 | 11,585 |
| Equity securities | – | – | – | – | 664 | 664 |
| HTM investments: | | | | | | |
| Government securities | 263 | – | 100 | 363 | – | 363 |
| Miscellaneous COCI | – | – | – | – | 165 | 165 |

[1/] COCI are unsettled demand items delivered to the Philippine Clearing House Corporation and 'Due from BSP' is composed of interest-earning short-term placements with the BSP and a demand deposit account to support the regular operations of the Parent Company.
[2/] Securities held under agreements to resell represent overnight lending to the BSP collateralized by securities. The interest rate applicable is fixed by the BSP through a memorandum.
[3/] Derivative assets represent the value of credit derivatives embedded in host contracts issued by financial intermediaries and the mark-to-market valuation of freestanding derivatives (see Note 31).
[4/] Unquoted debt securities represent investments in bonds and notes not quoted in the market issued by financial intermediaries, government and private entities.
[5/] Loans and receivables - Others is composed of Accrued interest receivable, Accounts receivable, Sales contracts receivable and other miscellaneous receivables (see Note 9).
[6/] Receivable from SPV represent notes received from the sale of NPAs to SPV (see Note 10).

*Impairment Assessment*
The Parent Company recognizes impairment losses based on the results of specific (individual) and collective assessment of its credit exposures. Impairment has taken place when there are 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; and
- 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
Loans and advances that are not individually significant (e.g., credit cards, housing loans, car loans, development incentives loans, fringe benefit loans) and individually significant loans and advances where there is no apparent evidence of individual impairment are collectively assessed for 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 on the allowance for credit losses on loans and advances to customers.

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 through the Treasury Group. Likewise, the RMG monitors the static liquidity via the MCO under normal and stressed scenarios. The table below shows the liquidity profile of the Parent Company's liabilities as of December 31, 2008 and 2007 based on the expected cash flows (in million pesos):

| | **2008** | | | | | |
|---|---|---|---|---|---|---|
| | **Up to 1 month** | **1 to 3 months** | **3 to 6 months** | **6 to 12 months** | **Beyond 1 year** | **Total** |
| Deposit liabilities: | | | | | | |
| Demand | **₱1,131** | **₱1,308** | **₱1,963** | **₱3,925** | **₱14,687** | **₱23,014** |
| Savings | **5,887** | **10,224** | **15,336** | **30,672** | **99,077** | **161,196** |
| Time | **1,116** | **1,380** | **1,891** | **3,790** | **9,734** | **17,911** |
| Financial liabilities at FVPL | **766** | **–** | **–** | **–** | **6,187** | **6,953** |
| Bills and acceptances payable | **3,483** | **5,689** | **99** | **217** | **1,981** | **11,469** |
| Subordinated debt | **–** | **3,000** | **–** | **–** | **5,446** | **8,446** |
| Accrued interest and other financial liabilities | **6,716** | **703** | **2** | **408** | **2,295** | **10,124** |
| Total financial liabilities | **₱19,099** | **₱22,304** | **₱19,291** | **₱39,012** | **₱139,407** | **₱239,113** |

| | 2007 | | | | | |
|---|---|---|---|---|---|---|
| | Up to 1 month | 1 to 3 months | 3 to 6 months | 6 to 12 months | Beyond 1 year | Total |
| Deposit liabilities: | | | | | | |
| Demand | ₱1,207 | ₱1,339 | ₱2,008 | ₱4,016 | ₱11,382 | ₱19,952 |
| Savings | 5,404 | 9,953 | 14,930 | 29,859 | 77,150 | 137,296 |
| Time | 3,302 | 1,716 | 2,572 | 4,969 | 11,084 | 23,643 |
| Financial liabilities at FVPL | 68 | – | – | – | – | 68 |
| Bills and acceptances payable | 969 | 36 | 353 | – | 2,116 | 3,474 |
| Subordinated debt | – | – | – | – | 8,416 | 8,416 |
| Accrued interest and other financial liabilities | 9,648 | 296 | 21 | 592 | 2,278 | 12,835 |
| Total financial liabilities | ₱20,598 | ₱13,340 | ₱19,884 | ₱39,436 | ₱112,426 | ₱205,684 |

For risk management purposes, the deposits reflected in the MCO are based on behavioral assumptions rather than its 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) of ₱23.0 billion and ₱20.0 billion as of December 31, 2008 and December 31, 2007, respectively, would have to be presented separately under a category captioned "On Demand".

Market Risk
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, foreign exchange and equity 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. Volatilities are updated monthly for equities VaR and quarterly for fixed income and foreign exchange. VaR limits have been established annually and exposures against the VaR limits are monitored on a daily basis. The RMG reports the VaR utilization and breaches to limits on an as need basis to ALCO and on monthly basis to RMC. All risk reports discussed in the RMC meeting are noted by the BOD. The VAR figures are back tested against actual and hypothetical profit and loss to validate the robustness 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.

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. VaR is computed on an undiversified basis; hence, the Parent Company does not consider the correlation effects of the three trading portfolios.

There is no instance for the years ended December 31, 2008 and 2007 that the aggregate daily losses were greater than the total VaR (in million pesos).

| | **Foreign Exchange** | **Interest Rate** | **Equities Price** | **Total VaR** |
|---|---|---|---|---|
| December 31, 2008 | **₱17.69** | **₱140.53** | **₱3.49** | **₱161.71** |
| Average Daily | **22.97** | **89.96** | **2.90** | **115.83** |
| Highest | **95.22** | **186.92** | **6.72** | **288.86** |
| Lowest | **4.79** | **26.68** | **1.52** | **32.99** |

| | Foreign Exchange | Interest Rate | Equities Price | Total VaR |
|---|---|---|---|---|
| December 31, 2007 | ₱18.54 | ₱37.02 | ₱3.27 | ₱58.83 |
| Average Daily | 14.60 | 91.35 | 4.04 | 109.99 |
| Highest | 33.30 | 224.66 | 5.68 | 263.64 |
| Lowest | 1.96 | 0.06 | 2.84 | 4.86 |

Note:
1.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.
2.Foreign currency exchange rate VaR is the bankwide foreign exchange risk.

The table below shows the interest rate VaR for AFS investments (in million pesos):

| | **2008** | 2007 |
|---|---|---|
| End of year | **₱288.83** | ₱525.76 |
| Average Daily | **836.21** | 343.36 |
| Highest | **1,369.29** | 831.20 |
| Lowest | **260.39** | 218.85 |

*Structural Market Risk*

Non-trading 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. This EaR computation is accomplished monthly, with a quarterly stress test.

The following table sets forth the repricing gap position of the Parent Company as of December 31, 2008 and 2007 (in million pesos):

| | 2008 | | | | | |
|---|---|---|---|---|---|---|
| | **Up to 1 month** | **1 to 3 months** | **3 to 6 months** | **6 to 12 months** | **Beyond 1 year** | **Total** |
| **Financial Assets** | | | | | | |
| COCI | **₱–** | **₱–** | **₱–** | **₱–** | **₱6,327** | **₱6,327** |
| Due from BSP and other banks | **14,152** | **9,847** | **–** | **–** | **1,924** | **25,923** |
| Interbank loans receivable | **12,345** | **–** | **–** | **474** | **–** | **12,819** |
| Securities held under agreements to resell | **5,600** | **–** | **–** | **–** | **–** | **5,600** |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | **–** | **–** | **–** | **–** | **3,905** | **3,905** |
| Derivative assets | **–** | **–** | **–** | **–** | **1,372** | **1,372** |
| Equity securities | **–** | **–** | **–** | **–** | **56** | **56** |
| Designated at FVPL: | | | | | | |
| Private debt | **588** | **3,541** | **1,581** | **–** | **–** | **5,710** |
| Loans receivables - gross | **24,192** | **31,776** | **4,422** | **5,938** | **17,514** | **83,842** |
| Unquoted debt securities - gross | **14** | **915** | **11** | **1,007** | **9,222** | **11,169** |
| Receivable from SPV | **–** | **719** | **–** | **–** | **–** | **719** |
| AFS investments | **–** | **1,693** | **203** | **25** | **11,470** | **13,391** |
| HTM investments | **–** | **5,425** | **3,438** | **–** | **35,191** | **44,054** |
| Miscellaneous COCI | **–** | **–** | **–** | **–** | **1** | **1** |
| Total financial assets | **56,891** | **53,916** | **9,655** | **7,444** | **86,982** | **214,888** |
| **Financial Liabilities** | | | | | | |
| Deposit liabilities: | | | | | | |
| Demand | **–** | **–** | **–** | **–** | **23,014** | **23,014** |
| Savings | **57,129** | **15,526** | **3,951** | **3,338** | **81,252** | **161,196** |
| Time | **10,973** | **3,736** | **2,556** | **621** | **25** | **17,911** |
| Financial liabilities at FVPL | **766** | **–** | **–** | **–** | **6,187** | **6,953** |
| Bills and acceptances payable | **3,483** | **5,689** | **99** | **218** | **1,980** | **11,469** |
| Subordinated debt | **–** | **3,000** | **–** | **–** | **5,446** | **8,446** |
| Accrued interest payable and other financial liabilities | **6,715** | **703** | **2** | **408** | **2,297** | **10,125** |
| Total financial liabilities | **79,066** | **28,654** | **6,608** | **4,585** | **120,201** | **239,114** |
| **Repricing gap** | **(₱22,175)** | **₱25,262** | **₱3,047** | **₱2,859** | **(₱33,219)** | **(₱24,226)** |
| **Cumulative gap** | **(22,175)** | **3,087** | **6,134** | **8,993** | **(24,226)** | **–** |

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

| | 2007 | | | | | |
|---|---|---|---|---|---|---|
| | Up to 1 month | 1 to 3 months | 3 to 6 months | 6 to 12 months | Beyond 1 year | Total |
| **Financial Assets** | | | | | | |
| COCI | ₱– | ₱– | ₱– | ₱– | ₱4,732 | ₱4,732 |
| Due from BSP and other banks | 13,458 | 6,880 | 8,083 | 2,400 | – | 30,821 |
| Interbank loans receivable | 12,825 | – | – | – | – | 12,825 |
| Securities held under agreements to resell | 11,200 | – | – | – | – | 11,200 |
| Financial assets at FVPL: | | | | | | |
| Government securities | – | – | – | – | 1,963 | 1,963 |
| Derivative assets | – | – | – | – | 1,173 | 1,173 |
| Equity securities | – | – | – | – | 58 | 58 |
| Loans receivables - gross | 19,280 | 23,384 | 3,813 | 3,711 | 12,670 | 62,858 |
| Unquoted debt securities - gross | 1 | 1 | 2 | 16 | 9,865 | 9,885 |
| Receivable from SPV | – | 726 | – | – | – | 726 |
| AFS investments | 4,773 | 4,784 | 972 | 725 | 32,043 | 43,297 |
| HTM investments | 179 | – | – | 184 | – | 363 |
| Miscellaneous COCI | – | – | – | – | 165 | 165 |
| Total financial assets | 61,716 | 35,775 | 12,870 | 7,036 | 62,699 | 180,066 |
| **Financial Liabilities** | | | | | | |
| Deposit liabilities: | | | | | | |
| Demand | – | – | – | – | 19,952 | 19,952 |
| Savings | 51,974 | 7,692 | 3,459 | 1,925 | 72,246 | 137,296 |
| Time | 14,261 | 4,474 | 3,841 | 1,066 | 1 | 23,643 |
| Financial liability at FVPL | 68 | – | – | – | – | 68 |
| Bills and acceptances payable | 1,436 | – | 351 | – | 1,687 | 3,474 |
| Subordinated debt | – | – | – | – | 8,416 | 8,416 |
| Accrued interest payable and other financial liabilities | 9,648 | 296 | 21 | 592 | 2,278 | 12,835 |
| Total financial liabilities | 77,387 | 12,462 | 7,672 | 3,583 | 104,580 | 205,684 |
| **Repricing gap** | (₱15,671) | ₱23,313 | ₱5,198 | ₱3,453 | (₱41,911) | (₱25,618) |
| **Cumulative gap** | (15,671) | 7,642 | 12,840 | 16,293 | (25,618) | - |

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

The following table sets forth, for the year indicated, the impact of changes in interest rates on the Parent Company's repricing gap for the years ended December 31, 2008 and 2007 (in million pesos):

| | **2008** | | 2007 | |
|---|---|---|---|---|
| | **Statement of Income** | **Equity** | Statement of Income | Equity |
| +50bps | **₱30** | **₱64** | ₱61 | ₱61 |
| -50bps | **(30)** | **(64)** | (61) | (61) |
| +100bps | **61** | **61** | 122 | 122 |
| -100bps | **(61)** | **(61)** | (122) | (122) |

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 financials 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.

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 exposure to foreign exchange rate risk as of December 31, 2008 and 2007. Included in the table are the assets and liabilities at carrying amounts, categorized by currency (in million pesos).

| | Consolidated | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | | 2007 | | |
| | **USD** | **Others** | **Total** | USD | Others | Total |
| **Assets** | | | | | | |
| COCI and due from BSP | **₱1,100** | **₱179** | **₱1,279** | ₱761 | ₱146 | ₱907 |
| Due from other banks | **2,774** | **2,856** | **5,630** | 1,325 | 1,105 | 2,430 |
| Interbank loans receivable and Securities held under agreements to resell | **47** | **724** | **771** | 8,807 | 542 | 9,349 |
| Loans and receivables | **2,718** | **1,424** | **4,142** | 10,229 | 21 | 10,250 |
| Financial assets at FVPL | **5,764** | **–** | **5,764** | 63 | – | 63 |
| AFS investments | **6,642** | **187** | **6,829** | 24,270 | 160 | 24,430 |
| HTM investments | **7,461** | **371** | **7,832** | 310 | – | 310 |
| Other assets | **6,183** | **69** | **6,252** | 3,093 | 42 | 3,135 |
| Total assets | **32,689** | **5,810** | **38,499** | 48,858 | 2,016 | 50,874 |
| **Liabilities** | | | | | | |
| Deposit liabilities | **712** | **2,629** | **3,341** | 37,556 | 776 | 38,332 |
| Bills and acceptances payable | **3,292** | **403** | **3,695** | 2,159 | 10 | 2,169 |
| Accrued taxes, interest and other expenses | **1,733** | **193** | **1,926** | 108 | 1 | 109 |
| Other liabilities | **646** | **108** | **754** | 4,000 | 473 | 4,473 |
| Total liabilities | **6,383** | **3,333** | **9,716** | 43,823 | 1,260 | 45,083 |
| **Net Exposure** | **₱26,306** | **₱2,477** | **₱28,783** | ₱5,035 | ₱756 | ₱5,791 |

| | Parent Company | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | | 2007 | | |
| | **USD** | **Others** | **Total** | USD | Others | Total |
| **Assets** | | | | | | |
| COCI and due from BSP | **₱1,099** | **₱174** | **₱1,273** | ₱761 | ₱146 | ₱907 |
| Due from other banks | **2,419** | **2,662** | **5,081** | 1,709 | 1,105 | 2,814 |
| Interbank loans receivable and Securities held under agreements to resell | **47** | **724** | **771** | 8,807 | 542 | 9,349 |
| Loans and receivables | **2,150** | **1,056** | **3,206** | 10,229 | 21 | 10,250 |
| Financial assets at FVPL | **5,764** | **–** | **5,764** | 63 | – | 63 |
| AFS investments | **6,595** | **187** | **6,782** | 24,270 | 160 | 24,430 |
| HTM investments | **7,461** | **371** | **7,832** | 310 | – | 310 |
| Other assets | **6,183** | **46** | **6,229** | 3,073 | 42 | 3,115 |
| Total assets | **31,718** | **5,220** | **36,938** | 49,222 | 2,016 | 51,238 |
| **Liabilities** | | | | | | |
| Deposit liabilities | **594** | **2,627** | **3,221** | 37,556 | 776 | 38,332 |
| Bills and acceptances payable | **2,768** | **4** | **2,772** | 2,159 | 10 | 2,169 |
| Accrued taxes, interest and other expenses | **1,722** | **192** | **1,914** | 108 | 1 | 109 |
| Other liabilities | **357** | **5** | **362** | 4,000 | 473 | 4,473 |
| Total liabilities | **5,441** | **2,828** | **8,269** | 43,823 | 1,260 | 45,083 |
| **Net Exposure** | **₱26,277** | **₱2,392** | **₱28,669** | ₱5,399 | ₱756 | ₱6,155 |

Information relating to the Parent Company's currency derivatives is contained in Note 31. The Parent Company has outstanding foreign currency spot transactions (in equivalent peso amounts) of ₱1.6 billion (sold) and ₱1.6 billion (bought) as of December 31, 2008 and ₱0.8 billion (sold) and ₱0.2 billion (bought) as of December 31, 2007.

*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 2006 to 2008, prepayment received by the Parent Company is less than 1.00% of the total housing loan and motor vehicle loan portfolio.

The Parent Company has a BOD approved policy on prepayment. It has a standard provision on prepayment in the documentation for term loans to compensate for any loss from prepayment. The Parent Company's initial database is on historical prepayment for consumer loans. The Parent Company intends to establish a database for the historical prepayment of corporate term loans. Further, the Parent Company's securities portfolio has no call option from the issuers of these securities.

