**Philippine National Bank**
Authorized Depository of the Republic of the Philippines
Trunk Lines: (632)526-3131 to 70/891-6040 t 70
P.O. Box 1884 (Manila) • P.O. Box 410 (Pasay)

July 22, 2013

**MS. JANET A. ENCARNACION**
Head, Disclosure Department
The Philippine Stock Exchange, Inc.
3rd Flr., Philippine Stock Exchange Plaza
Ayala Triangle, Ayala Avenue
Makati City

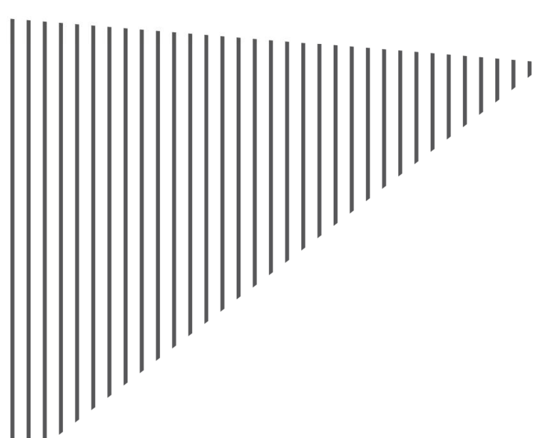
Dear Ms. Encarnacion:

We are pleased to furnish the Exchange a copy of the Consolidated Financial Statements of the Philippine National Bank (PNB) and Subsidiaries as of March 31, 2013, December 31, 2012 and January 1, 2012 and for the three (3) month period ended March 31, 2013 and 2012 and Independent Auditors' Report.

For your records.

Very truly yours,

**DORIS S. TE**
Corporate Secretary



# Philippine National Bank and Subsidiaries

Consolidated Financial Statements
March 31, 2013, December 31, 2012 and January 1, 2012
and for the three-month periods ended March 31, 2013 and 2012

and

Independent Auditors' Report

SyCip Gorres Velayo & Co.

**SyCip Gorres Velayo & Co.**
6760 Ayala Avenue
1226 Makati City
Philippines

Phone: (632) 891 0307
Fax: (632) 819 0872
www.sgv.com.ph

BOA/PRC Reg. No. 0001,
December 28, 2012, valid until December 31, 2015
SEC Accreditation No. 0012-FR-3 (Group A),
November 15, 2012, valid until November 16, 2015

**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), which comprise the consolidated statements of financial position as at March 31, 2013, December 31, 2012 and January 1, 2012, and the consolidated statements of income, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for the three-month periods ended March 31, 2013 and 2012, and a summary of significant accounting policies and other explanatory information.

**Management's Responsibility for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Philippine Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**Auditors' Responsibility**

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

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

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

**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at March 31, 2013, December 31, 2012 and January 1, 2012, and its financial performance and cash flows for the three-month periods ended March 31, 2013 and 2012 in accordance with Philippine Financial Reporting Standards.

SYCIP GORRES VELAYO & CO.

Vicky Lee Salas
Partner
CPA Certificate No. 86838
SEC Accreditation No. 0115 -AR-3 (Group A),
February 14, 2013, valid until February 13, 2016
Tax Identification No. 129-434-735,
BIR Accreditation No. 08-001998-53-2012
April 11, 2012, valid until April 10, 2015
PTR No. 3669690, January 2, 2013, Makati City

July 18, 2013

# PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

**(In Thousands)**

| | March 31, 2013 | December 31, 2012 (As restated - Note 2) | January 1, 2012 (As restated - Note 2) |
|---|---|---|---|
| **ASSETS** | | | |
| **Cash and Other Cash Items** | **₱7,918,010** | ₱5,599,088 | ₱5,404,110 |
| **Due from Bangko Sentral ng Pilipinas** (Notes 17 and 34) | **83,305,615** | 37,175,399 | 38,152,795 |
| **Due from Other Banks** (Note 34) | **15,016,791** | 4,042,769 | 6,423,981 |
| **Interbank Loans Receivable** | **8,275,969** | 11,498,756 | 17,097,648 |
| **Securities Held Under Agreements to Resell** (Notes 4 and 35) | **20,000,000** | 18,300,000 | 18,300,000 |
| **Financial Assets at Fair Value Through Profit or Loss** (Note 7) | **9,789,422** | 4,023,065 | 6,875,665 |
| **Available-for-Sale Investments** (Notes 8 and 17) | **101,627,626** | 66,997,479 | 52,323,808 |
| **Loans and Receivables** (Note 9) | **241,360,924** | 144,707,509 | 126,249,035 |
| **Receivable from Special Purpose Vehicle** (Note 10) | **–** | – | – |
| **Property and Equipment** (Note 11) | | | |
| At cost | **1,497,179** | 937,075 | 866,013 |
| At revalued amount | **21,473,551** | 15,566,650 | 15,698,514 |
| **Investments in a Subsidiary and an Associate** (Note 12) | **5,061** | 2,905,294 | 2,901,780 |
| **Investment Properties** (Notes 13 and 33) | **19,022,450** | 14,478,348 | 16,100,113 |
| **Deferred Tax Assets** (Note 29) | **1,089,464** | 1,780,682 | 1,775,789 |
| **Goodwill** (Note 14) | **16,017,500** | – | – |
| **Other Assets** (Note 15) | **4,000,332** | 2,178,637 | 3,382,169 |
| **TOTAL ASSETS** | **₱550,399,894** | ₱330,190,751 | ₱311,551,420 |

| | March 31, 2013 | December 31, 2012 (As restated - Note 2) | January 1, 2012 (As restated - Note 2) |
|---|---|---|---|
| **LIABILITIES AND EQUITY** | | | |
| **LIABILITIES** | | | |
| **Deposit Liabilities** (Notes 17 and 32) | | | |
| Demand | **₱83,945,182** | ₱28,152,296 | ₱29,896,120 |
| Savings | **263,347,412** | 192,793,260 | 184,676,120 |
| Time | **47,319,272** | 19,908,821 | 22,961,698 |
| | **394,611,866** | 240,854,377 | 237,533,938 |
| **Financial Liabilities at Fair Value Through Profit or Loss** (Note 18) | **10,304,323** | 6,479,821 | 6,650,183 |
| **Bills and Acceptances Payable** (Notes 19 and 35) | **15,121,397** | 13,076,901 | 8,458,425 |
| **Accrued Taxes, Interest and Other Expenses** (Note 20) | **5,313,253** | 3,914,290 | 3,739,048 |
| **Subordinated Debt** (Note 21) | **9,942,407** | 9,938,816 | 6,452,473 |
| **Income Tax Payable** | **166,682** | 149,050 | 242,169 |
| **Other Liabilities** (Note 22) | **28,450,238** | 17,285,251 | 14,668,239 |
| **TOTAL LIABILITIES** | **463,910,166** | 291,698,506 | 277,744,475 |

(Forward)