## 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 nonfinancial items, with the financial items being mapped to the categories of financial instruments under PAS 39.

| | Consolidated | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2008 | | | | | | |
| | Financial Instruments | | | | | | |
| | FVPL | HTM Investments | Loans and Receivables | AFS Investments | Other Financial Liabilities | Other Nonfinancial Items | Total |
| **ASSETS** | | | | | | | |
| COCI | **₱–** | **₱–** | **₱6,436,406** | **₱–** | **₱–** | **₱–** | **₱6,436,406** |
| Due from BSP | **–** | **–** | **20,056,705** | **–** | **–** | **–** | **20,056,705** |
| Due from other banks | **–** | **–** | **6,669,184** | **–** | **–** | **–** | **6,669,184** |
| Interbank loans receivable | **–** | **–** | **12,859,095** | **–** | **–** | **–** | **12,859,095** |
| Securities held under agreements to resell | **–** | **–** | **5,600,000** | **–** | **–** | **–** | **5,600,000** |
| Financial assets at FVPL | **11,052,293** | **–** | **–** | **–** | **–** | **–** | **11,052,293** |
| AFS investments | **–** | **–** | **–** | **14,589,537** | **–** | **–** | **14,589,537** |
| Loans and receivables | **–** | **–** | **102,401,109** | **–** | **–** | **–** | **102,401,109** |
| Receivable from SPV | **–** | **–** | **719,292** | **–** | **–** | **–** | **719,292** |
| HTM investments | **–** | **44,150,080** | **–** | **–** | **–** | **–** | **44,150,080** |
| Property and equipment | **–** | **–** | **–** | **–** | **–** | **16,710,912** | **16,710,912** |
| Investments in subsidiaries | **–** | **–** | **–** | **–** | **–** | **5,061** | **5,061** |
| Investment properties | **–** | **–** | **–** | **–** | **–** | **23,453,926** | **23,453,926** |
| Deferred tax assets | **–** | **–** | **–** | **–** | **–** | **1,736,589** | **1,736,589** |
| Other assets | **–** | **–** | **1,331** | **–** | **–** | **8,979,894** | **8,981,225** |
| Total Assets | **₱11,052,293** | **₱44,150,080** | **₱154,743,122** | **₱14,589,537** | **₱–** | **₱50,886,382** | **₱275,421,414** |
| **LIABILITIES** | | | | | | | |
| Deposit liabilities | **₱–** | **₱–** | **₱–** | **₱–** | **₱201,272,426** | **₱–** | **₱201,272,426** |
| Financial liabilities at FVPL | **6,952,831** | **–** | **–** | **–** | **–** | **–** | **6,952,831** |
| Bills and acceptances payable | **–** | **–** | **–** | **–** | **12,630,134** | **–** | **12,630,134** |
| Accrued taxes, interest and other expenses | **–** | **–** | **–** | **–** | **2,224,788** | **2,138,140** | **4,362,928** |
| Subordinated debt | **–** | **–** | **–** | **–** | **8,445,674** | **–** | **8,445,674** |
| Other liabilities | **–** | **–** | **–** | **–** | **9,545,582** | **2,905,672** | **12,451,254** |
| Total Liabilities | **₱6,952,831** | **₱–** | **₱–** | **₱–** | **₱234,118,604** | **₱5,043,812** | **₱246,115,247** |

| | Consolidated | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2007 | | | | | | |
| | Financial Instruments | | | | | | |
| | FVPL | HTM Investments | Loans and Receivables | AFS Investments | Other Financial Liabilities | Other Nonfinancial Items | Total |
| **ASSETS** | | | | | | | |
| COCI | ₱– | ₱– | ₱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 |
| Securities held under agreements to resell | – | – | 11,200,000 | – | – | – | 11,200,000 |
| Financial assets at FVPL | 3,215,235 | – | – | – | – | – | 3,215,235 |
| AFS investments | – | – | – | 44,821,522 | – | – | 44,821,522 |
| Loans and receivables | – | – | 76,575,031 | – | – | – | 76,575,031 |
| Receivable from SPV | – | – | 726,095 | – | – | – | 726,095 |
| 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 | – | – | 165,362 | – | – | 8,836,294 | 9,001,656 |
| Total Assets | ₱3,215,235 | ₱446,054 | ₱138,560,422 | ₱44,821,522 | ₱– | ₱52,661,807 | ₱239,705,040 |

*(Forward)*

| | Consolidated | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2007 | | | | | | |
| | Financial Instruments | | | | | | |
| | FVPL | HTM Investments | Loans and Receivables | AFS Investments | Other Financial Liabilities | Other Nonfinancial Items | Total |
| Deposit liabilities | ₱– | ₱– | ₱– | ₱– | ₱178,811,969 | ₱– | ₱178,811,969 |
| Financial liabilities at FVPL | 67,612 | – | – | – | – | – | 67,612 |
| Bills and acceptances payable | – | – | – | – | 4,299,094 | – | 4,299,094 |
| Accrued taxes, interest and other expenses | – | – | – | – | 2,053,372 | 2,221,346 | 4,274,718 |
| Subordinated debt | – | – | – | – | 8,416,424 | – | 8,416,424 |
| Other liabilities | – | – | – | – | 11,907,088 | 1,699,017 | 13,606,105 |
| Total Liabilities | ₱67,612 | ₱– | ₱– | ₱– | ₱205,487,947 | ₱3,920,363 | ₱209,475,922 |

| | **Parent Company** | | | | | | |
|---|---|---|---|---|---|---|---|
| | **2008** | | | | | | |
| | **Financial Instruments** | | | | | | |
| | **FVPL** | **HTM Investments** | **Loans and Receivables** | **AFS Investments** | **Other Financial Liabilities** | **Other Nonfinancial Items** | **Total** |
| **ASSETS** | | | | | | | |
| COCI | ₱– | ₱– | ₱6,326,528 | ₱– | ₱– | ₱– | ₱6,326,528 |
| Due from BSP | – | – | 19,840,705 | – | – | – | 19,840,705 |
| Due from other banks | – | – | 6,082,326 | – | – | – | 6,082,326 |
| Interbank loans receivable | – | – | 12,818,778 | – | – | – | 12,818,778 |
| Securities held under agreements to resell | – | – | 5,600,000 | – | – | – | 5,600,000 |
| Financial assets at FVPL | 11,042,856 | | | – | – | – | 11,042,856 |
| AFS investments | – | – | – | 13,390,840 | – | – | 13,390,840 |
| Loans and receivables | – | – | 96,395,893 | – | – | – | 96,395,893 |
| Receivable from SPV | – | – | 719,292 | – | – | – | 719,292 |
| HTM investments | – | 44,054,218 | – | – | – | – | 44,054,218 |
| Property and equipment | – | – | – | – | – | 16,591,798 | 16,591,798 |
| Investments in subsidiaries and an associate | – | – | – | – | – | 4,508,461 | 4,508,461 |
| Investment properties | – | – | – | – | – | 23,377,850 | 23,377,850 |
| Deferred tax assets | – | – | – | – | – | 1,692,278 | 1,692,278 |
| Other assets | – | – | 1,331 | – | – | 8,726,632 | 8,727,963 |
| Total Assets | ₱11,042,856 | ₱44,054,218 | ₱147,784,853 | ₱13,390,840 | ₱– | ₱54,897,019 | ₱271,169,786 |
| **LIABILITIES** | | | | | | | |
| Deposit liabilities | ₱– | ₱– | ₱– | ₱– | ₱202,121,198 | ₱– | ₱202,121,198 |
| Financial liabilities at FVPL | 6,952,831 | – | – | – | – | – | 6,952,831 |
| Bills and acceptances payable | – | – | – | – | 11,468,828 | – | 11,468,828 |
| Accrued taxes, interest and other expenses | – | – | – | – | 2,224,056 | 1,983,524 | 4,207,580 |
| Subordinated debt | – | – | – | – | 8,445,674 | – | 8,445,674 |
| Other liabilities | – | – | – | – | 8,039,142 | 2,118,542 | 10,157,684 |
| Total Liabilities | ₱6,952,831 | ₱– | ₱– | ₱– | ₱232,298,898 | ₱4,102,066 | ₱243,353,795 |

| | Parent Company | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2007 | | | | | | |
| | Financial Instruments | | | | | | |
| | FVPL | HTM Investments | Loans and Receivables | AFS Investments | Other Financial Liabilities | Other Nonfinancial Items | Total |
| **ASSETS** | | | | | | | |
| COCI | ₱– | ₱– | ₱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 |
| Securities held under agreements to resell | – | – | 11,200,000 | – | – | – | 11,200,000 |
| Financial assets at FVPL | 3,194,086 | – | – | – | – | – | 3,194,086 |
| AFS investments | – | – | – | 43,961,027 | – | – | 43,961,027 |
| Loans and receivables | – | – | 73,162,024 | – | – | – | 73,162,024 |
| Receivable from SPV | – | – | 726,095 | – | – | – | 726,095 |

*(Forward)*

| | Parent Company 2007 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Financial Instruments | | | | | | |
| | FVPL | HTM Investments | Loans and Receivables | AFS Investments | Other Financial Liabilities | Other Nonfinancial Items | Total |
| 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 | – | – | 165,362 | – | – | 8,677,485 | 8,842,847 |
| Total Assets | ₱3,194,086 | ₱362,795 | ₱133,631,525 | ₱43,961,027 | ₱– | ₱56,977,553 | ₱238,126,986 |
| **LIABILITIES** | | | | | | | |
| Deposit liabilities | – | – | – | – | 180,890,673 | – | 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 | – | – | – | 10,579,368 | 1,313,275 | 11,960,255 |
| Total Liabilities | ₱67,612 | ₱– | ₱– | ₱– | ₱205,407,387 | ₱3,432,966 | ₱208,907,965 |

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.

Equity securities - fair values of quoted equity securities are based on quoted prices published in markets. While fair values of unquoted equity securities 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 current market lending rates for similar types of loans. For loans with floating interest rates, with repricing frequencies on a quarterly 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 - 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 or acceptable valuation models.

Subordinated debt designated at FVPL - Fair value is determined using the discounted cash flow methodology.

The following tables summarize the carrying amounts and fair values of the financial assets and liabilities:

| | **Consolidated** | | | | **Parent Company** | | | |
|---|---|---|---|---|---|---|---|---|
| | **2008** | | 2007 | | **2008** | | 2007 | |
| | **Carrying Value** | **Fair Market Value** | Carrying Value | Fair Market Value | **Carrying Value** | **Fair Market Value** | Carrying Value | Fair Market Value |
| **Financial Assets** | | | | | | | | |
| COCI and due from BSP | **₱26,493,111** | **₱26,493,111** | ₱32,734,733 | ₱32,734,733 | **₱26,167,223** | **₱26,167,223** | ₱32,693,525 | ₱32,693,525 |
| Due from other banks | **6,669,184** | **6,669,184** | 3,962,000 | 3,962,000 | **6,082,326** | **6,082,326** | 2,859,908 | 2,859,908 |
| Interbank loans receivable | **12,859,095** | **12,859,095** | 13,197,201 | 13,197,201 | **12,818,778** | **12,818,778** | 12,824,611 | 12,824,611 |
| Securities held under agreements to resell | **5,600,000** | **5,600,000** | 11,200,000 | 11,200,000 | **5,600,000** | **5,600,000** | 11,200,000 | 11,200,000 |
| Financial assets at FVPL: | | | | | | | | |
| Held-for-trading: | | | | | | | | |
| Government securities | **3,904,883** | **3,904,883** | 1,963,207 | 1,963,207 | **3,904,883** | **3,904,883** | 1,963,207 | 1,963,207 |
| Derivative assets | **1,372,520** | **1,372,520** | 1,173,297 | 1,173,297 | **1,372,520** | **1,372,520** | 1,173,297 | 1,173,297 |
| Equity securities | **65,313** | **65,313** | 78,731 | 78,731 | **55,876** | **55,876** | 57,582 | 57,582 |
| Designated at FVPL: | | | | | | | | |
| Private debt | **5,709,577** | **5,709,577** | – | – | **5,709,577** | **5,709,577** | – | – |

*(Forward)*

| | Consolidated | | | | Parent Company | | | |
|---|---|---|---|---|---|---|---|---|
| | **2008** | | 2007 | | **2008** | | 2007 | |
| | **Carrying Value** | **Fair Market Value** | Carrying Value | Fair Market Value | **Carrying Value** | **Fair Market Value** | Carrying Value | Fair Market Value |
| Loans and receivables: | | | | | | | | |
| Business loans | **₱48,471,999** | **₱47,778,977** | ₱36,640,170 | ₱37,064,725 | **₱43,859,674** | **₱43,164,234** | ₱35,299,961 | ₱35,867,313 |
| GOCCs and NGAs | **20,573,636** | **20,480,420** | 11,303,641 | 11,291,818 | **20,573,636** | **20,480,420** | 11,303,641 | 11,291,818 |
| Consumers | **6,991,920** | **6,862,696** | 3,954,387 | 4,050,999 | **6,825,296** | **6,695,988** | 3,719,148 | 3,740,212 |
| LGUs | **5,610,455** | **5,606,403** | 5,312,104 | 5,312,872 | **5,610,456** | **5,606,403** | 5,312,104 | 5,312,872 |
| Fringe benefits | **773,514** | **773,429** | 858,573 | 858,573 | **770,356** | **770,356** | 858,573 | 858,573 |
| Unquoted debt securities | **9,010,660** | **9,517,063** | 8,304,396 | 9,045,655 | **9,010,660** | **9,517,063** | 8,304,396 | 9,045,665 |
| Others | **10,968,926** | **10,705,987** | 10,201,760 | 10,646,718 | **9,745,816** | **9,485,295** | 8,364,201 | 8,743,165 |
| Receivable from SPV | **719,292** | **683,285** | 726,095 | 684,004 | **719,292** | **683,285** | 726,095 | 684,004 |
| AFS investments: | | | | | | | | |
| Government securities | **10,884,046** | **10,884,046** | 32,310,169 | 32,310,169 | **10,092,715** | **10,092,715** | 31,712,072 | 31,712,072 |
| Other debt securities | **3,137,377** | **3,137,377** | 11,767,435 | 11,767,435 | **2,857,597** | **2,857,597** | 11,584,565 | 11,584,565 |
| Equity securities | **568,114** | **568,114** | 743,918 | 743,918 | **440,528** | **440,528** | 664,390 | 664,390 |
| HTM investments: | | | | | | | | |
| Government securities | **37,434,193** | **32,089,125** | 446,054 | 450,433 | **37,338,331** | **31,993,263** | 362,795 | 366,581 |
| Other debt securities | **6,715,887** | **7,500,634** | – | – | **6,715,887** | **7,500,634** | – | – |
| Other assets | **1,331** | **1,331** | 165,362 | 165,362 | **1,331** | **1,331** | 165,362 | 165,362 |
| **Financial Liabilities** | | | | | | | | |
| Deposit liabilities: | | | | | | | | |
| Demand | **22,742,300** | **22,742,300** | 20,167,642 | 20,167,642 | **23,013,773** | **23,013,773** | 19,952,002 | 19,952,002 |
| Savings | **161,343,347** | **161,343,347** | 137,315,472 | 137,315,472 | **161,196,424** | **161,196,424** | 137,295,678 | 137,295,678 |
| Time | **17,186,779** | **17,186,779** | 21,328,855 | 21,328,855 | **17,911,001** | **17,911,001** | 23,642,993 | 23,642,993 |
| Financial liabilities at FVPL: | | | | | | | | |
| Designated at FVPL | **6,187,302** | **6,187,302** | – | – | **6,187,302** | **6,187,302** | – | – |
| Derivative liabilities | **765,529** | **765,529** | 67,612 | 67,612 | **765,529** | **765,529** | 67,612 | 67,612 |
| Bills and acceptances payable: | | | | | | | | |
| Bills payable to: | | | | | | | | |
| Foreign banks | **1,355,414** | **1,355,414** | 1,002,912 | 1,002,912 | **907,572** | **907,572** | 768,099 | 768,099 |
| BSP and local bank | **10,962,745** | **10,962,745** | 2,456,145 | 2,456,145 | **10,180,027** | **10,180,027** | 1,748,311 | 1,748,311 |
| Others | **263,243** | **263,243** | 420,530 | 420,530 | **332,498** | **332,498** | 538,531 | 538,531 |
| Acceptances outstanding | **48,732** | **48,732** | 419,507 | 419,507 | **48,732** | **48,732** | 419,507 | 419,507 |
| Subordinated debt | **8,445,674** | **8,902,899** | 8,416,424 | 9,265,602 | **8,445,674** | **8,902,899** | 8,416,424 | 9,265,602 |
| Accrued interest payable | **2,224,788** | **2,224,788** | 2,053,372 | 2,053,372 | **2,224,056** | **2,224,056** | 2,046,474 | 2,046,474 |
| Other liabilities | **9,545,582** | **9,545,582** | 11,907,088 | 11,907,088 | **7,039,142** | **7,039,142** | 10,579,368 | 10,579,368 |

The discount rates used in estimating the fair value of loans and receivables ranges from 3.25% to 11.1% as of December 31, 2008 and from 6.50% to 12.00% as of December 31, 2007.

The following table shows an analysis of financial instruments recorded at fair value, between those whose fair value is based on quoted market prices, those involving valuation techniques, where all the model inputs are observable in the market and those where the valuation techniques involve the use of non-market observable inputs.

| | Consolidated | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | | | | |
| | | Fair Market Value | | | | |
| | **Carrying Value** | **Quoted Market Price** | **Valuation Technique (Market Observable)** | **Valuation Technique (Market Non-observable)** | **Cost** | **Total** |
| **Financial Assets** | | | | | | |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | **₱3,904,883** | **₱3,904,883** | **₱–** | **₱–** | **₱–** | **₱3,904,883** |
| Derivative assets | **1,372,520** | **–** | **1,372,520** | **–** | **–** | **1,372,520** |
| Equity securities | **65,313** | **65,313** | **–** | **–** | **–** | **65,313** |
| Designated at FVPL: | | | | | | |
| Private debt | **5,709,577** | **–** | **5,709,577** | **–** | **–** | **5,709,577** |
| AFS investments: | | | | | | |
| Government securities | **10,884,046** | **10,743,198** | **140,848** | **–** | **–** | **10,884,046** |
| Other debt securities | **3,137,377** | **3,11,328** | **26,049** | **–** | **–** | **3,137,377** |
| Equity securities | **568,114** | **202,028** | **–** | **–** | **384,086** | **568,114** |
| **Financial Liabilities** | | | | | | |
| Financial liabilities at FVPL: | | | | | | |
| Designated at FVPL | **6,187,302** | **–** | **6,187,302** | **–** | **–** | **6,187,302** |
| Derivative liabilities | **765,529** | **–** | **765,529** | **–** | **–** | **765,529** |

| | Consolidated | | | | | |
|---|---|---|---|---|---|---|
| | 2007 | | | | | |
| | | Fair Market Value | | | | |
| | Carrying Value | Quoted Market Price | Valuation Technique (Market Observable) | Valuation Technique (Market Non-observable) | Cost | Total |
| **Financial Assets** | | | | | | |
| 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 |
| AFS investments: | | | | | | |
| Government securities | 32,310,169 | 32,310,169 | – | – | – | 32,310,169 |
| Other debt securities | 11,767,435 | 438,132 | 10,543,151 | 786,152 | – | 11,767,435 |
| Equity securities | 743,918 | 391,119 | – | – | 352,799 | 743,918 |
| **Financial Liabilities** | | | | | | |
| Derivative liabilities | 67,612 | – | 67,612 | – | – | 67,612 |

| | **Parent Company** | | | | | |
|---|---|---|---|---|---|---|
| | **2008** | | | | | |
| | | **Fair Market Value** | | | | |
| | **Carrying Value** | **Quoted Market Price** | **Valuation Technique (Market Observable)** | **Valuation Technique (Market Non-observable)** | **Cost** | **Total** |
| **Financial Assets** | | | | | | |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | **₱3,904,883** | **₱3,904,883** | **₱–** | **₱–** | **₱–** | **₱3,904,883** |
| Derivative assets | **1,372,520** | **–** | **1,372,520** | **–** | **–** | **1,372,520** |
| Equity securities | **55,876** | **55,876** | **–** | **–** | **–** | **55,876** |
| Designated at FVPL: | | | | | | |
| Private debt | **5,709,577** | **–** | **5,709,577** | **–** | **–** | **5,709,577** |
| AFS investments: | | | | | | |
| Government securities | **10,092,715** | **10,092,715** | **–** | **–** | **–** | **10,092,715** |
| Other debt securities | **2,857,597** | **2,831,548** | **26,049** | **–** | **–** | **2,857,597** |
| Equity securities | **440,528** | **56,442** | **–** | **–** | **384,086** | **440,528** |
| **Financial Liabilities** | | | | | | |
| Financial liabilities at FVPL | **6,187,302** | **–** | **6,187,302** | **–** | **–** | **6,187,302** |
| Derivative liabilities | **765,529** | **–** | **765,529** | **–** | **–** | **765,529** |

| | Parent Company | | | | | |
|---|---|---|---|---|---|---|
| | 2007 | | | | | |
| | | Fair Market Value | | | | |
| | Carrying Value | Quoted Market Price | Valuation Technique (Market Observable) | Valuation Technique (Market Non-observable) | Cost | Total |
| **Financial Assets** | | | | | | |
| 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 |
| AFS investments: | | | | | | |
| Government securities | 31,712,072 | 31,712,072 | – | – | – | 31,712,072 |
| Other debt securities | 11,584,565 | 256,233 | 10,542,180 | 786,152 | – | 11,584,565 |
| Equity securities | 664,390 | 314,092 | – | – | 350,298 | 664,390 |
| **Financial Liabilities** | | | | | | |
| Derivative liabilities | 67,612 | – | 67,612 | – | – | 67,612 |