| | March 31, 2013 | December 31, 2012 (As restated - Note 2) | January 1, 2012 (As restated - Note 2) |
|---|---|---|---|
| **EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT COMPANY** | | | |
| **Capital Stock** (Note 25) | **₱43,448,337** | ₱26,489,837 | ₱26,489,837 |
| **Capital Paid in Excess of Par Value** (Note 25) | **26,499,909** | 2,037,272 | 2,037,272 |
| **Surplus Reserves** (Notes 25 and 31) | **715,637** | 569,887 | 560,216 |
| **Surplus** (Note 25) | **9,947,737** | 7,266,067 | 2,567,178 |
| **Revaluation Increment on Land and Buildings** (Note 11) | **2,816,962** | 2,816,962 | 2,816,962 |
| **Remeasurement Losses on Retirement Plan** (Note 27) | **(1,920,407)** | (781,900) | (1,004,057) |
| **Accumulated Translation Adjustment** (Note 25) | **(918,840)** | (992,620) | (451,708) |
| **Net Unrealized Gain on Available-for-Sale Investments** (Note 8) | **2,978,917** | 1,037,252 | 742,343 |
| **Equity in Net Unrealized Gain on Available-for-Sale Investment of an Associate** (Note 12) | **–** | – | 6,795 |
| **Parent Company Shares Held by a Subsidiary** (Note 25) | **(4,740)** | (4,740) | (4,740) |
| | **83,563,512** | 38,438,017 | 33,760,098 |
| **NON-CONTROLLING INTERESTS** (Note 2) | **2,926,216** | 54,228 | 46,847 |
| **TOTAL EQUITY** | **86,489,728** | 38,492,245 | 33,806,945 |
| **TOTAL LIABILITIES AND EQUITY** | **₱550,399,894** | ₱330,190,751 | ₱311,551,420 |

*See accompanying Notes to Consolidated Financial Statements.*

## PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

**(In Thousands, Except Earnings Per Share)**

| | Three Months Ended March 31 | |
|---|---|---|
| | **2013** | 2012 (As restated - Note 2) |
| **INTEREST INCOME ON** | | |
| Loans and receivables (Notes 9 and 32) | **₱2,914,132** | ₱1,944,255 |
| Trading and investment securities (Notes 7 and 8) | **927,878** | 802,512 |
| Deposits with banks and others (Note 32) | **250,068** | 193,652 |
| Interbank loans receivable | **6,964** | 3,427 |
| | **4,099,042** | 2,943,846 |
| **INTEREST EXPENSE ON** | | |
| Deposit liabilities (Notes 17 and 32) | **1,058,968** | 793,136 |
| Bills payable and other borrowings (Notes 19 and 21) | **417,787** | 287,654 |
| | **1,476,755** | 1,080,790 |
| **NET INTEREST INCOME** | **2,622,287** | 1,863,056 |
| Service fees and commission income (Notes 26 and 32) | **762,442** | 521,051 |
| Service fees and commission expense (Note 32) | **152,523** | 54,555 |
| **NET SERVICE FEES AND COMMISSION INCOME** | **609,919** | 466,496 |
| **OTHER INCOME** | | |
| Trading and investment securities gains - net (Notes 7, 8 and 18) | **3,272,105** | 1,749,829 |
| Premiums - net of reinsurance (Note 26) | **371,174** | 114,567 |
| Net gain on sale or exchange of assets (Note 26) | **167,226** | 245,932 |
| Gain on step - up acquisition (Note 12) | **140,958** | – |
| Foreign exchange gains - net | **40,815** | 414,582 |
| Miscellaneous (Notes 26 and 28) | **372,106** | 121,350 |
| **TOTAL OPERATING INCOME** | **7,596,590** | 4,975,812 |
| **OPERATING EXPENSES** | | |
| Compensation and fringe benefits (Notes 27 and 32) | **1,342,281** | 927,128 |
| Taxes and licenses (Note 29) | **447,900** | 348,759 |
| Depreciation and amortization (Note 11) | **296,535** | 211,223 |
| Occupancy and equipment - related costs (Note 28) | **274,094** | 230,601 |
| Provision for impairment and credit losses (Note 16) | **180,048** | 358,977 |
| Miscellaneous (Note 26) | **1,554,241** | 1,371,714 |
| **TOTAL OPERATING EXPENSES** | **4,095,099** | 3,448,402 |
| **INCOME BEFORE INCOME TAX** | **3,501,491** | 1,527,410 |
| **PROVISION FOR INCOME TAX** (Note 29) | **661,892** | 238,084 |
| **NET INCOME** | **₱2,839,599** | ₱1,289,326 |
| **ATTRIBUTABLE TO:** | | |
| **Equity Holders of the Parent Company** | **₱2,827,420** | ₱1,287,197 |
| **Non-controlling Interests** | **12,179** | 2,129 |
| | **₱2,839,599** | ₱1,289,326 |
| Basic/Diluted Earnings Per Share Attributable to Equity Holders of the Parent Company (Note 30) | **₱2.99** | ₱1.94 |

*See accompanying Notes to Consolidated Financial Statements.*

## PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

**(In Thousands)**

| | Three Months Ended March 31 | |
|---|---|---|
| | **2013** | 2012 (As restated - Note 2) |
| **NET INCOME** | **₱2,839,599** | ₱1,289,326 |
| **OTHER COMPREHENSIVE INCOME (LOSS)** | | |
| Items that recycle to profit or loss in subsequent periods: | | |
| Accumulated translation adjustment | **80,617** | 18,016 |
| Net unrealized gain (loss) on available-for-sale investments (Note 8) | **2,031,700** | (496,394) |
| Share in equity adjustments of an associate (Note 12) | **–** | (6,795) |
| Items that do not recycle to profit or loss in subsequent periods: | | |
| Remeasurement gains (losses) on retirement plan (Note 27) | **(1,138,507)** | 56,677 |
| **OTHER COMPREHENSIVE INCOME (LOSS) FOR THE PERIOD, NET OF TAX** | **973,810** | (428,496) |
| **TOTAL COMPREHENSIVE INCOME FOR PERIOD** | **₱3,813,409** | ₱860,830 |
| **ATTRIBUTABLE TO:** | | |
| **Equity holders of the Parent Company** | **₱3,704,358** | ₱858,701 |
| **Non-controlling Interests** | **109,051** | 2,129 |
| | **₱3,813,409** | ₱860,830 |