## 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; and

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:

| | | | 2008 | | |
|---|---|---|---|---|---|
| | **Retail Banking** | **Corporate Banking** | **Treasury** | **Others** | **Total** |
| Gross income | **₱2,709,297** | **₱6,887,046** | **₱5,111,540** | **₱2,642,619** | **₱17,350,502** |
| Segment result | **₱1,971,685** | **₱2,172,852** | **(₱88,932)** | **₱1,628,735** | **₱5,684,340** |
| Unallocated expenses | | | | | **3,720,805** |
| Income before income tax | | | | | **1,963,535** |
| Provision for income tax | | | | | **(843,932)** |
| Minority interest | | | | | **(11,809)** |
| Net income for the year attributable to equity holders of the Parent Company | | | | | **₱1,107,794** |
| Other Information | | | | | |
| Segment assets | **₱28,185,045** | **₱94,275,298** | **₱96,456,343** | **₱34,905,700** | **₱253,822,386** |
| Unallocated assets | | | | | **21,599,028** |
| Total assets | | | | | **₱275,421,414** |
| Segment liabilities | **₱25,184,579** | **₱84,239,132** | **₱86,187,992** | **₱31,189,781** | **₱226,801,484** |
| Unallocated liabilities | | | | | **19,313,763** |
| Total liabilities | | | | | **₱246,115,247** |
| Other Segment Information | | | | | |
| Capital expenditures | **₱183,056** | **₱9,287** | **₱462** | **₱6,801** | **₱199,606** |
| Total capital expenditures | | | | | **₱199,606** |
| Depreciation and amortization | **₱160,806** | **₱149,129** | **₱3,144** | **₱19,134** | **₱332,213** |
| Unallocated depreciation and amortization | | | | | **497,847** |
| Total depreciation and amortization | | | | | **₱829,959** |
| Provision for impairment and credit losses | **₱86,526** | **₱821,435** | **₱55,800** | **₱302** | **₱964,064** |

| | | | 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 income 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 |

*(Forward)*

| | 2007 | | | | |
|---|---|---|---|---|---|
| | Retail Banking | Corporate Banking | Treasury | Others | Total |
| 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 | ₱1,148,881 | ₱1,913,848 | ₱203,480 | ₱14,666 | ₱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 | ₱744,233 | ₱1,524,341 | ₱3,008,677 | ₱356,997 | ₱5,634,248 |
| Unallocated expenses | | | | | 3,881,540 |
| Income before income 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 | ₱1,233,938 | ₱768,075 | ₱602,019 | ₱198,251 | ₱2,802,283 |

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, 2008 and 2007 follows:

| | Assets | | Liabilities | | Capital Expenditure | | Credit Commitments | | Revenues | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 | **2008** | 2007 | **2008** | 2007 | **2008** | 2007 |
| Philippines | **₱262,530,513** | ₱229,728,831 | **₱237,241,606** | ₱200,877,990 | **₱197,106** | ₱494,608 | **₱8,537,883** | ₱9,657,971 | **₱15,554,580** | ₱17,822,127 |
| Asia (excluding Philippines) | **5,861,458** | 5,626,513 | **4,893,044** | 5,505,600 | **2,500** | 38,411 | **84,861** | 371,413 | **832,905** | 766,395 |
| USA and Canada | **5,239,620** | 2,813,821 | **2,684,202** | 2,166,554 | **–** | 8,253 | **36,899** | 31,837 | **768,084** | 987,999 |
| United Kingdom | **1,271,192** | 1,140,063 | **884,583** | 577,187 | **–** | 5,915 | **52** | 90 | **129,170** | 177,861 |
| Other European Union Countries | **518,631** | 395,812 | **411,812** | 348,591 | **–** | – | **–** | – | **65,765** | 106,875 |
| | **₱275,421,414** | ₱239,705,040 | **₱246,115,247** | ₱209,475,922 | **₱199,606** | ₱547,187 | **₱8,659,695** | ₱10,061,311 | **₱17,350,504** | ₱19,861,257 |

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 | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Held-for-trading: | | | | |
| Government securities | **₱3,904,883** | ₱1,963,207 | **₱3,904,883** | ₱1,963,207 |
| Derivative assets (Note 31) | **1,372,520** | 1,173,297 | **1,372,520** | 1,173,297 |
| Equity securities | **65,313** | 78,731 | **55,876** | 57,582 |
| | **5,342,716** | 3,215,235 | **5,333,279** | 3,194,086 |
| Designated at FVPL: | | | | |
| Private debt | **5,709,577** | – | **5,709,577** | – |
| | **₱11,052,293** | ₱3,215,235 | **₱11,042,856** | ₱3,194,086 |

Designated at FVPL represents US dollar-denominated investments in credit-linked notes. The credit-linked notes are part of a group of financial instruments that together are managed on a fair value basis, in accordance with the documented risk management and investment strategy.

Government securities include unrealized loss of ₱39.0 million and ₱9.4 million as of December 31, 2008 and 2007, respectively, for the Group and the Parent Company.

As of December 31, 2008 and 2007, the effective interest rates of government securities range from 2.50% to 9.50% and from 6.26% to 10.63%, respectively.

Equity securities include unrealized gain (loss) of (₱5.3 million) and ₱3.5 million as of December 31, 2008 and 2007, respectively, for the Group and the Parent Company.

## 9. Loans and Receivables

This account consists of:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Loans receivables: | | | | |
| Loans and discounts | **₱75,602,876** | ₱57,038,829 | **₱72,062,662** | ₱56,256,936 |
| Customers' liabilities on acceptances, letters of credit and trust receipts | **9,493,362** | 1,873,498 | **9,493,362** | 1,873,498 |
| Bills purchased | **1,654,398** | 4,168,527 | **1,654,398** | 4,168,527 |
| Lease contracts receivable | **1,509,987** | 1,148,977 | – | – |
| Credit card accounts | **632,007** | 558,624 | **632,007** | 558,624 |
| | **88,892,630** | 64,788,455 | **83,842,429** | 62,857,585 |
| Less unearned and other deferred income | **424,995** | 492,963 | **260,521** | 354,725 |
| | **88,467,635** | 64,295,492 | **83,581,908** | 62,502,860 |
| Unquoted debt securities | **11,168,998** | 9,885,248 | **11,168,998** | 9,885,248 |
| Other receivables: | | | | |
| Accrued interest receivable | **6,618,906** | 5,958,476 | **6,583,054** | 5,930,497 |
| Accounts receivable | **5,296,701** | 4,592,332 | **4,058,369** | 3,697,554 |
| Sales contract receivables | **2,376,696** | 2,113,878 | **2,376,696** | 2,113,878 |
| Miscellaneous | **868,714** | 1,695,893 | **788,347** | 715,097 |
| | **15,161,017** | 14,360,579 | **13,806,466** | 12,457,026 |
| | **114,797,650** | 88,541,319 | **108,557,372** | 84,845,134 |
| Less allowance for credit losses (Note 16) | **12,396,541** | 11,966,288 | **12,161,479** | 11,683,110 |
| | **₱102,401,109** | ₱76,575,031 | **₱96,395,893** | ₱73,162,024 |

Below is the reconciliation of loans and receivables as to classes:

| | Consolidated | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2008 | | | | | | | |
| | **Business Loans** | **GOCCs andNGA's** | **LGUs** | **Consumer** | **Fringe Benefits** | **Unquoted Debt Securities** | **Other** | **Total** |
| Loans receivables: | | | | | | | | |
| Loans and discounts | **₱49,016,366** | **₱13,542,167** | **₱5,630,977** | **₱6,596,810** | **₱811,400** | **₱–** | **₱5,156** | **₱75,602,876** |
| Customers' liabilities on acceptances, letters of credit and trust receipts | **2,438,838** | **7,032,472** | **22,052** | **–** | **–** | **–** | **–** | **9,493,362** |
| Bills purchased | **1,654,398** | **–** | **–** | **–** | **–** | **–** | **–** | **1,654,398** |
| Lease contracts receivable | **1,509,987** | **–** | **–** | **–** | **–** | **–** | **–** | **1,509,987** |
| Credit card accounts | **–** | **–** | **–** | **632,007** | | **–** | **–** | **632,007** |
| | **54,619,589** | **20,574,639** | **5,653,029** | **7,228,817** | **811,400** | **–** | **5,156** | **88,892,630** |
| Less unearned and other deferred income | **424,995** | **–** | **–** | **–** | **–** | **–** | **–** | **424,995** |
| | **54,194,594** | **20,574,639** | **5,653,029** | **7,228,817** | **811,400** | **–** | **5,156** | **88,467,635** |
| Unquoted debt securities | **–** | **–** | **–** | **–** | **–** | **11,168,998** | **–** | **11,168,998** |
| Other receivables: | | | | | | | | |
| Accrued interest receivable | **–** | **–** | **–** | **–** | **–** | **–** | **6,618,906** | **6,618,906** |
| Accounts receivable | **–** | **–** | **–** | **–** | **–** | **–** | **5,296,701** | **5,296,701** |
| Sales contract receivables | **–** | **–** | **–** | **–** | **–** | **–** | **2,376,696** | **2,376,696** |
| Miscellaneous | **–** | **–** | **–** | **–** | **–** | **–** | **868,714** | **868,714** |
| | **54,194,594** | **20,574,639** | **5,653,029** | **7,228,817** | **811,400** | **11,168,998** | **15,166,173** | **114,797,650** |
| Less allowance for credit losses (Note 16) | **5,722,595** | **1,003** | **42,574** | **236,897** | **37,886** | **2,158,338** | **4,197,248** | **12,396,541** |
| | **₱48,471,999** | **₱20,573,636** | **₱5,610,455** | **₱6,991,920** | **₱773,514** | **₱9,010,660** | **₱10,968,925** | **₱102,401,109** |

| | Consolidated | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2007 | | | | | | | |
| | Business Loans | GOCCs and NGA's | LGUs | Consumer | Fringe Benefits | Unquoted Debt Securities | Other | Total |
| Loans receivables: | | | | | | | | |
| Loans and discounts | ₱35,572,587 | ₱11,419,674 | ₱5,322,252 | ₱3,830,343 | ₱893,973 | ₱– | ₱– | ₱57,038,829 |
| Bills purchased | 4,168,527 | – | – | – | – | – | – | 4,168,527 |
| Customers' liabilities on acceptances, letters of credit and trust receipts | 1,850,488 | 23,010 | – | – | – | – | – | 1,873,498 |
| Lease contracts receivable | 1,148,977 | – | – | – | – | – | – | 1,148,977 |
| Credit card accounts | – | – | – | 558,624 | – | – | – | 558,624 |
| | 42,740,579 | 11,442,684 | 5,322,252 | 4,388,967 | 893,973 | – | – | 64,788,455 |
| Less unearned and other deferred income | 492,963 | – | – | – | – | – | – | 492,963 |
| | 42,247,616 | 11,442,684 | 5,322,252 | 4,388,967 | 893,973 | – | – | 64,295,492 |
| Unquoted debt securities | – | – | – | – | – | 9,885,248 | – | 9,885,248 |
| Other receivables: | | | | | | | | |
| Accrued interest receivable | – | – | – | – | – | – | 5,958,476 | 5,958,476 |
| Accounts receivable | – | – | – | – | – | – | 4,592,332 | 4,592,332 |
| Sales contract receivables | – | – | – | – | – | – | 2,113,878 | 2,113,878 |
| Miscellaneous | – | – | – | – | – | – | 1,695,893 | 1,695,893 |
| | 42,247,616 | 11,442,684 | 5,322,252 | 4,388,967 | 893,973 | 9,885,248 | 14,360,579 | 88,541,319 |
| Less allowance for credit losses (Note 16) | 5,607,446 | 139,043 | 10,148 | 434,580 | 35,400 | 1,580,852 | 4,158,819 | 11,966,288 |
| | ₱36,640,170 | ₱11,303,641 | ₱5,312,104 | ₱3,954,387 | ₱858,573 | ₱8,304,396 | ₱10,201,760 | ₱76,575,031 |

| | Parent Company | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2008 | | | | | | | |
| | **Business Loans** | **GOCCs andNGA's** | **LGUs** | **Consumer** | **Fringe Benefits** | **Unquoted Debt Securities** | **Other** | **Total** |
| Loans receivables: | | | | | | | | |
| Loans and discounts | **₱45,711,142** | **₱13,542,167** | **₱5,630,977** | **₱6,370,134** | **₱808,242** | **₱–** | **₱–** | **₱72,062,662** |
| Customers' liabilities on acceptances, letters of credit and trust receipts | **2,438,838** | **7,032,472** | **22,052** | **–** | **–** | **–** | **–** | **9,493,362** |
| Bills purchased | **1,654,398** | **–** | **–** | **–** | **–** | **–** | **–** | **1,654,398** |
| Credit card accounts | **–** | **–** | **–** | **632,007** | **–** | **–** | **–** | **632,007** |
| | **49,804,378** | **20,574,639** | **5,653,029** | **7,002,141** | **808,242** | **–** | **–** | **83,842,429** |
| Less unearned and other deferred income | **260,521** | **–** | **–** | **–** | **–** | **–** | **–** | **260,521** |
| | **49,543,857** | **20,574,639** | **5,653,029** | **7,002,141** | **808,242** | **–** | **–** | **83,581,908** |
| Unquoted debt securities | **–** | **–** | **–** | **–** | **–** | **11,168,998** | **–** | **11,168,998** |
| Other receivables: | | | | | | | | |
| Accrued interest receivable | **–** | **–** | **–** | **–** | **–** | **–** | **6,583,054** | **6,583,054** |
| Accounts receivable | **–** | **–** | **–** | **–** | **–** | **–** | **4,058,369** | **4,058,369** |
| Sales contract receivables | **–** | **–** | **–** | **–** | **–** | **–** | **2,376,696** | **2,376,696** |
| Miscellaneous | **–** | **–** | **–** | **–** | **–** | **–** | **788,347** | **788,347** |
| | **49,543,857** | **20,574,639** | **5,653,029** | **7,002,141** | **808,242** | **11,168,998** | **13,806,466** | **108,557,372** |
| Less allowance for credit losses (Note 16) | **5,684,183** | **1,003** | **42,574** | **176,845** | **37,886** | **2,158,338** | **4,060,650** | **12,161,479** |
| | **₱43,859,674** | **₱20,573,636** | **₱5,610,455** | **₱6,825,296** | **₱770,356** | **₱9,010,660** | **₱9,745,816** | **₱96,395,893** |

| | Parent Company | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2007 | | | | | | | |
| | Business Loans | GOCCs andNGA's | LGUs | Consumer | Fringe Benefits | Unquoted Debt Securities | Other | Total |
| Loans receivables: | | | | | | | | |
| Loans and discounts | ₱35,102,736 | ₱11,419,674 | ₱5,322,252 | ₱3,518,301 | ₱893,973 | ₱– | ₱– | ₱56,256,936 |
| Bills purchased | 4,168,527 | – | – | – | – | – | – | 4,168,527 |
| Customers' liabilities on acceptances, letters of credit and trust receipts | 1,850,488 | 23,010 | – | – | – | – | – | 1,873,498 |
| Credit card accounts | – | – | – | 558,624 | – | – | – | 558,624 |
| | 41,121,751 | 11,442,684 | 5,322,252 | 4,076,925 | 893,973 | – | – | 62,857,585 |
| Less unearned and other deferred income | 354,725 | – | – | – | – | – | – | 354,725 |
| | 40,767,026 | 11,442,684 | 5,322,252 | 4,076,925 | 893,973 | – | – | 62,502,860 |
| Unquoted debt securities | – | – | – | – | – | 9,885,248 | – | 9,885,248 |
| Other receivables: | | | | | | | | |
| Accrued interest receivable | – | – | – | – | – | – | 5,930,497 | 5,930,497 |
| Accounts receivable | – | – | – | – | – | – | 3,697,554 | 3,697,554 |
| Sales contract receivables | – | – | – | – | – | – | 2,113,878 | 2,113,878 |
| Miscellaneous | – | – | – | – | – | – | 715,097 | 715,097 |
| | 40,767,026 | 11,442,684 | 5,322,252 | 4,076,925 | 893,973 | 9,885,248 | 12,457,026 | 84,845,134 |
| Less allowance for credit losses (Note 16) | 5,467,065 | 139,043 | 10,148 | 357,777 | 35,400 | 1,580,852 | 4,092,825 | 11,683,110 |
| | ₱35,299,961 | ₱11,303,641 | ₱5,312,104 | ₱3,719,148 | ₱858,573 | ₱8,304,396 | ₱8,364,201 | ₱73,162,024 |

As of December 31, 2008 and 2007, 89.05% and 82.59%, respectively, of the total loans receivables of the Parent Company were subject to quarterly interest repricing. Remaining receivables carry annual fixed interest rates ranging from 2.47% to 8.74% as of December 31, 2008 and from 8.65% to 13.26% as of December 31, 2007 for foreign currency-denominated receivables, and from 6.0% to 12.50% as of December 31, 2008 and from 5.00% to 22.00% as of December 31, 2007 for peso-denominated receivables.

Sales contract receivables bear fixed interest rate per annum ranging from 1.67% to 16.50% and from 1.76% to 15.00% as of December 31, 2008 and 2007, respectively.

The effective interest rates of 'Loans receivables', 'Unquoted debt instruments' and 'Sales contract receivables' range from 5.66% to 9.30% as of December 31, 2008 and from 5.43% to 10.68% as of December 31, 2007 for foreign currency-denominated receivables, and from 6.86% to 12.52% as of December 31, 2008 and from 3.29% to 18.29% as of December 31, 2007 for peso-denominated receivables.

In 2004, the Parent Company sold the outstanding loans receivables 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 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, recognized as deferred charges under 'Other Assets', and amortized over 10 years 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, 2008 and 2007, these notes had a carrying value of ₱1.9 billion and ₱2.7 billion, respectively.