*See accompanying Notes to Consolidated Financial Statements.*

## PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

**(In Thousands)**

| | Attributable to Equity Holders of the Parent Company | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Capital Stock (Note 25) | Capital Paid in Excess of Par Value (Note 25) | Surplus Reserves (Notes 25 and 31) | Surplus (Notes 2 and 25) | Revaluation Increment on Land and Buildings (Note 11) | Accumulated Translation Adjustment (Note 25) | Net Unrealized Gain on Available-for-Sale Investments (Note 8) | Equity in Net Unrealized Gain on AFS Investment of an Associate (Note 12) | Parent Company Shares Held by a Subsidiary (Note 25) | Remeasurement Losses on Retirement Plan (Note 2) | Total | Non-controlling Interests (Note 2) | Total Equity |
| Balance at January 1, 2013, as previously reported | ₱26,489,837 | ₱2,037,272 | ₱569,887 | ₱6,888,348 | ₱2,816,962 | (₱992,620) | ₱1,037,252 | ₱– | (₱4,740) | ₱– | ₱38,842,198 | ₱904,693 | ₱39,746,891 |
| Effect of retroactive application of PAS 19 (Revised) (Note 2) | – | – | – | 331,500 | – | – | – | – | – | (781,900) | (450,400) | 22 | (450,378) |
| Effect of retroactive application of PFRS 10 (Note 2) | – | – | – | 46,219 | – | – | – | – | – | – | 46,219 | (850,487) | (804,268) |
| Balance at January 1, 2013, as restated | 26,489,837 | 2,037,272 | 569,887 | 7,266,067 | 2,816,962 | (992,620) | 1,037,252 | – | (4,740) | (781,900) | 38,438,017 | 54,228 | 38,492,245 |
| Total comprehensive income (loss) for the period | – | – | – | 2,827,420 | – | 73,780 | 1,941,665 | – | – | (1,138,507) | 3,704,358 | 109,051 | 3,813,409 |
| Issuance of capital stocks (Note 25) | 16,958,500 | 24,462,637 | – | – | – | – | – | – | – | – | 41,421,137 | – | 41,421,137 |
| Non-controlling interest arising on a business combination (Note 14) | – | – | – | – | – | – | – | – | – | – | – | 2,762,937 | 2,762,937 |
| Transfer to surplus reserves (Note 31) | – | – | 145,750 | (145,750) | – | – | – | – | – | – | – | – | – |
| **Balance at March 31, 2013** | ₱43,448,337 | ₱26,499,909 | ₱715,637 | ₱9,947,737 | ₱2,816,962 | (₱918,840) | ₱2,978,917 | ₱– | (₱4,740) | (₱1,920,407) | ₱83,563,512 | ₱2,926,216 | ₱86,489,728 |
| | | | | | | | | | | | | | |
| Balance at January 1, 2012, as previously reported | ₱26,489,837 | ₱2,037,272 | ₱560,216 | ₱2,246,213 | ₱2,816,962 | (₱451,708) | ₱742,343 | ₱6,795 | (₱4,740) | ₱– | ₱34,443,190 | ₱531,247 | ₱34,974,437 |
| Effect of retroactive application of PAS 19 (Revised) (Note 2) | – | – | – | 320,965 | – | – | – | – | – | (1,004,057) | (683,092) | (39) | (683,131) |
| Effect of retroactive application of PFRS 10 (Note 2) | – | – | – | – | – | – | – | – | – | – | – | (484,361) | (484,361) |
| Balance at January 1, 2012, as restated | 26,489,837 | 2,037,272 | 560,216 | 2,567,178 | 2,816,962 | (451,708) | 742,343 | 6,795 | (4,740) | (1,004,057) | 33,760,098 | 46,847 | 33,806,945 |
| Total comprehensive income (loss) for the period before restatements | – | – | – | 1,343,874 | – | 18,016 | (496,394) | (6,795) | – | – | 858,701 | 26,735 | 885,436 |
| Effect of retroactive application of PAS 19 (Revised) (Note 2) | – | – | – | (56,677) | – | – | – | – | – | 56,677 | – | – | – |
| Effect of retroactive application of PFRS 10 (Note 2) | – | – | – | – | – | – | – | – | – | – | – | (24,606) | (24,606) |
| Total comprehensive income (loss) for the period after restatements | – | – | – | 1,287,197 | – | 18,016 | (496,394) | (6,795) | – | 56,677 | 858,701 | 2,129 | 860,830 |
| Balance at March 31, 2012 | ₱26,489,837 | ₱2,037,272 | ₱560,216 | ₱3,854,375 | ₱2,816,962 | (₱433,692) | ₱245,949 | ₱– | (₱4,740) | (₱947,380) | ₱34,618,799 | ₱48,976 | ₱34,667,775 |

*See accompanying Notes to Consolidated Financial Statements.*

## PHILIPPINE NATIONAL BANK AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF CASH FLOWS
**(In Thousands)**

| | Three Months Ended March 31 | |
|---|---|---|
| | **2013** | 2012 (As restated - Note 2) |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Income before income tax | **₱3,501,491** | ₱1,527,410 |
| Adjustments for: | | |
| Realized trading gain on available-for-sale (AFS) investments (Note 8) | **(2,590,049)** | (1,506,817) |
| Depreciation and amortization (Note 11) | **296,535** | 211,223 |
| Mark-to-market gain on derivatives (Note 23) | **(192,449)** | (9,738) |
| Provision for impairment and credit losses (Note 16) | **180,048** | 358,977 |
| Net gain (loss) on sale or exchange of assets (Note 26) | **167,226** | (245,932) |
| Increase in aggregate reserve for life policies (Note 26) | **142,906** | – |
| Gain from step-up acquisition (Notes 12 and 26) | **(140,958)** | – |
| Amortization of premium (discount) on AFS investments | **116,064** | (182,548) |
| Gain on mark-to-market of financial liability designated at fair value through profit or loss (FVPL) (Notes 8 and 18) | **(99,562)** | (157,393) |
| Amortization of software costs (Note 15) | **42,946** | 37,429 |
| Amortization of transaction costs (Notes 17 and 21) | **8,047** | 4,603 |
| Share in net income of an associate (Notes 12 and 26) | **(4,975)** | (18,300) |
| Dividend income | **(160)** | (103) |
| Changes in operating assets and liabilities: | | |
| Decrease (increase) in amounts of: | | |
| Financial assets at FVPL | **977,460** | 2,192,436 |
| Loans and receivables | **(4,914,166)** | (3,703,476) |
| Other assets | **4,025,956** | (155,678) |
| Increase (decrease) in amounts of: | | |
| Deposit liabilities | **12,564,259** | (10,392,480) |
| Accrued taxes, interest and other expenses | **(254,717)** | 36,694 |
| Other liabilities | **(3,111,231)** | (85,032) |
| Net cash generated from (used in) operations | **10,714,671** | (12,088,725) |
| Income taxes paid | **(700,063)** | (331,388) |
| Dividends received | **160** | 103 |
| Net cash provided by (used in) operating activities | **10,014,768** | (12,420,010) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Proceeds from sale of: | | |
| AFS investments | **116,959,861** | 54,546,322 |
| Investment properties | **480,669** | 1,080,943 |
| Property and equipment (Note 11) | **77,138** | 6,536 |
| Proceeds from redemption of placements with the Bangko Sentral ng Pilipinas (BSP) | **–** | 20,200,000 |
| Placements with the BSP and other banks (Note 34) | **(3,484,186)** | (19,300,000) |

(Forward)

| | Three Months Ended March 31 | |
|---|---|---|
| | **2013** | 2012 (As restated - Note 2) |
| Acquisitions of: | | |
| AFS investments | **(₱127,768,855)** | (₱70,009,786) |
| Property and equipment (Note 11) | **(208,503)** | (118,476) |
| Software cost (Note 15) | **(79,233)** | (2,312) |
| Cash acquired from business combination (Note 14) | **64,444,869** | – |
| Net cash provided by (used in) investing activities | **50,421,760** | (13,596,773) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Settlement of bills and acceptances payable | **(25,823,741)** | (11,458,989) |
| Proceeds from bills and acceptances payable | **24,388,192** | 12,822,642 |
| Redemption of subordinated debt (Note 21) | **(4,500,000)** | – |
| Transaction cost attributable to issuance of shares (Note 14) | **(84,792)** | – |
| Net cash provided by (used in) financing activities | **(6,020,341)** | 1,363,653 |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | **54,416,187** | (24,653,130) |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD** | | |
| Cash and other cash items | **5,599,088** | 5,404,110 |
| Due from BSP | **37,175,399** | 17,952,795 |
| Due from other banks | **4,042,769** | 6,423,981 |
| Interbank loans receivable | **11,498,756** | 17,097,648 |
| Securities held under agreements to resell | **18,300,000** | 18,300,000 |
| | **76,616,012** | 65,178,534 |
| **CASH AND CASH EQUIVALENTS AT END OF PERIOD** | | |
| Cash and other cash items | **7,918,010** | 4,155,014 |
| Due from BSP (Note 34) | **83,305,615** | 19,402,437 |
| Due from other banks (Note 34) | **11,532,605** | 4,279,027 |
| Interbank loans receivable | **8,275,969** | 3,888,926 |
| Securities held under agreements to resell | **20,000,000** | 8,800,000 |
| | **₱131,032,199** | ₱40,525,404 |
| **OPERATIONAL CASH FLOWS FROM INTEREST AND DIVIDENDS** | | |
| Interest received | **₱4,227,997** | ₱2,869,328 |
| Interest paid | **1,480,025** | 1,298,415 |
| Dividends received | **160** | 103 |