On October 10, 2008, simultaneous to the application in the Philippine courts for injunctive relief, the SPV companies filed a Notice of Arbitration with the Singapore International Arbitration Centre ("SIAC"). Mainly, the SPV companies claimed damages and a suspension of payments on the ground that the consortium of banks (the banks) and the Liquidator breached a duty to pay all real estate taxes due on the NSC Land and to deliver it free from all liens and encumbrances. The arbitration proceedings have not commenced. However, the banks and the Liquidator dispute the assertions that taxes were in arrears under an installment agreement executed between the Liquidator and the City of Iligan and, in any case, all real estate taxes due on the land have been paid in advance on December 18. 2008.

On October 13, 2008, the SPV companies filed, as a preservatory measure, a petition for injunctive relief against the NSC Liquidator, NSC Secured Creditors, and NSC Stockholders so that the arbitration proceedings under SIAC will not be rendered moot. On October 14, 2008, the Singapore High Court granted the petition and restrained the NSC Liquidator, the NSC Secured Creditors and the NSC Shareholders, jointly and severally, substantially from declaring the SPV companies to be in default and declaring all installments due until the arbitration proceeding at the SIAC is settled.

Thereafter, upon application by the Parent Company and an order of the Singapore High court, the SPV companies remitted ₱750.0 million as Standby Letter of Credit which they undertook to provide under the Asset Purchase Agreement, subject to the condition that the amount shall not be subject to any set-off pending an award from the arbitration proceedings.

On January 26, 2009, the Parent Company applied for an Order to compel the SPV companies to issue another Standby Letter of Credit of ₱1.0 billion which they likewise undertook to provide under the Asset Purchase Agreement, but this application was denied on March 5, 2009. The NSC Secured Creditors voted to appeal the adverse decision.

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 NPAs 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. This loss was deferred and amortized over 10 years (see Note 15).

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 NPAs to SPV companies can be amortized over 10 years based on the following schedule:

| End of Year 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 RCIT, 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 been decreased by ₱7.1 billion and ₱7.7 billion as of December 31, 2008 and 2007, respectively.

For the years ended December 31, 2008, 2007 and 2006, the amortization of the loss on sale of NPAs amounting to ₱608.2 million, ₱413.9 million and ₱267.9 million, respectively, were 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 bonds issued by Philippine Sugar Corporation (PSC) amounting to ₱2.8 billion with accrued interest under 'Accrued interest receivable' amounting to ₱2.3 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, 2008 and 2007, the sinking fund amounted to ₱4.3 billion and ₱4.1 billion, respectively, earning an average rate of return of 8.1% 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, 2008 and 2007, the balance of these receivables amounting to ₱3.5 billion may be offset against the equivalent amount of transferred liabilities (included under 'Bills payable to BSP and local banks' - see Note 19 and 'Accrued interest payable') amounting to ₱3.2 billion. The excess of the transferred receivables over the transferred liabilities is fully covered by an allowance for credit losses amounting to ₱303.9 million and ₱303.5 million as of December 31, 2008 and 2007, respectively. The remaining equity ownership of the Parent Company in Maybank was sold in June 2000 (see Note 30).

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 ₱179.9 million and ₱147.4 million as of December 31, 2008 and 2007, respectively.

BSP Reporting

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

| | Consolidated | | | |
|---|---|---|---|---|
| | **2008** | | 2007 | |
| | **Amount** | **%** | Amount | % |
| Secured: | | | | |
| Real estate mortgage | **₱24,384,764** | **27.43** | ₱21,148,948 | 32.64 |
| Chattel mortgage | **3,645,754** | **4.10** | 3,484,198 | 5.38 |
| Bank deposit hold-out | **872,335** | **0.65** | 967,825 | 1.49 |
| Shares of stocks | **576,027** | **0.98** | 588,506 | 0.91 |
| Others | **6,144,061** | **6.91** | 1,707,473 | 2.64 |
| | **35,622,941** | **40.07** | 27,896,950 | 43.06 |
| Unsecured | **53,269,689** | **59.93** | 36,891,505 | 56.94 |
| | **₱88,892,630** | **100.00** | ₱64,788,455 | 100.00 |

| | Parent Company | | | |
|---|---|---|---|---|
| | **2008** | | 2007 | |
| | **Amount** | **%** | Amount | % |
| Secured: | | | | |
| Real estate mortgage | **₱24,343,452** | **29.03** | ₱21,088,999 | 33.55 |
| Chattel mortgage | **3,261,955** | **3.89** | 1,963,517 | 3.12 |
| Bank deposit hold-out | **576,027** | **0.69** | 866,343 | 1.38 |
| Shares of stocks | **790,172** | **0.94** | 588,506 | 0.94 |
| Others | **1,992,611** | **2.38** | 1,706,302 | 2.71 |
| | **30,964,217** | **36.93** | 26,213,667 | 41.70 |
| Unsecured | **52,878,212** | **63.07** | 36,643,918 | 58.30 |
| | **₱83,842,429** | **100.00** | ₱62,857,585 | 100.00 |

NPLs as to secured and unsecured follows:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Secured | **₱6,463,959** | ₱6,403,140 | **₱6,459,301** | ₱6,377,317 |
| Unsecured | **3,543,003** | 3,923,583 | **3,542,611** | 3,766,084 |
| | **₱10,006,962** | ₱10,326,723 | **₱10,001,912** | ₱10,143,401 |

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 | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Total NPL | **₱10,006,962** | ₱10,326,723 | **₱10,001,912** | ₱10,143,401 |
| Less NPL fully covered by allowance for credit losses | **2,020,576** | 1,324,255 | **2,020,518** | 1,176,196 |
| | **₱7,986,386** | ₱9,002,468 | **₱7,981,394** | ₱8,967,205 |

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

Restructured loans of the Group and the Parent Company as of December 31, 2008 and 2007 amounted to ₱8.2 billion and ₱9.6 billion, respectively.

Interest income on loans and receivables for the years ended December 31, 2008, 2007 and 2006 consists of:

| | Consolidated | | | Parent Company | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| Loan receivables and sales contract receivables | **₱5,960,727** | ₱4,929,802 | ₱5,238,176 | **₱5,699,030** | ₱4,742,998 | ₱5,052,686 |
| Unquoted debt securities | **202,928** | 412,351 | 802,352 | **202,928** | 412,350 | 802,352 |
| | **₱6,163,655** | ₱5,342,153 | ₱6,040,528 | **₱5,901,958** | ₱5,155,348 | ₱5,855,038 |

Interest income accrued on impaired loans and receivable amounted to ₱655.4 million, ₱484.1 million and ₱932.5 million for the years ended December 31, 2008, 2007 and 2006, respectively.

## 10. Receivable from Special Purpose Vehicle

Receivable from SPV represents the present value of the note received by the Parent Company from the sale of the first pool and second pool of NPAs to an SPV in December 2006 and March 2007, respectively. The asset sale and purchase agreements (ASPA) were executed on December 19, 2006. As of December 31, 2008 and 2007, Receivable from SPV is net of allowance for credit losses amounting to ₱641.8 million and ₱682.9 million, respectively (see Note 16).

The first pool of NPAs was sold on December 29, 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.

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

   i. An initial amount of ₱1.1 billion, 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.

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 (see Note 15). 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.

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 NPAs 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, liabilities and minority interest in equity of consolidated entities would have been increased by ₱2.3 billion, ₱2.5 billion and ₱21.7 million, respectively, as of December 31, 2008. As of December 31, 2007, total assets, liabilities and minority interest in equity of consolidated entities would have been increased by ₱2.0 billion, ₱1.9 billion and ₱28.8 million, respectively.

## 11. Investment Securities

This account consists of:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| AFS investments: | | | | |
| Government securities (Notes 17 and 28) | **₱10,884,046** | ₱32,310,169 | **₱10,092,715** | ₱31,712,072 |
| Other debt securities | **3,137,377** | 11,767,435 | **2,857,597** | 11,584,565 |
| Equity securities - net of allowance for impairment and credit losses of ₱623.6 million and ₱619.4 million in 2008 and 2007, respectively (Note 16) | **568,114** | 743,918 | **440,528** | 664,390 |
| | **₱14,589,537** | ₱44,821,522 | **₱13,390,840** | ₱43,961,027 |
| HTM investments: | | | | |
| Government securities (Notes 17 and 28) | **₱37,434,193** | ₱446,054 | **₱37,338,331** | ₱362,795 |
| Other debt securities | **6,715,887** | – | **6,715,887** | – |
| | **₱44,150,080** | ₱446,054 | **₱44,054,218** | ₱362,795 |

Unquoted AFS equity securities of the Group amounted to ₱384.1 million and ₱352.8 million as of December 31, 2008 and 2007, respectively. Unquoted AFS equity securities of the Parent Company amounted to ₱384.1 million and ₱350.3 million as of December 31, 2008 and 2007, respectively.

Other debt securities consist of notes issued by private entities and the host contract on the credit-linked notes and deposits issued by foreign banks.

In view of the increased risk-weights of foreign currency-denominated national government bonds under the new risk-based capital adequacy framework (BSP Circular No. 538), BSP and PAS 39 provisions 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 US$23.0 million worth of ROP bonds from HTM investments to AFS investments in February 2007.

Effective interest rates range from 5.5% to 18.25% and from 2.75% to 11.38% for peso-denominated and foreign currency-denominated AFS investments, respectively, as of December 31, 2008. Effective interest rates range from 3.90% to 11.85% and from 3.39% to 9.28% for peso-denominated and foreign currency-denominated AFS investments, respectively, as of December 31, 2007.

Effective interest rates range from 5.23% to 12.38% and from 4.90% to 10.63% for peso-denominated and foreign currency-denominated HTM investments, respectively, as of December 31, 2008. Effective interest rates range from 7.00% to 10.38% and from 5.81% to 6.49% for peso-denominated and foreign currency-denominated HTM investments, respectively, as of December 31, 2007.

Interest income on trading and investment securities for the years ended December 31, 2008, 2007 and 2006 consists of:

| | Consolidated | | | Parent Company | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| AFS investments | **₱2,267,242** | ₱2,864,562 | ₱2,756,421 | **₱2,233,136** | ₱2,778,947 | ₱2,584,733 |
| HTM investments | **1,097,687** | 82,551 | 365,552 | **1,094,391** | 82,552 | 365,551 |
| Financial assets at FVPL | **751,101** | 806,872 | 1,102,862 | **751,101** | 806,872 | 1,102,862 |
| | **₱4,116,030** | ₱3,753,985 | ₱4,224,835 | **₱4,078,628** | ₱3,668,371 | ₱4,053,146 |

Trading and investment securities gains (losses) - net for the years ended December 31, 2008, 2007 and 2006 consist of:

| | Consolidated | | | Parent Company | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| Financial assets at FVPL: | | | | | | |
| Designated at FVPL | **(₱1,004,261)** | ₱– | ₱– | **(₱1,004,261)** | ₱– | ₱– |
| Held-for-trading | **(37,574)** | (47,130) | 117,195 | **(28,870)** | (107,236) | 93,042 |
| AFS investments | **490,582** | 1,032,205 | 1,024,925 | **462,378** | 1,031,780 | 1,024,476 |
| Derivatives | **(367,072)** | 103,367 | 929,503 | **(367,072)** | 103,367 | 929,503 |
| | **(₱918,325)** | ₱1,088,442 | ₱2,071,623 | **(₱937,825)** | ₱1,027,911 | ₱2,047,021 |

In 2008, there was no change in the fair value of the financial liability designated as at FVPL that is attributable to changes in credit risk.

The movements in net unrealized gains (losses) on AFS investments, gross of deferred tax, for the years ended December 31, 2008 and 2007 are as follows:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Balance at the beginning of the period | **₱892,573** | ₱875,740 | **₱809,804** | ₱819,765 |
| Realized gains | **(490,582)** | (1,032,205) | **(462,378)** | (1,031,780) |
| Unrealized gains (losses) recognized in equity | **(1,569,068)** | 1,049,038 | **(1,518,032)** | 1,021,819 |
| Balance at end of period | **(₱1,167,077)** | ₱892,573 | **(₱1,170,606)** | ₱809,804 |

Reclassification of Financial Assets

2008 was characterized by a substantial deterioration in global market conditions, including severe shortage of liquidity and credit availability. These conditions have led to a reduction in the level of market activity for many assets and the inability to sell other than at substantially lower prices.

Following the amendments to PAS 39 and PFRS 7, and as a result of the contraction in the market for many classes of assets, the Parent Company has undertaken a review of assets that are classified as held-for-trading, in order to determine whether this classification remains appropriate. Where it was determined that the market for an asset is no longer active or that the Parent Company no longer intends to trade, management has reviewed the instrument to determine whether it is appropriate to reclassify to HTM investments or Loans and receivables. This reclassification has only been performed where the Parent Company, at the reclassification date, has the clear intention and ability to hold the financial asset for the foreseeable future or until maturity.

On September 11, 2008, the Parent Company reclassified financial assets held-for-trading and AFS investments to HTM investments. It also reclassified the related embedded credit derivatives on ROP credit-linked notes previously bifurcated and classified as FVPL to HTM investments.

The HTM securities reclassified from held-for-trading have the following balances:

| | | | December 31, 2008 | | | | |
|---|---|---|---|---|---|---|---|
| | Face Value | Cost as at reclassification date | Carrying value | Fair Value | Amortization of discount/ Premium | Loss Recognition prior to reclassification during the year | Effective interest rate |
| Government bonds | ₱1,383,305 | ₱1,454,226 | ₱1,450,396 | ₱1,409,819 | ₱3,829 | (₱40,420) | 3.6% - 8.3% |

Net positive fair value of embedded credit derivatives amounting to ₱10.5 million was reclassified to HTM investments and included in the EIR amortization until the maturity of the host instrument.

HTM investments reclassified from AFS investments have the following balances as of December 31, 2008:

| | | | December 31, 2008 | | | | |
|---|---|---|---|---|---|---|---|
| | Face Value | Cost as at reclassification date | Carrying value | Fair Value | Net unrealized gain (loss) | Amortization of discount/ premium | Effective interest rate |
| Private bonds | ₱6,755,925 | ₱6,333,272 | ₱6,612,427 | ₱5,703,701 | (₱629,571) | ₱279,155 | 5.4% - 8.9% |
| Government bonds | 31,939,273 | 35,913,851 | 35,834,590 | 33,924,691 | (1,989,160) | (79,261) | 3.0% - 6.8% |
| | ₱38,695,198 | ₱42,247,123 | ₱42,447,017 | ₱39,628,392 | (₱2,618,731) | ₱199,894 | |

The Bank expects to recover 100% of principal and interest totaling ₱70.9 billion and no impairment loss was recognized during the year.

Had these securities not been reclassified to HTM investments, derivative liabilities, net unrealized loss from AFS investments as of December 31, 2008 and net trading losses in 2008 would have been increased by ₱499.5 million, ₱2.8 billion and ₱540.1 million, respectively.

## 12. Property and Equipment

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

| | **Consolidated 2008** | | |
|---|---|---|---|
| | **Furniture, Fixtures and Equipment** | **Leasehold Improvements** | **Total** |
| **Cost** | | | |
| Balance at beginning of year | **₱2,762,861** | **₱231,472** | **₱2,994,333** |
| Additions | **108,698** | **90,907** | **199,605** |
| Disposals/others | **(80,170)** | **(93,374)** | **(173,544)** |
| Balance at end of year | **2,791,389** | **229,005** | **3,020,394** |
| **Accumulated Depreciation and Amortization** | | | |
| Balance at beginning of year | **2,037,589** | **134,934** | **2,172,523** |
| Depreciation and amortization | **220,378** | **32,131** | **252,509** |
| Disposals/others | **(109,866)** | **(52,855)** | **(162,721)** |
| Balance at end of year | **2,148,101** | **114,210** | **2,262,311** |
| **Net Book Value at End of Year** | **₱643,288** | **₱114,795** | **₱758,083** |

| | Consolidated 2007 | | |
|---|---|---|---|
| | Furniture, Fixtures and Equipment | Leasehold Improvements | Total |
| **Cost** | | | |
| Balance at beginning of year | ₱2,603,625 | ₱223,391 | ₱2,827,016 |
| Additions | 503,882 | 33,010 | 536,892 |
| Disposals/others | (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 | 204,129 | 30,823 | 234,952 |
| Disposals/others | (141,878) | (17,386) | (159,264) |
| 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 |

| | **Parent Company 2008** | | |
|---|---|---|---|
| | **Furniture, Fixtures and Equipment** | **Leasehold Improvements** | **Total** |
| **Cost** | | | |
| Balance at beginning of year | **₱2,523,685** | **₱160,698** | **₱2,684,383** |
| Additions | **90,452** | **78,970** | **169,422** |
| Disposals/others | **(94,517)** | **(100,892)** | **(195,409)** |
| Balance at end of year | **2,519,620** | **138,776** | **2,658,396** |
| **Accumulated Depreciation and Amortization** | | | |
| Balance at beginning of year | **1,890,789** | **79,081** | **1,969,870** |
| Depreciation and amortization | **184,636** | **23,946** | **208,582** |
| Disposals/others | **(104,982)** | **(54,043)** | **(159,025)** |
| Balance at end of year | **1,970,443** | **48,984** | **2,019,427** |
| **Net Book Value at End of Year** | **₱549,177** | **₱89,792** | **₱638,969** |

| | Parent Company 2007 | | |
|---|---|---|---|
| | Furniture, Fixtures and Equipment | Leasehold Improvements | Total |
| **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 |

*(Forward)*

| | Parent Company | | |
|---|---|---|---|
| | 2007 | | |
| | Furniture, Fixtures and Equipment | Leasehold Improvements | Total |
| **Accumulated Depreciation and Amortization** | | | |
| Balance at beginning of year | ₱1,810,126 | ₱57,120 | ₱1,867,246 |
| Depreciation and amortization | 182,969 | 21,926 | 204,895 |
| Disposals/others | (102,306) | 35 | (102,271) |
| 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 |

The composition of and movements in land and buildings of the Group and the Parent Company follow:

| | **2008** | | |
|---|---|---|---|
| | **Land** | **Buildings** | **Total** |
| **Appraised Value** | | | |
| Balance at beginning of year | **₱11,241,778** | **₱6,313,559** | **₱17,555,337** |
| Appraisal increase (decrease) | **9,908** | **(73,754)** | **(63,846)** |
| Additions | **–** | **3,258** | **3,258** |
| Disposals/others | **(9,018)** | **6,519** | **(2,499)** |
| Balance at end of year | **11,242,668** | **6,249,582** | **17,492,250** |
| **Accumulated Depreciation** | | | |
| Balance at beginning of year | **–** | **1,566,542** | **1,566,542** |
| Depreciation | **–** | **162,817** | **162,817** |
| Disposals/others | **–** | **(431,803)** | **(431,803)** |
| Balance at end of year | **–** | **1,297,556** | **1,297,556** |
| **Allowance for Impairment Losses** (Note 16) | **205,494** | **36,371** | **241,865** |
| **Net Book Value at End of Year** | **₱11,037,174** | **₱4,915,655** | **₱15,952,829** |

The appraised value of land and building as of December 31, 2008 was determined by independent appraisers.

| | 2007 | | |
|---|---|---|---|
| | Land | Buildings | Total |
| **Appraised Value** | | | |
| Balance at beginning of year | ₱11,242,706 | ₱6,304,011 | ₱17,546,717 |
| Additions | – | 10,295 | 10,295 |
| Disposals/others | (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 |

Depreciation on the revaluation increment of the buildings amounted to ₱77.1 million for the year ended December 31, 2008 and ₱77.7 million for the years ended December 31, 2007 and 2006 for the Group and 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 ₱415.3 million, ₱403.3 million and ₱365.0 million for the years ended December 31, 2008, 2007 and 2006, respectively, and ₱371.4 million, ₱371.4 million and ₱320.7 billion for the years ended December 31, 2008, 2007 and 2006, respectively, 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, 2008 and 2007, respectively, for the Group and the Parent Company.