*See accompanying Notes to Consolidated 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. On May 27, 1996, the Philippine Securities and Exchange Commission (SEC) approved the Parent Company's application to extend its corporate term for another 50 years. Its principal place of business is at PNB Financial Center, President Diosdado Macapagal Boulevard, Pasay City. As of March 31, 2013, the Lucio Tan Group Inc. (LTG) held indirect ownership of the Parent Company shares amounting to about 48.61% and the shareholders related to or who issue proxies/special powers of attorney in favor of Director Lucio C. Tan from time to time held a total of about 18.25%, while the remaining 33.14% are owned by other stockholders. As of December 31, 2012, the companies and persons affiliated/associated to or who issue proxies/special powers of attorney in favor of Director Lucio C. Tan were the majority shareholder of the Parent Company at 68.85% and the remaining 31.15% 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 National Government (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 654 domestic and 16 overseas branches and offices as of March 31, 2013, respectively, and 339 domestic and 13 overseas branches and offices as of December 31, 2012, respectively. The Parent Company's international subsidiaries have a network of 73 and 65 offices as of March 31, 2013 and December 31, 2012, respectively, in key cities of the United States of America (USA), Canada, Western Europe, Middle East and Asia.

The subsidiaries of the Parent Company are engaged in a number of diversified financial and related businesses such as remittance, life and non-life insurance, merchant banking, leasing, stock brokerage, foreign exchange trading and/or related services.

The Parent Company previously operated under a rehabilitation program pursuant to the memorandum of agreement signed by the Republic of the Philippines, the Philippine Deposit Insurance Corporation (PDIC) and LTG on May 3, 2002. In May 2007, the Parent Company concluded its 5-year Rehabilitation Plan as approved by the Bangko Sentral ng Pilipinas (BSP).

Merger with Allied Banking Corporation
The respective shareholders of the Parent Company and Allied Banking Corporation (ABC), representing at least two-thirds of the outstanding capital stock of both banks, approved the amended terms of the Plan of Merger of the two banks on March 6, 2012. The original plan of the merger which was effected via a share-for-share exchange was approved by the affirmative vote of ABC and the Parent Company's respective shareholders, representing at least two-thirds of the outstanding capital stock of both banks, on June 24, 2008. Under the approved amended terms, the Parent Company will be the surviving entity. It will issue to ABC shareholders 130 Parent Company shares for every ABC common share and 22.763 Parent Company shares for every ABC preferred share. Merger and business combination are terms used interchangeably within the accompanying consolidated financial statementents and have the same meaning.

On March 26, 2012, the Parent Company submitted to the BSP and PDIC applications for consent to the merger. On April 12, 2012, the application for the merger was filed with the Philippine SEC. The PDIC, the Monetary Board of the BSP and the Philippine SEC gave consent and approved the merger on July 25, 2012, August 2, 2012 and January 17, 2013, respectively. In addition, with respect to ABC's overseas subsidiaries, the Parent Company has also filed notices in relation to the merger with various relevant foreign regulatory agencies; and as of February 9, 2013 had received all necessary approvals and complied with conditions to effectuate the merger.

On February 9, 2013, the Parent Company concluded its planned merger with ABC as approved and confirmed by the Board of Directors of the Parent Company and of ABC on January 22 and 23, 2013, respectively. The purchase consideration as of February 9, 2013, the acquisition date, amounted to ₱41.5 billion which represents 423,962,500 common shares at the fair value of ₱97.90 per share in exchange for the 100.00% voting interest in ABC at the share swap ratio of 130 PNB common shares for one ABC share and 22.763 PNB common shares for one ABC preferred share. The fair value of the shares is the published price of the shares of the Parent Company as of February 9, 2013. There are no contingent considerations arrangements as part of the merger.

The Parent Company, the Acquirer, has elected to measure the non-controlling interests in ABC, the Acquiree, at their proportionate share in ABC's net identifiable assets and liabilities. As at July 18, 2013, the Parent Company, is still in the process of finalizing the fair values of ABC's net identifiable assets and liabilities and the total acquisition/transaction related costs.

The merger of the Parent Company and ABC will enable the two banks to advance their long-term strategic business interests as they capitalized on their individual strengths and markets.