Depreciation and amortization consists of:

| | **Consolidated** | | | **Parent Company** | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| Property and equipment | **₱415,326** | ₱402,747 | ₱363,069 | **₱371,399** | ₱372,690 | ₱320,675 |
| Investment properties (Note 14) | **411,574** | 621,976 | 720,955 | **409,557** | 620,004 | 718,984 |
| Other foreclosed properties | **2,059** | 125,591 | 27,340 | **2,059** | 125,591 | 27,340 |
| | **₱828,959** | ₱1,150,314 | ₱1,111,364 | **₱783,015** | ₱1,118,285 | ₱1,066,999 |

As of December 31, 2008 and 2007, property and equipment of the Parent Company with gross carrying amounts of ₱513.6 million and ₱434.0 million, respectively, is fully depreciated but is still being used.

## 13. Investments in Subsidiaries and an Associate

The details of this account follow:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| 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 | **–** | – | **377,876** | 577,876 |
| PNB Capital | **–** | – | **350,000** | 350,000 |
| PNB Italy - SpA | **–** | – | **176,520** | 58,380 |
| PNB Securities | **–** | – | **62,351** | 62,351 |
| PNB Forex, Inc. | **–** | – | **50,000** | 50,000 |
| 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. (Benlife) (40% owned in 2007) | **–** | 499,814 | **–** | 499,814 |
| | **5,061** | 504,875 | **4,865,518** | 5,447,192 |
| Accumulated equity in net earnings: | | | | |
| Balance at beginning of year | **124,027** | 207,371 | **–** | – |
| Equity in net losses for the year | **(2,471)** | (79,739) | **–** | – |
| Dividends during the year | **–** | (3,605) | **–** | – |
| Reversal due to the sale of the associate | **(121,556)** | – | **–** | – |
| Balance at end of year | **–** | 124,027 | **–** | – |
| Share in the equity adjustments of an associate: | | | | |
| Equity in net unrealized gain on AFS investments | **–** | 10,201 | **–** | – |
| Equity in revaluation increment | **–** | 29,278 | **–** | – |
| Equity in accumulated translation adjustment | **–** | (3,258) | **–** | – |
| | **–** | 36,221 | **–** | – |
| Less allowance for impairment losses (Note 16) | **–** | – | **357,057** | 66,053 |
| | **₱5,061** | ₱665,123 | **₱4,508,461** | ₱5,381,139 |

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 in the balance sheet) 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, 2008 and 2007, 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.

Sale of Investment in Benlife

On May 30, 2008, the Parent Company entered into a Memorandum of Agreement (Agreement) with FMF Development Corporation and Merje Trading Inc. for the sale of its 40% ownership interest in Benlife for a total consideration of ₱700.0 million, which was fully collected on November 30, 2008.

The following table illustrates the summarized financial information of the Group's investment in Benlife as of and for the year ended December 31, 2007:

| | |
|---|---|
| Total assets | ₱3,080,005 |
| Total liabilities | 1,429,852 |
| Total revenues | 744,938 |
| Net loss | (105,763) |

## 14. Investment Properties

The composition of and movements in this account follow:

| | Consolidated | | |
|---|---|---|---|
| | 2008 | | |
| | **Land** | **Building and Improvements** | **Total** |
| **Cost** | | | |
| Balance at beginning of year | **₱26,153,252** | **₱7,722,139** | **₱33,875,391** |
| Additions | **377,386** | **219,470** | **596,856** |
| Disposals/others | **(2,164,692)** | **(629,780)** | **(2,794,472)** |
| Balance at end of year | **24,365,946** | **7,311,829** | **31,677,775** |
| **Accumulated Depreciation and Impairment Losses** | | | |
| Balance at beginning of year | **5,480,968** | **3,594,821** | **9,075,789** |
| Depreciation | **–** | **411,574** | **411,574** |
| Provision for impairment losses | **180,780** | **127,535** | **308,315** |
| Disposals/others | **(1,102,395)** | **(469,434)** | **(1,571,829)** |
| Balance at end of year | **4,559,353** | **3,664,496** | **8,223,849** |
| **Net Book Value at End of Year** | **₱19,806,593** | **₱3,647,333** | **₱23,453,926** |

| | Consolidated | | |
|---|---|---|---|
| | 2007 | | |
| | Land | Building and Improvements | Total |
| **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 |
| Disposals/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 |

| | Parent Company | | |
|---|---|---|---|
| | 2008 | | |
| | **Land** | **Building and Improvements** | **Total** |
| **Cost** | | | |
| Balance at beginning of year | **₱26,153,252** | **₱7,622,614** | **₱33,775,866** |
| Additions | **377,386** | **217,070** | **594,456** |
| Disposals/others | **(2,164,692)** | **(629,780)** | **(2,794,472)** |
| Balance at end of year | **24,365,946** | **7,209,904** | **31,575,850** |
| **Accumulated Depreciation and Impairment Losses** | | | |
| Balance at beginning of year | **5,480,968** | **3,571,013** | **9,051,981** |
| Depreciation | **–** | **409,557** | **409,557** |
| Provision for impairment losses | **180,780** | **127,535** | **308,315** |
| Disposals/others | **(1,102,395)** | **(469,458)** | **(1,571,853)** |
| Balance at end of year | **4,559,353** | **3,638,647** | **8,198,000** |
| **Net Book Value at End of Year** | **₱19,806,593** | **₱3,571,257** | **₱23,377,850** |

| | Parent Company | | |
|---|---|---|---|
| | 2007 | | |
| | Land | Building and Improvements | Total |
| **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 |
| Disposals/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 |

The fair value of the investment properties of the Group as of December 31, 2008 and 2007, as determined by independent and/or in-house appraisers amounted to ₱34.8 billion and ₱37.8 billion, respectively, of which ₱34.7 billion and ₱37.6 billion, respectively, pertains to the Parent Company. Valuations were derived on the basis of recent sales of similar properties in the same area as the investment properties and taking into account the economic conditions prevailing at the time the valuations were made.

As discussed in Note 30, investment properties with an aggregate fair value of ₱300.0 million are mortgaged in favor of BSP.

Foreclosed investment properties still subject to redemption period by the borrowers amounted to ₱340.7 million and ₱393.1 million, in 2008 and 2007, respectively.

## 15. Other Assets

This account consists of:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Deferred charges | **₱7,234,015** | ₱7,772,368 | **₱7,231,931** | ₱7,769,531 |
| Software costs | **555,168** | 422,545 | **555,168** | 417,674 |
| Deferred reinsurance premiums | **103,211** | – | **–** | – |
| Prepaid expenses | **79,341** | 62,369 | **61,475** | 41,786 |
| Sundry debits | **65,356** | 24,324 | **65,134** | 24,324 |
| Miscellaneous COCI | **1,331** | 165,362 | **1,331** | 165,362 |
| Miscellaneous (Note 24) | **954,548** | 586,953 | **824,403** | 456,169 |
| | **8,992,970** | 9,033,921 | **8,739,442** | 8,874,846 |
| Less allowance for impairment losses (Note 16) | **11,745** | 32,265 | **11,479** | 31,999 |
| | **₱8,981,225** | ₱9,001,656 | **₱8,727,963** | ₱8,842,847 |

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

Miscellaneous include retirement asset and 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.

As of December 31, 2008 and 2007, the latest transacted price of the exchange trading right (as provided by the PSE) amounted to ₱12.8 million and ₱8.0 million, respectively.

Changes in the software costs are as follows:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Balance at beginning of year | **₱422,545** | ₱230,685 | **₱417,674** | ₱224,065 |
| Additions | **196,844** | 249,146 | **196,844** | 249,146 |
| Amortization | **(64,221)** | (57,286) | **(59,350)** | (55,537) |
| Balance at end of year | **₱555,168** | ₱422,545 | **₱555,168** | ₱417,674 |

## 16. Allowance for Impairment and Credit Losses

Movements in the allowance for impairment losses follow:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Balance at beginning of year: | | | | |
| Property and equipment | **₱306,926** | ₱306,926 | **₱306,926** | ₱306,926 |
| Investment properties | **6,419,716** | 4,134,211 | **6,419,716** | 4,134,211 |
| Other assets | **32,265** | 515,512 | **31,999** | 513,591 |
| Investments in subsidiaries and an associate | **–** | – | **66,053** | 7,672 |
| | **6,758,907** | 4,956,649 | **6,824,694** | 4,962,400 |
| Provisions during the year | **308,315** | 2,452,653 | **599,319** | 2,452,653 |
| Disposals, transfers and others | **(1,651,552)** | (650,395) | **(1,294,495)** | (590,359) |
| Balance at end of year: | | | | |
| Property and equipment (Note 12) | **241,865** | 306,926 | **241,865** | 306,926 |
| Investment properties | **5,519,117** | 6,419,716 | **5,519,117** | 6,419,716 |
| Other assets (Note 15) | **11,745** | 32,265 | **11,479** | 31,999 |
| Investments in subsidiaries and an associate (Note 13) | **–** | – | **357,057** | 66,053 |
| | **₱5,772,727** | ₱6,758,907 | **₱6,129,518** | ₱6,824,694 |

Movements in the allowance for credit losses follow:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Balance at beginning of year: | | | | |
| Loans and receivables | **₱11,966,288** | ₱13,497,223 | **₱11,683,110** | ₱13,270,803 |
| Receivable from SPV | **682,932** | – | **682,932** | – |
| AFS investments | **619,399** | 445,428 | **619,399** | 445,428 |
| NPAs to be sold to SPV | **–** | 5,466,310 | **–** | 5,466,310 |
| | **13,268,619** | 19,408,961 | **12,985,441** | 19,182,541 |
| Provisions during the year | **655,749** | 828,222 | **643,712** | 799,034 |
| Accounts charged off, transfers and others | **(262,465)** | (6,968,564) | **(202,312)** | (6,996,134) |
| Balance at end of year: | | | | |
| Loans and receivables (Note 9) | **12,396,541** | 11,966,288 | **12,161,479** | 11,683,110 |
| Receivable from SPV (Note 10) | **641,782** | 682,932 | **641,782** | 682,932 |
| AFS investments (Note 11) | **623,580** | 619,399 | **623,580** | 619,399 |
| | **₱13,661,903** | ₱13,268,619 | **₱13,426,841** | ₱12,985,441 |

Below is the breakdown of provision for (recoveries from) credit losses by type of loans and receivable for the years ended December 31, 2008 and 2007, respectively.

| | Consolidated | | | | | |
|---|---|---|---|---|---|---|
| | **2008** | | | 2007 | | |
| | **Individual Impairment** | **Collective Impairment** | **Total** | Individual Impairment | Collective Impairment | Total |
| Loans receivables | **₱417,817** | **(₱181,477)** | **₱236,340** | (₱201,109) | ₱287,444 | ₱86,335 |
| Unquoted debt securities | **319,080** | **–** | **319,080** | – | – | – |
| Others | **100,329** | **–** | **100,329** | 362,647 | – | 362,647 |
| | **₱837,226** | **(₱181,477)** | **₱655,749** | ₱161,538 | ₱287,444 | ₱448,982 |

| | Parent Company | | | | | |
|---|---|---|---|---|---|---|
| | **2008** | | | 2007 | | |
| | **Individual Impairment** | **Collective Impairment** | **Total** | Individual Impairment | Collective Impairment | Total |
| Loans receivables | **₱425,006** | **(₱200,787)** | **₱224,219** | (₱229,151) | ₱287,444 | ₱58,293 |
| Unquoted debt securities | **319,080** | **–** | **319,080** | – | – | – |
| Others | **100,413** | **–** | **100,413** | 361,502 | – | 361,502 |
| | **₱844,499** | **(₱200,787)** | **₱643,712** | ₱132,351 | ₱287,444 | ₱419,795 |

The movements in allowance for credit losses for loans and receivables by class follow:

| | Consolidated | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2008 | | | | | | | |
| | **Business Loans** | **GOCCs and NGAs** | **LGUs** | **Consumers** | **Fringe Benefits** | **Unquoted Debt Securities** | **Others** | **Total** |
| Balance at beginning of year | **₱5,607,446** | **₱139,043** | **₱10,148** | **₱434,580** | **₱35,400** | **₱1,580,852** | **₱4,158,819** | **₱11,966,288** |
| Provisions (recoveries) during the year | **526,049** | **(138,040)** | **32,426** | **(186,581)** | **2,486** | **319,080** | **100,329** | **655,749** |
| Accretion on impaired loans | **(308,425)** | **–** | **–** | **(14,117)** | **(1,952)** | **–** | **–** | **(324,494)** |
| Accounts charged off, transfers and others | **(102,475)** | **–** | **–** | **3,015** | **1,952** | **258,406** | **(61,900)** | **98,998** |
| Balance at end of year | **₱5,722,595** | **₱1,003** | **₱42,574** | **₱236,897** | **₱37,886** | **₱2,158,338** | **₱4,197,248** | **₱12,396,541** |

| | Consolidated | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2007 | | | | | | | |
| | Business Loans | GOCCs and NGAs | LGUs | Consumers | Fringe Benefits | Unquoted Debt Securities | Others | Total |
| 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 (recoveries) during the year | (13,177) | 122,458 | (807) | (22,536) | 397 | – | 362,647 | 448,982 |
| Accretion on impaired loans | (418,723) | – | – | (14,080) | (2,242) | – | (1,108) | (436,153) |
| Accounts charged off, transfers and others | (280,853) | – | – | (3,296) | 2,242 | (201,217) | (1,060,640) | (1,543,764) |
| Balance at end of year | ₱5,607,446 | ₱139,043 | ₱10,148 | ₱434,580 | ₱35,400 | ₱1,580,852 | ₱4,158,819 | ₱11,966,288 |

| | Parent Company | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2008 | | | | | | | |
| | **Business Loans** | **GOCCs and NGAs** | **LGUs** | **Consumers** | **Fringe Benefits** | **Unquoted Debt Securities** | **Others** | **Total** |
| Balance at beginning of year | **₱5,467,065** | **₱139,043** | **₱10,148** | **₱357,777** | **₱35,400** | **₱1,580,852** | **₱4,092,825** | **₱11,683,110** |
| Provisions (recoveries) during the year | **508,279** | **(138,040)** | **32,426** | **(180,932)** | **2,486** | **319,080** | **100,413** | **643,712** |
| Accretion on impaired loans | **(308,425)** | **–** | **–** | **(14,117)** | **(1,952)** | **–** | **–** | **(324,494)** |
| Accounts charged off, transfers and others | **17,264** | **–** | **–** | **14,117** | **1,952** | **258,406** | **(132,588)** | **159,151** |
| Balance at end of year | **₱5,684,183** | **₱1,003** | **₱42,574** | **₱176,845** | **₱37,886** | **₱2,158,338** | **₱4,060,650** | **₱12,161,479** |

| | Parent Company | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2007 | | | | | | | |
| | Business Loans | GOCCs and NGAs | LGUs | Consumers | Fringe Benefits | Unquoted Debt Securities | Others | Total |
| 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 (recoveries) during the year | (24,007) | 122,458 | (807) | (39,748) | 397 | – | 361,502 | 419,795 |
| Accretion on impaired loans | (418,723) | – | – | (14,080) | (2,242) | – | (1,108) | (436,153) |
| Accounts charged off, transfers and others | (316,041) | – | – | 14,080 | 2,242 | (201,217) | (1,070,399) | (1,571,335) |
| 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 |

The movements in allowance for credit losses on AFS investments, receivable from SPV and NPAs to be sold to SPV for the Group and the Parent Company follow:

| | **2008** | | 2007 | | |
|---|---|---|---|---|---|
| | **AFS Investments - equity securities** | **Receivable from SPV** | AFS Investments - equity securities | Receivable from SPV | NPAs to be sold to SPV |
| Balance at beginning of year | **₱619,399** | **₱682,932** | ₱445,428 | ₱– | ₱5,466,310 |
| Provisions during the year | **–** | **–** | 146,881 | 664,908 | – |
| Disposals, transfers and others | **4,181** | **(41,150)** | 27,090 | 18,024 | (5,466,310) |
| Balance at end of year | **₱623,580** | **₱641,782** | ₱619,399 | ₱682,932 | ₱– |

## 17. Deposit Liabilities

Of the total deposit liabilities of the Parent Company, ₱9.1 billion and ₱7.6 billion as of December 31, 2008 and 2007, respectively, are noninterest-bearing. Remaining deposit liabilities generally earned annual fixed interest rates ranging from 0.25% to 4.50% as of December 31, 2008 and from 0.50% to 5.14% as of December 31, 2007 for foreign currency-denominated deposit liabilities, and from 0.50% to 10.50% as of December 31, 2008 and from 0.50% to 13.94% as of December 31, 2007 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 8.00% and10.00% as of December 31, 2008 and 2007, respectively. Available reserves follow:

| | **2008** | 2007 |
|---|---|---|
| Cash on hand | **₱6,253,033** | ₱3,594,104 |
| Due from BSP | **19,840,705** | 27,961,521 |
| Securities held under agreements to resell | **5,600,000** | 11,200,000 |
| AFS investments | **1,485,532** | 3,733,032 |
| HTM investments | **13,252,272** | – |
| | **₱46,431,542** | ₱46,488,657 |

As of December 31, 2008 and 2007, the Parent Company was in compliance with such regulations.

Interest expense on deposit liabilities for the years ended December 31, 2008, 2007 and 2006 consists of:

| | **Consolidated** | | | **Parent Company** | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| Savings | **₱3,020,665** | ₱2,984,817 | ₱4,070,575 | **₱3,019,430** | ₱2,984,262 | ₱4,088,182 |
| Time | **311,886** | 793,549 | 987,658 | **371,014** | 790,919 | 1,071,120 |
| Demand | **115,841** | 108,480 | 100,243 | **116,434** | 108,480 | 100,243 |
| | **₱3,448,392** | ₱3,886,846 | ₱5,158,476 | **₱3,506,878** | ₱3,883,661 | ₱5,259,545 |

## 18. Financial Liabilities at Fair Value Through Profit or Loss

This account consists of:

| | **2008** | 2007 |
|---|---|---|
| Designated at FVPL | **₱6,187,302** | ₱– |
| Derivative liabilities (Note 31) | **765,529** | 67,612 |
| | **₱6,952,831** | ₱67,612 |

Financial liability designated at FVPL represents the subordinated debt issued in 2008. On April 18, 2008, the BOD of the Parent Company approved the issuance of at least ₱3.0 billion in additional tier 2 capital. On June 19, 2008, the Parent Company issued ₱6.0 billion subordinated notes due in 2018 (2008 Notes). The subordinated debt is part of a group of financial instruments that together are managed on a fair value basis, in accordance with the documented risk management and investment strategy.

Among the significant terms and conditions of the issuance of such 2008 Notes are:

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

(b) The 2008 Notes bear interest at the rate of 8.50% per annum from and including June 19, 2008 to but excluding June 19, 2013. Interest will be payable quarterly in arrears on the 19th of March, June, September and December of each year, commencing on September 19, 2008. Unless the 2008 Notes are previously redeemed, interest from and including June 19, 2013 to but excluding June 19, 2018 will be reset at the equivalent of the higher of

(i) five-year PDST-F Fixed Rate Treasury Notes (FXTN) as of reset date multiplied by 80.00%, plus a step-up spread of 2.0123% per annum or (ii) difference of interest rate and five-year PDST-F FXTN as of issue date multiplied by 150% plus five-year PDST-F FXTN as of reset date, and such step-up interest rate shall be payable quarterly in arrears on 19th of March, June, September and December of each year, commencing on September 19, 2013. The Notes will mature on June 19, 2018, if not redeemed earlier;

(c) The 2008 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 2008 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 Parent Company with the prevailing requirements for the granting by the BSP of its consent thereof. The 2008 Notes may not be redeemed at the option of the noteholders; and

(e) Each noteholder, by accepting the 2008 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 2008 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.

## 19. Bills and Acceptances Payable

This account consists of:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Bills payable to: | | | | |
| BSP and local banks | **₱10,962,745** | ₱2,456,145 | **₱10,180,027** | ₱1,748,311 |
| Foreign banks | **1,355,414** | 1,002,912 | **907,572** | 768,099 |
| Others | **263,243** | 420,530 | **332,497** | 538,531 |
| | **12,581,402** | 3,879,587 | **11,420,096** | 3,054,941 |
| Acceptances outstanding | **48,732** | 419,507 | **48,732** | 419,507 |
| | **₱12,630,134** | ₱4,299,094 | **₱11,468,828** | ₱3,474,448 |

As of December 31, 2008, 5.66% and 12.50% of the bills payable of the Group and the Parent Company, respectively, are subject to periodic interest repricing. 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. The annual interest rates range from 2.50% to 5.67% as of December 31, 2008 and from 4.68% to 6.08% as of December 31, 2007 for foreign currency-denominated borrowings, and from 2.75% to 12.00% as of December 31, 2008 and from 2.00% to 12.50% as of December 31, 2007 for peso-denominated borrowings of the Group and the Parent Company.

The Parent Company's bills payable to BSP includes the transferred liabilities from Maybank amounting to ₱1.6 billion as of December 31, 2008 and 2007 (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 through "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. 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 for the years ended December 31, 2008, 2007 and 2006 consists of:

| | Consolidated | | | Parent Company | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| Subordinated debt | **₱1,238,611** | ₱953,206 | ₱663,362 | **₱1,238,611** | ₱965,723 | ₱663,362 |
| Bills payable | **313,399** | 460,571 | 636,779 | **249,956** | 410,491 | 589,637 |
| Others | **39,597** | 15,396 | 254,074 | **35,459** | 13,326 | 252,090 |
| | **₱1,591,607** | ₱1,429,173 | ₱1,554,215 | **₱1,524,026** | ₱1,389,540 | ₱1,505,089 |

## 20. Accrued Taxes, Interest and Other Expenses

This account consists of:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Interest | **₱2,224,788** | ₱2,053,372 | **₱2,224,056** | ₱2,046,474 |
| Income taxes | **134,943** | 52,458 | **117,876** | 82,276 |
| Other taxes and licenses | **160,363** | 131,968 | **113,512** | 33,657 |
| Others | **1,842,834** | 2,036,920 | **1,752,136** | 2,003,758 |
| | **₱4,362,928** | ₱4,274,718 | **₱4,207,580** | ₱4,166,165 |

## 21. Subordinated Debt

*10% ₱5.5 Billion Subordinated Notes*

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 ofreset date multiplied by 80.00%, plus a spread of 4.4935% per annum. The stepped-up interest will be payable quarterly in arrears on 10th of 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.

*12.5% ₱3.0 Billion Subordinated Notes*

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 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 31, 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, ROP and US Treasury bonds.

Among the significant terms and conditions of the issuance of the 2004 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 the 16th February and August 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 16th February and August 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.

On February 17, 2009, the 2004 Notes were redeemed by the Parent Company at par/face value.

As of December 31, 2008 and 2007, subordinated debt is net of unamortized transaction cost of ₱54.3 million and ₱83.6 million, respectively.

## 22. Other Liabilities

This account consists of:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Accounts payable | **₱4,941,924** | ₱5,186,627 | **₱4,723,176** | ₱5,093,465 |
| Bills purchased - contra (Note 9) | **1,640,949** | 4,159,741 | **1,640,949** | 4,159,741 |
| Insurance contract liabilities | **950,406** | 670,671 | **–** | – |
| Retirement liability (Note 24) | **855,532** | 579,717 | **826,147** | 551,234 |
| Manager's checks and demand drafts outstanding | **782,141** | 450,396 | **782,141** | 450,396 |
| Deferred credits | **465,239** | 223,794 | **465,239** | 223,794 |
| Other dormant credits | **288,867** | 340,692 | **288,867** | 340,692 |
| Payment order payable | **282,360** | 191,098 | **282,360** | 191,098 |
| Deferred reinsurance premiums | **270,565** | 33,722 | **–** | – |
| Due to other banks | **266,519** | 368,275 | **190,600** | 301,322 |
| Deposits on lease contracts | **262,990** | 223,919 | **–** | – |
| Margin deposits and cash letters of credit | **157,534** | 35,684 | **157,534** | 35,684 |
| Due to Treasurer of the Philippines (TOP) | **134,419** | 135,335 | **134,419** | 135,335 |
| Due to BSP | **127,596** | 122,818 | **127,596** | 122,818 |
| Withholding tax payable | **76,023** | 127,866 | **73,898** | 123,989 |
| Miscellaneous | **948,190** | 755,750 | **464,758** | 163,075 |
| | **₱12,451,254** | ₱13,606,105 | **₱10,157,684** | ₱11,892,643 |

## 23. Equity

Capital stock as of December 31, 2008 and 2007 consists of (amounts in thousand pesos, except for par value and number of shares):

| | **2008** | | 2007 | | 2006 | |
|---|---|---|---|---|---|---|
| | **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 |
| Conversion to common stock | **–** | **–** | 54,357,751 | 2,174,310 | – | – |
| Balance at end of the year | **–** | **–** | – | – | 54,357,751 | 2,174,310 |
| Common - ₱40 par value | | | | | | |
| Authorized | **1,054,824,557** | | 1,054,824,557 | | 1,054,824,557 | |
| Issued and outstanding | | | | | | |
| Balance at beginning of the year | **662,245,916** | **26,489,837** | 518,888,165 | 20,755,527 | 518,888,165 | 20,755,527 |
| Conversion from preferred stock | **–** | **–** | 54,357,751 | 2,174,310 | – | – |
| Additional issuance | **–** | **–** | 89,000,000 | 3,560,000 | – | – |
| | **662,245,916** | **26,489,837** | 662,245,916 | 26,489,837 | 518,888,165 | 20,755,527 |
| | | **₱26,489,837** | | ₱26,489,837 | | ₱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 through 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.

As of December 31, 2008 and 2007, the Group has 48,535 and 198,535 treasury shares, respectively.

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 periods.

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, surplus (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 NG 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% | Micro Small and Medium Enterprises (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 AFS 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% | | | | | | | |
| LGUs | 20% | 20% | 50% | 50% | 100% | 100% | 150% | 100% |
| Government corporations | 20% | 20% | 50% | 100% | 100% | 150% | 150% | 100% |
| Corporate | 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% | | | | | | | |

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% to 8.00% for interest rate exposures under specific risk, from 0% to 12.50% for the interest rate exposures under general market risks, and 8% for equity and foreign exchange exposures. 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, 2008 and 2007, the Group was in compliance with the CAR.

The CAR of the Group, which is based on consolidated CAR combined credit, market and operational risks (BSP Circular No. 538), as reported to the BSP as of December 31, 2008 and 2007 are shown in the table below (in million pesos).

| | **2008** | | 2007 | |
|---|---|---|---|---|
| | **Actual [1/]** | **Required** | Actual [2/] | Required |
| Tier 1 capital | **₱22,198.6** | | ₱22,706.8 | |
| Tier 2 capital | **13,245.8** | | 10,345.0 | |
| Gross qualifying capital | **35,444.4** | | 33,051.8 | |
| Less required deductions | **0.4** | | 0.4 | |
| **Total qualifying capital** | **₱35,444.0** | **₱20,169.0** | ₱33,051.4 | ₱17,365.50 |
| **Risk weighted assets** | **₱201,690.1** | | ₱173,655.2 | |
| Tier 1 capital ratio | **11.01%** | | 13.08% | |
| Total capital ratio | **17.57%** | | 19.03% | |

[1/] *Data are based on consolidated CAR combined credit, market and operational risks (BSP Circular No. 538).*
[2/] *Data are based on consolidated CAR for credit risks (BSP Circular No. 280).*

The BSP, under BSP Circular No. 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 2008 is mainly due to the issuance of subordinated debt in 2008 which qualified as a Tier 2 capital.

Financial Performance
The following basic ratios measure the financial performance for the periods ended December 31, 2008, 2007 and 2006 of the Group and the Parent Company (in million pesos):

| | Consolidated | | | Parent Company | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| Return on average equity (a/b) | **3.78%** | 5.45% | 3.44% | **2.61%** | 5.09% | 3.17% |
| a.) Net income | **₱1,120** | ₱1,498 | ₱820 | **₱744** | ₱1,335 | ₱706 |
| b.) Average total equity | **29,654** | 27,493 | 23,833 | **28,518** | 26,242 | 22,280 |
| Return on average assets (c/d) | **0.43%** | 0.62% | 0.35% | **0.29%** | 0.56% | 0.30% |
| c.) Net income | **₱1,120** | ₱1,498 | ₱820 | **₱744** | ₱1,335 | ₱706 |
| d.) Average total assets | **257,563** | 241,588 | 233,065 | **254,648** | 239,890 | 231,550 |
| Net interest margin on average earning assets (e/f) | **3.74%** | 3.75% | 3.77% | **3.68%** | 3.59% | 3.59% |
| e.) Net interest income | **₱6,619** | ₱5,878 | ₱5,345 | **₱6,237** | ₱5,441 | ₱4,891 |
| f.) Average interest earning assets | **176,795** | 156,567 | 141,691 | **171,270** | 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).

## 24. 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 credited service.

The following table shows the actuarial assumptions as of January 1, 2008 and 2007 used in determining the retirement benefit obligation of the Parent Company:

| | **2008** | 2007 |
|---|---|---|
| Expected rate of return on plan assets | **7%** | 7% |
| Discount rate | **10%** | 7% |
| Salary rate increase | **8%** | 8% |
| Estimated working lives | **15 years** | 15 years |

As of December 31, 2008, the discount rate used in determining the retirement obligation is 14.5%.

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, 2008.

The amount of liability recognized in the Parent Company balance sheets (included under 'Other liabilities') follows:

| | **2008** | 2007 |
|---|---|---|
| Present value of defined benefit obligation | **₱1,218,986** | ₱1,648,256 |
| Fair value of plan assets | **421,196** | 958,856 |
| | **797,790** | 689,400 |
| Unrecognized actuarial gain (loss) | **28,357** | (138,166) |
| Retirement liability | **₱826,147** | ₱551,234 |

The amounts included in 'Compensation and fringe benefits' in the Parent Company's statements of income are as follows:

| | **2008** | 2007 | 2006 |
|---|---|---|---|
| Current service cost | **₱168,784** | ₱157,093 | ₱68,859 |
| Interest cost | **170,100** | 139,077 | 108,597 |
| Expected return on plan assets | **(67,120)** | (66,154) | (71,032) |
| Net actuarial gains recognized during the year | **–** | 37,275 | (2,305) |
| Curtailment loss | **3,149** | – | – |
| | **₱274,913** | ₱267,291 | ₱104,119 |

The actual return on plan assets of the Parent Company amounted to (₱83.9 million), ₱98.4 million and ₱289.9 million in 2008, 2007 and 2006, respectively.

In preparation for the merger with Allied Banking Corporation (ABC) (see Note 35) in 2008, the Parent Company offered its employees with the early retirement plan program. A total of 675 employees, representing 12% of the total number of the Parent Company employees, availed of the program and were retired effective December 31, 2008.

The movements in the retirement liability recognized in the Parent Company balance sheet follow:

| | **2008** | 2007 |
|---|---|---|
| Balance at beginning of year | **₱551,234** | ₱283,943 |
| Retirement expense | **274,913** | 267,291 |
| Balance at end of year | **₱826,147** | ₱551,234 |

Changes in the present value of the defined benefit obligation of the Parent Company are as follows:

| | **2008** | 2007 |
|---|---|---|
| Balance at beginning of year | **₱1,648,256** | ₱1,986,807 |
| Interest cost | **170,100** | 139,077 |
| Current service cost | **168,784** | 157,093 |
| Benefits paid | **(161,773)** | (84,555) |
| Actuarial gain | **(264,894)** | (550,166) |
| Effect of curtailment | **(341,487)** | – |
| Balance at end of year | **₱1,218,986** | ₱1,648,256 |

Changes in the fair value of the plan assets of the Parent Company are as follows:

| | **2008** | 2007 |
|---|---|---|
| Balance at beginning of period | **₱958,856** | ₱945,053 |
| Expected return | **67,120** | 66,154 |
| Benefits paid | | |
| Early retirement program | **(291,972)** | – |
| Regular benefits | **(161,773)** | (84,555) |
| Actuarial gain (loss) | **(151,035)** | 32,204 |
| Balance at end of period | **₱421,196** | ₱958,856 |

The fair value of the plan assets as of December 31, 2008 and 2007 includes the fair value of the investments in the Parent Company shares of stocks amounting to ₱109.7 million and ₱391.7 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 2009.

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

| | **2008** | 2007 |
|---|---|---|
| Government securities | **71%** | 23% |
| Parent Company's own common shares | **26** | 41 |
| Debt securities and others | **3** | 24 |
| Receivables from related parties | **–** | 12 |
| | **100%** | 100% |

Information on the Parent Company's retirement plan are as follows:

| | **2008** | 2007 | 2006 |
|---|---|---|---|
| Present value of the defined benefit obligation | **₱1,218,986** | ₱1,648,256 | ₱1,986,807 |
| Fair value of plan assets | **421,196** | 958,856 | 945,053 |
| Deficit on plan assets | **797,790** | 689,400 | 1,041,754 |
| Experience adjustments arising on plan liabilities | **(92,518)** | 86,992 | 52,968 |
| Experience adjustments arising on plan assets | **151,035** | 32,204 | 218,872 |

As of December 31, 2008 and 2007, the retirement liability (asset) included in 'Other liabilities' and 'Other assets', respectively, of certain subsidiaries of the Group follows:

| | PNB Europe | PNB Capital | PNB Securities | Japan-PNB | PNB Gen |
|---|---|---|---|---|---|
| **2008** | **₱27,284** | **(₱1,597)** | **₱309** | **₱1,792** | **(₱5,239)** |
| 2007 | 25,783 | (1,597) | 196 | 2,504 | (6,628) |

Retirement expense of the Group charged against operations, included in 'Compensation and fringe benefits' in the statements of income amounted to ₱380.0 million, ₱273.7 million and ₱107.9 million in 2008, 2007 and 2006, respectively.

## 25. 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 ₱362.6 million in 2008, ₱393.0 million in 2007 and ₱346.3 million in 2006 for the Group, of which ₱238.4 million in 2008, ₱247.3 million in 2007 and ₱247.6 million in 2006 pertain to the Parent Company.

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

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Within one year | **₱214,001** | ₱157,777 | **₱117,384** | ₱121,020 |
| Beyond one year but not more than five years | **330,677** | 288,145 | **212,415** | 261,452 |
| Beyond more than five years | **52,023** | 31,302 | **24,299** | 31,302 |
| | **₱596,701** | ₱477,224 | **₱354,098** | ₱413,774 |

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 2008, 2007 and 2006, total rent income (included under 'Miscellaneous income') amounted to ₱214.5 million, ₱196.3 million and ₱209.9 million, respectively, for the Group and ₱201.0 million, ₱192.1 million and ₱207.5 million, respectively, for the Parent Company (see Note 27).

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

| | **2008** | 2007 |
|---|---|---|
| Within one year | **₱18,044** | ₱9,882 |
| Beyond one year but not more than five years | **36,631** | 27,715 |
| | **₱54,675** | ₱37,597 |

## 26. 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.

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 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 | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| Current | | | | | | |
| Regular | **₱192,868** | ₱174,934 | ₱214,971 | **₱136,522** | ₱66,925 | ₱56,852 |
| Final | **596,425** | 442,939 | 513,142 | **570,227** | 412,940 | 482,000 |
| | **789,293** | 617,873 | 728,113 | **706,749** | 479,865 | 538,852 |
| Deferred | **54,639** | (8,361) | 204,566 | **40,801** | (12,684) | 220,022 |
| | **₱843,932** | ₱609,512 | ₱932,679 | **₱747,550** | ₱467,181 | ₱758,874 |

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

| | **2008** | 2007 |
|---|---|---|
| Deferred tax assets | **₱1,736,589** | ₱1,857,109 |
| Other liabilities | **15,971** | 29,121 |
| | **₱1,720,618** | ₱1,827,988 |

The components of net deferred tax assets are as follows:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Deferred tax asset on: | | | | |
| Allowance for impairment losses | **₱4,809,538** | ₱5,166,976 | **₱4,781,155** | ₱5,158,928 |
| Accumulated depreciation on investment properties | **804,270** | 789,680 | **803,665** | 789,680 |
| Others | **109,655** | 124,044 | **–** | – |
| | **5,723,463** | 6,080,700 | **5,584,820** | 5,948,608 |
| Deferred tax liability on: | | | | |
| Fair value adjustment on investment properties | **2,483,710** | 2,695,502 | **2,483,710** | 2,695,502 |
| Revaluation increment on land and buildings | **964,129** | 859,117 | **964,129** | 859,117 |
| Unrealized trading gains on derivatives | **243,830** | 352,743 | **243,830** | 352,743 |
| Unrealized gain on AFS investments | **8,161** | 60,442 | **1,988** | 41,417 |
| Others | **303,015** | 284,908 | **198,885** | 201,167 |
| | **4,002,845** | 4,252,712 | **3,892,542** | 4,149,946 |
| | **₱1,720,618** | ₱1,827,988 | **₱1,692,278** | ₱1,798,662 |

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

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Unrealized gain on AFS investments | **₱52,281** | ₱17,192 | **₱39,429** | ₱8,313 |
| Revaluation increment on land and buildings | **(105,012)** | – | **(105,012)** | – |
| | **(₱52,731)** | ₱17,192 | **(₱65,583)** | ₱8,313 |

Based on the five-year financial forecast prepared by management and duly approved by the Executive Committee of the BOD, the Parent Company's net deferred tax assets of ₱1.7 billion and ₱1.8 billion as of December 31, 2008 and 2007, 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 unused tax losses and temporary differences:

| | Consolidated | | Parent Company | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| NOLCO | **₱27,177,801** | ₱27,097,239 | **₱27,133,761** | ₱27,080,071 |
| Allowance for impairment and credit losses | **247,381** | 546,795 | **202,825** | 496,224 |
| MCIT | **128,286** | 76,178 | **127,869** | 75,761 |
| Others | **1,124,206** | 1,888,586 | **1,121,941** | 1,887,711 |
| | **₱28,677,674** | ₱29,608,798 | **₱28,586,396** | ₱29,539,767 |

Details of the Group's NOLCO follow:

| Year Incurred | Amount | Used/Expired | Balance | Expiry Year |
|---|---|---|---|---|
| 1998 to 2000 | ₱5,797 | ₱3,380 | ₱2,417 | 2009 to 2010 |
| 2005 | 7,029,130 | – | 7,029,130 | 2009 to 2010 |
| 2006 | 11,473,748 | – | 11,473,748 | 2009 to 2011 |
| 2007 | 8,618,816 | – | 8,618,816 | 2010 to 2012 |
| 2008 | 53,690 | – | 53,690 | 2011 |
| | ₱27,181,181 | ₱3,380 | ₱27,177,801 | |

The Group's NOLCO of ₱8.6 billion in 2007, ₱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 ₱6.8 billion in 2007, ₱9.6 billion in 2006 and ₱5.4 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 1998 to 2000 amounting to ₱2.4 million recognized based on applicable tax laws similar to those of United States of America. Guam's NOLCO expires 10 years from the date such NOLCO was incurred.

Details of the Group's MCIT follow:

| Year Incurred | Amount | Used/Expired | Balance | Expiry Year |
|---|---|---|---|---|
| 2005 | ₱25,510 | ₱25,510 | ₱– | 2008 |
| 2006 | 14,045 | – | 14,045 | 2009 |
| 2007 | 36,623 | – | 36,623 | 2010 |
| 2008 | 77,618 | – | 77,618 | 2011 |
| | ₱153,796 | ₱25,510 | ₱128,286 | |

Details of the Parent Company's NOLCO follow:

| Year Incurred | Amount | Used/Expired | Balance | Expiry Year |
|---|---|---|---|---|
| 2005 | ₱7,029,130 | ₱– | ₱7,29,130 | 2008 to 2010 |
| 2006 | 11,432,125 | – | 11,432,125 | 2009 to 2011 |
| 2007 | 8,618,816 | – | 8,618,816 | 2010 to 2012 |
| 2008 | 53,690 | – | 53,690 | 2011 |
| | ₱27,133,761 | ₱– | ₱27,133,761 | |

Details of the Parent Company's MCIT follow:

| Year Incurred | Amount | Used/Expired | Balance | Expiry Year |
|---|---|---|---|---|
| 2005 | ₱25,510 | ₱25,510 | ₱– | 2008 |
| 2006 | 13,628 | – | 13,628 | 2009 |
| 2007 | 36,623 | – | 36,623 | 2010 |
| 2008 | 77,618 | – | 77,618 | 2011 |
| | ₱153,379 | ₱25,510 | ₱127,869 | |

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

| | Consolidated | | | Parent Company | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| Statutory income tax rate | **35.00%** | 35.00% | 35.00% | **35.00%** | 35.00% | 35.00% |
| Tax effects of: | | | | | | |
| Net unrecognized deferred tax assets | **28.88** | 33.04 | 39.52 | **35.17** | 38.57 | 41.13 |
| Non-deductible expenses | **20.99** | 11.14 | 10.76 | **27.63** | 10.63 | 12.74 |
| FCDU income before tax | **(31.49)** | (15.18) | (16.12) | **(41.40)** | (17.75) | (19.28) |
| Tax-exempt income | **(16.86)** | (8.55) | (12.01) | **(22.17)** | (8.39) | (14.37) |
| Tax-paid income | **5.81** | (24.88) | (3.94) | **15.42** | (32.14) | (3.41) |
| Change in tax rate | **0.65** | (1.66) | – | **0.47** | – | – |
| Effective income tax rate | **42.98%** | 28.91% | 53.21% | **50.12%** | 25.92% | 51.81% |

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 ₱131.8 million in 2008, ₱130.8 million in 2007 and ₱117.7 million in 2006 for the Group and ₱119.8 million in 2008, ₱126.3 million in 2007 and ₱111.7 million in 2006 for the Parent Company (see Note 27).

## 27. Income and Expenses

Service fees and commission income consists of:

| | **Consolidated** | | | **Parent Company** | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| Remittance | **₱1,034,925** | ₱1,021,760 | ₱1,142,124 | **₱405,326** | ₱355,984 | ₱366,878 |
| Deposit-related | **1,034,235** | 891,322 | 928,936 | **1,034,235** | 891,322 | 928,936 |
| Credit-related | **203,244** | 196,775 | 250,339 | **194,337** | 188,675 | 241,646 |
| Trust fees (Note 28) | **111,174** | 106,685 | 238,828 | **111,174** | 106,685 | 238,828 |
| Miscellaneous | **118,908** | 264,695 | 207,235 | **21,301** | 15,957 | 19,915 |
| | **₱2,502,486** | ₱2,481,237 | ₱2,767,462 | **₱1,766,373** | ₱1,558,623 | ₱1,796,203 |

Miscellaneous income consists of:

| | Consolidated | | | Parent Company | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| Net gain on sale or exchange of assets | **₱808,862** | ₱3,410,352 | ₱1,317,083 | **₱807,765** | ₱3,409,364 | ₱1,317,083 |
| Rental (Notes 25 and 29) | **214,489** | 196,295 | 209,918 | **200,970** | 192,129 | 207,535 |
| Others | **545,304** | 701,374 | 626,785 | **529,090** | 693,029 | 726,032 |
| | **₱1,568,655** | ₱4,308,021 | ₱2,153,786 | **₱1,537,825** | ₱4,294,522 | ₱2,250,650 |

Net gains on sale or exchange of assets include net gains (losses) from sale of investment properties in 2008, 2007 and 2006 amounted to (₱52.8 million), ₱66.9 million and (₱163.8 million), respectively, for the Group and the Parent Company.

Miscellaneous expenses consist of:

| | Consolidated | | | Parent Company | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| Security, clerical, messengerial | **₱548,224** | ₱279,418 | ₱316,232 | **₱488,301** | ₱276,986 | ₱310,232 |
| Information technology | **427,433** | 182,940 | 128,520 | **283,286** | 178,987 | 124,223 |
| Insurance | **406,875** | 410,623 | 383,333 | **395,705** | 408,685 | 379,922 |
| Foreclosure | **337,465** | 219,777 | 187,135 | **337,465** | 219,777 | 187,135 |
| Promotional | **291,121** | 121,481 | 156,325 | **273,896** | 121,475 | 146,331 |
| Transportation and travel | **198,482** | 138,944 | 133,742 | **186,699** | 127,783 | 127,498 |
| Stationery and supplies used | **134,041** | 124,441 | 132,958 | **111,047** | 121,178 | 126,179 |
| EARE (Note 26) | **131,816** | 130,754 | 117,710 | **119,797** | 126,312 | 111,655 |
| Management and professional fees | **108,292** | 122,935 | 152,895 | **62,270** | 80,647 | 110,229 |
| Others | **423,857** | 765,921 | 825,387 | **290,061** | 307,536 | 380,965 |
| | **₱3,007,606** | ₱2,497,234 | ₱2,534,237 | **₱2,548,527** | ₱1,969,366 | ₱2,004,369 |

Direct operating expenses on investment properties that generated rental income during the period, included under 'Miscellaneous expenses - Foreclosure', amounted to ₱44.0 million, ₱82.0 million, and ₱23.9 million for 2008, 2007 and 2006, respectively. While direct operating expenses on investment properties that did not generate rental income during the period, included under 'Miscellaneous expenses - Foreclosure', amounted to ₱257.3 million, ₱137.8 million, and ₱163.2 million for 2008, 2007 and 2006, respectively.

Miscellaneous - others include amortization of software costs, postage, telephone and telegraph, repairs and maintenances and litigation expenses.

## 28. 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 ₱20.1 billion and ₱22.4 billion as of December 31, 2008 and 2007, respectively (see Note 30). In connection with the trust functions of the Parent Company, government securities amounting to ₱251.4 million and ₱232.4 million (included under 'AFS investments' and 'HTM investments') as of December 31, 2008 and 2007, 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 ₱7.24 million and ₱19.9 million for the years ended December 31, 2008 and 2007, respectively, corresponding to the 10.00% of the net income realized in the preceding years from its trust, investment management and other fiduciary business until such related surplus reserve constitutes 20.00% of its regulatory capital.

## 29. 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, 2008 and 2007, the Parent Company was in compliance with such regulations.

The information relating to the DOSRI loans of the Group follows:

| | **2008** | 2007 |
|---|---|---|
| Total outstanding DOSRI loans | **₱5,615,799** | ₱2,410,629 |
| Percent of DOSRI loans to total loans | **6.70%** | 3.71% |
| Percent of unsecured DOSRI loans to total DOSRI loans | **11.39%** | 3.32% |
| Percent of past due DOSRI loans to total DOSRI loans | **0.50%** | 1.21% |

As discussed in Note 2, in August 2007, the Parent Company completed its Tier 1 follow-on equity offering where it raised about ₱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 through 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, 2008 and 2007 no longer includes loans to NG and GOCCs as they are no longer considered related parties.

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

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 a bank's net worth, the unsecured portion of which shall not exceed 5% of such net worth. Further, the total outstanding exposures to subsidiaries and affiliates shall not exceed 20% of the net worth of the lending bank. BSP Circular No. 560 is effective on February 15, 2007.

The Parent Company has lease agreements with some of its subsidiaries. The lease agreements include the share of the subsidiaries in the maintenance of the building in lieu of rental payments. The income related to these agreements amounting to ₱5.7 million, ₱4.8 million and ₱4.8 million in 2008, 2007 and 2006, respectively, is included in 'Miscellaneous income' in the statements of income.

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

| | **2008** | | 2007 | |
|---|---|---|---|---|
| Related Party | **Loans Receivable** | **Interest Income** | Loans Receivable | Interest Income |
| Fortune Tobacco Corporation (FTC) | **₱3,000,000** | **₱224,385** | ₱1,500,000 | ₱100,132 |
| Philippine Airlines (PAL) | **1,896,400** | **66,511** | 134,782 | 14,277 |
| Asia Brewery Inc. (ABI) | **–** | **–** | 500,000 | 33,425 |
| Asian Institute of Management (AIM) | **124,711** | **17,781** | – | – |
| Others | **594,688** | **95,800** | 275,847 | 60,120 |
| | **₱5,615,799** | **₱404,477** | ₱2,410,629 | ₱207,954 |

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 included above represent real estate and other loans granted to the officers of the Group.

The compensation of the key management personnel follows:

| | **Consolidated** | | | **Parent Company** | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | 2006 | **2008** | 2007 | 2006 |
| Short term employee benefits | **₱180,168** | ₱144,732 | ₱109,213 | **₱74,699** | ₱49,036 | ₱48,296 |
| Post-employment benefits | **18,000** | 8,937 | 4,843 | **11,345** | 6,486 | 2,527 |
| | **₱198,168** | ₱153,669 | ₱114,056 | **₱86,044** | ₱55,522 | ₱50,823 |

## 30. 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 which 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 P150.0 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 over certain investment properties with an aggregate fair value of ₱300.0 million in favor of the BSP (see Note 14).

As of December 31, 2008 and 2007, the total trust assets of the escrow account maintained with the BSP amounted to ₱2.4 billion and ₱2.2 billion, respectively. Average yield during the year was 7.3%. 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 | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Trust department accounts | **₱20,076,868** | ₱22,435,217 | **₱20,076,868** | ₱22,435,217 |
| Deficiency claims receivable | **7,526,661** | 7,667,406 | **7,526,661** | 7,667,406 |
| Outstanding guarantees issued | **409,445** | 582,795 | **116,873** | 304,794 |
| Other contingent accounts | **271,680** | 123,874 | **191,978** | 117,819 |
| Outward bills for collection | **161,112** | 164,860 | **161,060** | 164,770 |
| Confirmed export letters of credit | **34,037** | 2,750,714 | **34,037** | 2,750,714 |
| Unused commercial letters of credit | **4,173** | 4,986,755 | **4,173** | 4,986,755 |
| Inward bills for collection | **1,967** | 1,576,187 | **1,967** | 1,576,187 |
| Items held as collateral | **638** | 597 | **625** | 597 |

## 31. 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, 2008 and 2007 and are not indicative of either market risk or credit risk (amounts in thousands, except average forward rate).

| | 2008 | | | |
|---|---|---|---|---|
| | **Assets** | **Liabilities** | **Average Forward Rate** | **Notional Amount*** |
| **Freestanding derivatives:** | | | | |
| Currency forwards | | | | |
| BUY: | | | | |
| USD | **₱2,305** | **₱3,841** | **29.70** | **411,900** |
| EUR | **34** | **97** | **66.25** | **89,023** |
| SELL: | | | | |
| USD | **36,623** | **43,220** | **48.50** | **188,750** |
| EUR | **4,924** | **–** | **1.40** | **3,500** |
| Cross currency swaps | **477,730** | **616,537** | | **238,253** |
| Interest rate swaps | **692,884** | **60,436** | | **7,174,585** |
| Warrants | **149,126** | **–** | | **132,102** |
| **Embedded derivatives:** | | | | |
| Currency forwards | **7,796** | **–** | **47.11** | **830** |
| Credit default swaps | **1,098** | **41,398** | | **26,700** |
| | **₱1,372,520** | **₱765,529** | | |

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

| | 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.

On March 2, 2004, the Parent Company entered into a cross currency swap agreement with a counterparty bank in which the proceeds from the 2004 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 on February 13, 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 P477.7 million and ₱971.5 million as of December 31, 2008 and 2007, respectively.

In June 2008, the Parent Company entered into cross currency swap agreements with various counterparty banks in which the proceeds from the 2008 Notes were swapped for USD. The aggregate notional amount of the cross currency swaps is US$137.5 million or ₱6.1 billion while its negative fair value amounted to ₱481.6 million as of December 31, 2008.

As of December 31, 2008, the Parent Company holds 261,515 shares of ROP Warrants Series B1 with total cost of US$2.8 million.

The Parent Company enters into certain financial and nonfinancial 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 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$26.7 million with a positive fair value of ₱1.1 million and ₱63.0 million as of December 31, 2008 and 2007, respectively and negative fair value of ₱41.4 million and ₱40.5 million as of December 31, 2008 and 2007, respectively, and currency forwards in purchase and service contracts with a notional reference of US$0.83 million and US$3.8 million with positive fair value of ₱7.80 million and ₱51.3 million as of December 31, 2008 and 2007, respectively.

## 32. Earnings Per Share

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

| | | **2008** | 2007 | 2006 |
|---|---|---|---|---|
| a) | Net income attributable to equity holders of the Parent Company | **₱1,107,794** | ₱1,490,157 | ₱814,435 |
| | Less income attributable to convertible preferred stocks classified as equity (in thousand pesos) | **–** | 82,427 | 77,228 |
| b) | Net income attributable to common shareholders | **₱1,107,794** | ₱1,407,730 | ₱737,207 |
| c) | Weighted average number of common shares for basic earnings per share | **662,245,916** | 578,620,561 | 518,888,165 |
| d) | Effect of dilution: | | | |
| | Convertible preferred shares | **–** | 31,708,688 | 54,357,751 |
| e) | Adjusted weighted average number of common shares for diluted earnings per share | **662,245,916** | 610,329,249 | 573,245,916 |
| f) | Basic earnings per share (b/c) | **₱1.67** | ₱2.43 | ₱1.42 |
| g) | Diluted earnings per share (a/e) | **1.67** | 2.43 | 1.42 |

## 33. Maturity Analysis 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:

| | Consolidated | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | | 2007 | | |
| | **Less than Twelve Months** | **Over Twelve Months** | **Total** | Less than Twelve Months | Over Twelve Months | Total |
| **Financial Assets** | | | | | | |
| COCI | **₱6,436,406** | **₱–** | **₱6,436,406** | ₱4,773,212 | ₱– | ₱4,773,212 |
| Due from BSP | **20,056,705** | **–** | **20,056,705** | 27,961,521 | – | 27,961,521 |
| Due from other banks | **6,669,184** | **–** | **6,669,184** | 3,962,000 | – | 3,962,000 |
| Interbank loans receivable | **12,859,095** | **–** | **12,859,095** | 13,197,201 | – | 13,197,201 |
| Securities held under agreements to resell | **5,600,000** | **–** | **5,600,000** | 11,200,000 | – | 11,200,000 |
| Financial assets at FVPL | **11,052,293** | **–** | **11,052,293** | 3,215,235 | – | 3,215,235 |
| Loans receivables - gross (Note 9) | **47,367,780** | **41,524,850** | **88,892,630** | 28,096,152 | 36,692,303 | 64,788,455 |
| Unquoted debt securities classified as loans (Note 9) | **1,602,382** | **9,566,616** | **11,168,998** | 26,497 | 9,858,751 | 9,885,248 |
| Other receivables - gross (Note 9) | **10,130,078** | **5,030,939** | **15,161,017** | 9,382,110 | 4,978,469 | 14,360,579 |
| Receivable from SPV - net | **–** | **719,292** | **719,292** | – | 726,095 | 726,095 |
| AFS investments - gross (Note 11) | **2,236,458** | **12,976,659** | **15,213,117** | 6,404,732 | 39,036,189 | 45,440,921 |
| HTM investments | **131,606** | **44,018,474** | **44,150,080** | 83,259 | 362,795 | 446,054 |
| Miscellaneous COCI (Note 15) | **1,331** | **–** | **1,331** | 165,362 | – | 165,362 |
| | **124,143,318** | **113,836,830** | **237,980,148** | 108,467,281 | 91,654,602 | 200,121,883 |
| **Nonfinancial Assets** | | | | | | |
| Property and equipment - net | | | | | | |
| At cost | **–** | **758,083** | **758,083** | – | 821,810 | 821,810 |
| At appraised value | **–** | **15,952,829** | **15,952,829** | – | 15,681,869 | 15,681,869 |
| Investments in subsidiaries and an associate | **–** | **5,061** | **5,061** | – | 665,123 | 665,123 |
| Investment properties - net | **–** | **23,453,926** | **23,453,926** | – | 24,799,602 | 24,799,602 |
| Deferred tax assets | **–** | **1,736,589** | **1,736,589** | – | 1,857,109 | 1,857,109 |
| Other assets - gross (Note 15)* | **1,687,974** | **7,303,665** | **8,991,639** | 828,270 | 8,040,289 | 8,868,559 |
| | **1,687,974** | **49,210,153** | **50,898,127** | 828,270 | 51,865,802 | 52,694,072 |
| Less: | | | | | | |
| Allowance for impairment and credit losses (Note 16) | **–** | **13,031,866** | **13,031,866** | – | 12,617,952 | 12,617,952 |
| Unearned and other deferred income (Note 9) | **–** | **424,995** | **424,995** | – | 492,963 | 492,963 |
| | **–** | **13,456,861** | **13,456,861** | – | 13,110,915 | 13,110,915 |
| | **₱125,831,292** | **₱149,590,122** | **₱275,421,414** | ₱109,295,551 | ₱130,409,489 | ₱239,705,040 |

*includes deferred charges, prepaid expense and intangibles (software).

| | Consolidated | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | | 2007 | | |
| | **Less than Twelve Months** | **Over Twelve Months** | **Total** | Less than Twelve Months | Over Twelve Months | Total |
| **Financial Liabilities** | | | | | | |
| Deposit liabilities | **₱195,315,171** | **₱5,957,254** | **₱201,272,425** | ₱170,218,809 | ₱8,593,160 | ₱178,811,969 |
| Financial liabilities at FVPL | **765,529** | **6,187,302** | **6,952,831** | 67,612 | – | 67,612 |
| Bills and acceptances payable | **12,272,939** | **357,195** | **12,630,134** | 2,566,945 | 1,732,149 | 4,299,094 |
| Subordinated debt | **3,000,000** | **5,445,674** | **8,445,674** | – | 8,416,424 | 8,416,424 |
| Accrued interest payable | **665,536** | **1,559,252** | **2,224,788** | 491,025 | 1,562,347 | 2,053,372 |
| Other liabilities | | | | | | |
| Accounts payable | **4,804,807** | **–** | **4,804,807** | 5,394,352 | – | 5,394,352 |
| Bills purchased - contra | **1,640,949** | **–** | **1,640,949** | 4,159,741 | – | 4,159,741 |
| Due to other banks | **266,519** | **–** | **266,519** | 368,275 | – | 368,275 |
| Managers' checks and demand drafts outstanding | **782,141** | **–** | **782,141** | 450,396 | – | 450,396 |
| Payment order payable | **282,729** | **–** | **282,729** | 191,098 | – | 191,098 |
| Deposit on lease contracts | **101,038** | **161,952** | **262,990** | 74,355 | 149,565 | 223,920 |

*(Forward)*

| | Consolidated | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | | 2007 | | |
| | **Less than Twelve Months** | **Over Twelve Months** | **Total** | Less than Twelve Months | Over Twelve Months | Total |
| Due to TOP | **₱–** | **₱134,419** | **₱134,419** | ₱– | ₱135,335 | ₱135,335 |
| Margin deposits and cash letters of credit | **157,534** | **–** | **157,534** | 35,684 | – | 35,684 |
| Due to BSP | **127,596** | **–** | **127,596** | 122,818 | – | 122,818 |
| Other liabilities | **984,861** | **101,038** | **1,085,899** | 763,825 | 61,644 | 825,469 |
| | **221,167,349** | **19,904,086** | **241,071,435** | 184,904,935 | 20,650,624 | 205,555,559 |
| **Nonfinancial Liabilities** | | | | | | |
| Accrued taxes and other expenses | **967,572** | **1,170,568** | **2,138,140** | 1,405,411 | 815,935 | 2,221,346 |
| Other liabilities** | **985,063** | **1,920,609** | **2,905,672** | 665,167 | 1,033,850 | 1,699,017 |
| | **1,952,635** | **3,091,177** | **5,043,812** | 2,070,578 | 1,849,785 | 3,920,363 |
| | **₱223,119,984** | **₱22,995,263** | **₱246,115,247** | ₱186,975,513 | ₱22,500,409 | ₱209,475,922 |

**Includes income tax payable, withholding taxes payable, and other tax payable.

| | Parent Company | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | | 2007 | | |
| | **Less than Twelve Months** | **Over Twelve Months** | **Total** | Less than Twelve Months | Over Twelve Months | Total |
| **Financial Assets** | | | | | | |
| COCI | **₱6,326,528** | **₱–** | **₱6,326,528** | ₱4,732,004 | ₱– | ₱4,732,004 |
| Due from BSP | **19,840,705** | **–** | **19,840,705** | 27,961,521 | – | 27,961,521 |
| Due from other banks | **6,082,326** | **–** | **6,082,326** | 2,859,908 | – | 2,859,908 |
| Interbank loans receivable | **12,818,778** | **–** | **12,818,778** | 12,824,611 | – | 12,824,611 |
| Securities held under agreements to resell | **5,600,000** | **–** | **5,600,000** | 11,200,000 | – | 11,200,000 |
| Financial assets at FVPL | **11,042,856** | **–** | **11,042,856** | 3,194,086 | – | 3,194,086 |
| Loans receivables - gross (Note 9) | **45,363,483** | **38,478,946** | **83,842,429** | 27,085,816 | 35,771,769 | 62,857,585 |
| Unquoted debt securities classified as loans (Note 9) | **1,602,382** | **9,566,616** | **11,168,998** | 26,497 | 9,858,751 | 9,885,248 |
| Other receivables - gross (Note 9) | **8,876,129** | **4,930,336** | **13,806,465** | 7,578,733 | 4,878,293 | 12,457,026 |
| Receivable from SPV - net | **–** | **719,292** | **719,292** | – | 726,095 | 726,095 |
| AFS investments - gross (Note 11) | **1,595,174** | **12,419,246** | **14,014,420** | 6,186,893 | 38,393,533 | 44,580,426 |
| HTM investments | **35,744** | **44,018,474** | **44,054,218** | – | 362,795 | 362,795 |
| Miscellaneous COCI (Note 15) | **1,331** | **–** | **1,331** | 165,362 | – | 165,362 |
| | **119,185,436** | **110,132,910** | **229,318,346** | 103,815,431 | 89,991,236 | 193,806,667 |
| **Nonfinancial Assets** | | | | | | |
| Property and equipment - net | | | | | | |
| At cost | **–** | **638,970** | **638,970** | – | 714,513 | 714,513 |
| At appraised value | **–** | **15,952,829** | **15,952,829** | – | 15,681,869 | 15,681,869 |
| Investments in subsidiaries and an associate - net (Note 13) | **–** | **4,508,461** | **4,508,461** | – | 5,381,139 | 5,381,139 |
| Investment properties - net | **–** | **23,377,850** | **23,377,850** | – | 24,723,885 | 24,723,885 |
| Deferred tax assets | **–** | **1,692,278** | **1,692,278** | – | 1,798,662 | 1,798,662 |
| Other assets - gross (Note 15)* | **1,462,545** | **7,275,566** | **8,738,111** | 610,748 | 8,098,736 | 8,709,484 |
| | **1,462,545** | **53,445,954** | **54,908,499** | 610,748 | 56,398,804 | 57,009,552 |
| Less: | | | | | | |
| Allowance for impairment and credit losses (Note 16) | **–** | **12,796,538** | **12,796,538** | – | 12,334,508 | 12,334,508 |
| Unearned and other deferred income (Note 9) | **–** | **260,521** | **260,521** | – | 354,725 | 354,725 |
| | **–** | **13,057,059** | **13,057,059** | – | 12,689,233 | 12,689,233 |
| | **₱120,647,981** | **₱150,521,805** | **₱271,169,786** | ₱104,426,179 | ₱133,700,807 | ₱238,126,986 |

*Includes deferred charges, prepaid expense and intangibles (software).

| | Parent Company | | | | | |
|---|---|---|---|---|---|---|
| | **2008** | | | 2007 | | |
| | **Less than Twelve Months** | **Over Twelve Months** | **Total** | Less than Twelve Months | Over Twelve Months | Total |
| **Financial Liabilities** | | | | | | |
| Deposit liabilities | **₱196,163,943** | **₱5,957,255** | **₱202,121,198** | ₱172,297,515 | ₱8,593,158 | ₱180,890,673 |
| Financial assets at FVPL | **765,529** | **6,187,302** | **6,952,831** | 67,612 | – | 67,612 |
| Bills and acceptances payable | **11,136,331** | **332,497** | **11,468,828** | 1,844,935 | 1,629,513 | 3,474,448 |
| Subordinated debt | **3,000,000** | **5,445,674** | **8,445,674** | – | 8,416,424 | 8,416,424 |
| Accrued interest payable | **668,638** | **1,555,418** | **2,224,056** | 491,025 | 1,555,449 | 2,046,474 |
| Other liabilities | | | | | | |
| Accounts payable | **4,586,058** | **–** | **4,586,058** | 5,093,465 | – | 5,093,465 |
| Bills purchased - contra | **1,640,949** | **–** | **1,640,949** | 4,159,741 | – | 4,159,741 |
| Due to other banks | **190,600** | **–** | **190,600** | 301,322 | – | 301,322 |
| Managers' checks and demand drafts outstanding | **782,141** | **–** | **782,141** | 450,396 | – | 450,396 |
| Payment order payable | **282,729** | **–** | **282,729** | 191,098 | – | 191,098 |
| Due to TOP | **–** | **134,419** | **134,419** | – | 135,335 | 135,335 |
| Margin deposits and cash letters of credit | **157,534** | **–** | **157,534** | 35,684 | – | 35,684 |
| Due to BSP | **127,596** | **–** | **127,596** | 122,818 | – | 122,818 |
| Other liabilities | **137,116** | **–** | **137,116** | 27,864 | 61,645 | 89,509 |
| | **219,639,164** | **19,612,565** | **239,251,729** | 185,083,475 | 20,391,524 | 205,474,999 |
| **Nonfinancial Liabilities** | | | | | | |
| Accrued taxes and other expenses | **863,869** | **1,119,655** | **1,983,524** | 1,336,917 | 782,774 | 2,119,691 |
| Other liabilities** | **458,239** | **1,660,303** | **2,118,542** | 538,247 | 775,028 | 1,313,275 |
| | **1,322,108** | **2,779,958** | **4,102,066** | 1,875,164 | 1,557,802 | 3,432,966 |
| | **₱220,961,272** | **₱22,392,523** | **₱243,353,795** | ₱186,958,639 | ₱21,949,326 | ₱208,907,965 |

**Includes income tax payable, withholding taxes payable, and other tax payable.

The table below shows the liquidity information of the Parent Company for December 31, 2008 and 2007 which includes coupon cash flows categorized by contractual timing (in million pesos).

| | 2008 | | | | | | |
|---|---|---|---|---|---|---|---|
| | **On demand** | **Up to 1 month** | **1 to 3 months** | **3 to 6 months** | **6 to 12 months** | **Beyond 1 year** | **Total** |
| Deposit liabilities: | | | | | | | |
| Demand | **₱23,014** | **₱–** | **₱–** | **₱–** | **₱–** | **₱–** | **₱23,014** |
| Savings | **78,616** | **48,010** | **106,373** | **6,653** | **2,836** | **6,930** | **249,418** |
| Time | **–** | **11,909** | **2,940** | **1,908** | **1,182** | **27** | **17,966** |
| Financial liability at FVPL | **–** | **–** | **–** | **–** | **–** | **6,187** | **6,187** |
| | **101,630** | **59,919** | **109,313** | **8,561** | **4,018** | **13,144** | **296,585** |
| Derivative liabilities (asset): | | | | | | | |
| Contractual amounts payable | **–** | **11,007** | **2,876** | **–** | **–** | **–** | **13,883** |
| Contractual amounts receivable | **–** | **10,982** | **3,857** | **–** | **–** | **–** | **14,339** |
| | **–** | **25** | **(481)** | **–** | **–** | **–** | **(456)** |
| Bills and acceptances payable | **–** | **2,542** | **6,600** | **132** | **1** | **2,194** | **11,469** |
| Subordinated debt | **–** | **–** | **3,000** | **–** | **–** | **5,446** | **8,446** |
| Accrued interest and other liabilities | **2,179** | **6,625** | **166** | **207** | **22** | **1,692** | **10,891** |
| Total financial liabilities | **₱103,809** | **₱69,111** | **₱118,598** | **₱8,900** | **₱4,041** | **₱22,476** | **₱326,935** |

| | 2007 | | | | | | |
|---|---|---|---|---|---|---|---|
| | On demand | Up to 1 month | 1 to 3 months | 3 to 6 months | 6 to 12 months | Beyond 1 year | Total |
| Deposit liabilities: | | | | | | | |
| Demand | ₱19,952 | ₱– | ₱– | ₱– | ₱– | ₱– | ₱19,952 |
| Savings | 64,158 | 48,199 | 11,051 | 3,538 | 1,922 | 8,543 | 137,411 |
| Time | – | 13,815 | 4,525 | 4,420 | 898 | 91 | 23,749 |
| Bills and acceptances payable | – | 975 | 39 | 361 | 9 | 2,173 | 3,557 |
| Subordinated debt | – | – | 325 | 138 | 463 | 10,200 | 11,126 |
| | 84,110 | 62,989 | 15,940 | 8,457 | 3,292 | 21,007 | 195,795 |
| Derivative liabilities: | | | | | | | |
| Contractual amounts payable | – | 1,934 | 2,601 | – | – | – | 4,535 |
| Contractual amounts receivable | – | 1,924 | 2,598 | – | – | – | 4,522 |
| | – | 10 | 3 | – | – | – | 13 |
| Accrued interest and other liabilities | – | 8,312 | 296 | 21 | 1,039 | 2,958 | 12,626 |
| Total financial liabilities | ₱84,110 | ₱71,311 | ₱16,239 | ₱8,478 | ₱4,331 | ₱23,965 | ₱208,434 |

## 34. 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:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Due from BSP | **₱8,900,000** | ₱12,700,000 | ₱– |
| Interbank loans receivable | **–** | – | 3,151,961 |

## 35. Other Matters

Merger with ABC
On April 30, 2008 and June 24, 2008, the BOD and stockholders, respectively, of the Parent Company approved the following:

a. Merger of the Parent Company and ABC under the following salient terms:
   - Share swap of 140 common shares of the Parent Company for each common share of ABC;
   - Share swap of 30.73 common shares of the Parent Company for each preferred shares of ABC; and
   - The Parent Company will be the surviving entity.
b. Issue price of the new common shares is ₱55 per share subject to BOD approval
c. Issuance of 456,885,800 common shares from the Parent Company's authorized but unissued common stock
d. Plan of Merger of the Parent Company and ABC
e. Articles of Merger of the Parent Company and ABC
f. Authority of the President and Chief Executive Officer to sign the Plan of Merger and Articles of Merger
g. Amendment of the Parent Company's Articles of Incorporation to reclassify the authorized preferred stock into common stock to accommodate the Parent Company's new issuance of shares
h. Amendment of the Parent Company's Articles of Incorporation to increase the number of Directors from eleven (11) to fifteen (15)

The effectivity of the Plan of Merger will be subject to the approval of BSP, SEC and PDIC, and will be further conditioned on the issuance of BIR of a ruling that the Plan of Merger qualifies as a tax-free merger under section 40(c) 2 of the NIRC of 1997.

To date, the merger has not yet been consummated pending the sale of ABC's subsidiary in the US.

Issuance of Long-Term Negotiable Certificate of Time Deposits (LTNCD)
On December 19, 2008, the BOD of the Parent Company approved the issuance of ₱3.25 billion worth of LTNCD, which will mature in 2014, to expand the Parent Company's long-term deposit base.

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

a. The LTNCDs will be issued at a minimum investment of ₱0.5 million and in increments of ₱0.1 million thereafter. The LTNCDs will be issued in scripless form.

b. Issue price at 100% of the face value of each LTNCD.

c. The LTNCDs bear interest at the rate of 6.50% per annum from and including March 27, 2009 to but excluding June 30, 2009. Interest will be payable quarterly.

d. Subject to the BSP Rules, the Parent Company shall have the option, but not the obligation, to preterminate and redeem all and not part of the LTNCDs before the maturity date on any interest payment date.

On March 27, 2009, the Parent Company issued the LTNCD and was able to generate ₱3.25 billion.

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# DIRECTORY OF BRANCHES AND OFFICES

## REGIONAL HEADS

**North Metro Manila**
Narciso S. Capito, Jr.

**South Metro Manila**
Miguel P. Reyes

**Luzon**
Rafael B. De Peralta, Jr.

**Visayas/Mindanao**
Rafael A. Ruiz

## AREA HEADS

### METRO MANILA

| | |
|---|---|
| Metro 1 | Laudico D. Nicdao (Acting) |
| Metro 2 | Lucibar T. Perocho |
| Metro 3 | Julieta F. Cruz (Acting) |
| Metro 4 | Rosario A. Rodil |
| Metro 5 | Carina L. Salonga |
| Metro 6 | Estrella V. Ceballo |
| Metro 7 | Lani Q. Balaquiao |
| Metro 8 | Sonia D. Caday (Acting) |
| Metro 9 | Annabelle L. Domingo |
| Metro 10 | Elynor P. Imperio |

### LUZON

| | |
|---|---|
| Nol 1 | Crisanto C. Danao |
| Nol 2 | Corcino G. Estacio, Jr. |
| Nol 3 | Nicolas S. Diaz |
| Nol 4 | Roger P. Colobong |
| Nol 5 | Adranaida V. Alfaro |
| Nol 6 | Eris O. Francisco |
| Sol 1 | Reynaldo A. Intal |
| Sol 2 | Vicente A. Longno |
| Sol 3 | Alvin A. Lista |
| Sol 4 | Severino P. Francia |

### VISAYAS/MINDANAO

| | |
|---|---|
| Cebu/Bohol | Josefina Rosario C. Dinsay |
| Samar/Leyte | Gaudioso Y. Ypanto |
| Negros | Edwin J. Arroyo |
| Panay | Edwin J. Arroyo |
| NMin | Expedito B. Zambas |
| SMin | Dolores T. Martinez |
| WMin | Teresita U. Sebastian |
| SWMin | Cirilo G. Cameros |

## COMMERCIAL LENDING CENTERS

### METRO MANILA

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Amalia F. Davin
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Angeline Grace T. Go
Head

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Ferdinand G. Austria
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Felizardo M. Mangubat
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### LUZON

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Jahil L. Macapagal
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George A. Fortea
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Renato P. Tapel
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Fe C. Juplo
Head

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Chairman

Manuel S. Banayad
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Eric O. Recto
Chairman

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# 2008 List of Distinctions

Bangko Sentral ng Pilipinas

- 2008 Hall of Fame Award as Outstanding Commercial Bank Respondent on OFW Remittances

Social Security System

- 2008 Balikat ng Bayan Award as Best Collecting Bank for OFW Remittances

MegaLink

- Highest Reply Rate
- 3rd Highest Controllable Rate
- Top 10, Host Availability
- Top 10, Best Selling Offsite ATM (three locations)
- Top 10, Best Selling Onsite ATM (four locations)

digitalFilipino.com

- Best Website, Consumer Banking and Bills Payment Category The Digital Filipino 2008 Web Awards

Watson Wyatt Philippines' 94th survey on investment performance of retirement funds

- Number One, "All Trusteed Funds – Investment Managers Handling Less Than Five Funds" Category
- Number One, "Trusteed Funds Managed with Full Discretion – Investment Managers Handling Less Than Five Funds" Category

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