## 2. Summary of Significant Accounting Policies

Basis of Preparation

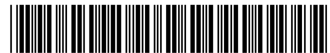
The accompanying financial statements of the Parent Company and its subsidiaries (the Group) have been prepared on a historical cost basis except for financial assets and liabilities at fair value through profit or loss (FVPL), and available-for-sale (AFS) investments, that are measured at fair value, and land and building that are measured at revalued amount.

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 (Php) 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 and transactions 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 the 'Basis of Consolidation'.

Amounts in the consolidated financial statements are presented to the nearest thousand pesos (₱000) unless otherwise stated.



Statement of Compliance
The consolidated financial statements have been prepared in accordance with Philippine Financial Reporting Standards (PFRS).

**Changes in Accounting Policies and Disclosures**

The accounting policies adopted are consistent with those of the previous financial year except for the following new, amendments and improvements to PFRS which became effective as of January 1, 2013. Except as otherwise indicated, these changes in the accounting policies did not have any significant impact on the financial position or performance of the Group:

*New and Revised Standards and Interpretations*
- PFRS 11, *Joint Arrangements*
- PAS 27, *Separate Financial Statements* (as revised in 2011)
- PAS 28, *Investments in Associates and Joint Ventures* (as revised in 2011)

*Improvements to PFRSs* (2009-2011 cycle)
- PFRS 1, *First-time Adoption of PFRS - Borrowing Costs*
- PAS 1, *Presentation of Financial Statements - Clarification of the requirements for comparative information*
- PAS 16*, Property, Plant and Equipment - Classification of servicing equipment*
- PAS 32*, Financial Instruments: Presentation - Tax effect of distribution to holders of equity instruments*
- PAS 34, *Interim Financial Reporting - Interim financial reporting and segment information for total assets and liabilities*

PFRS 7*, Financial instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities*
The Group disclosed the requirements of the amendments regarding the information about rights of set-off and related arrangements (such as collateral agreements). The new disclosures are required for all recognized financial instruments that are set off in accordance with PAS 32. These disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or 'similar agreement', irrespective of whether they are set-off in accordance with PAS 32.

Refer to Note 35 for the details and the tabular format of the required offsetting disclosures which the Group retrospectively applied.

PFRS 10, *Consolidated Financial Statements*
PFRS 10 replaces the portion of PAS 27, *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. It also includes the issues raised in Standing Interpretations Committee (SIC) No. 12, *Consolidation - Special Purpose Entities*. PFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by PFRS 10 requires management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements in PAS 27. Refer to Note 3 for the significant judgment made by management in identifiying entities for consolidation.

*Deconsolidation of Investment in SPV - Opal Portfolio Investments (SPV-AMC), Inc. (OPII)*
Before the effectivity of PFRS 10, OPII is consolidated by PNB based on the provisions of SIC 12. Under SIC 12, control over an SPE may exist even in cases where an entity owns little or none of the SPE's equity, such as when an entity retains majority of the residual risks related to

the SPE in order to obtain benefits from its activities. Beginning January 1, 2013, the Group adopted PFRS 10 which supersedes SIC 12. PFRS 10 establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. Based on management's assessment, the Parent Company should no longer consolidate OPII since it failed to demonstrate control over OPII.

PAS 1, *Presentation of Financial Statements - Presentation of Items of Other Comprehensive Income or OCI (Amendments)*
The Group applied amendments to PAS 1 and changed the grouping of items presented in OCI either:

- items that can be reclassified (or "recycled") to profit or loss at a future point in time (for example, upon derecognition or settlement). These include 'Accumulated Translation Adjustment', 'Net Unrealized Gain (Loss) on Available-for-Sale Investments' and 'Equity in Net Unrealized Gain on AFS Investment of an Associate'; or
- items that will never be recycled to profit or loss. These include 'Remeasurement Losses on Retirement Plan'.

The amendments affect presentation only and have no impact on the Group's financial position or performance.

PFRS 12, *Disclosure of Interests with Other Entities*
PFRS 12 includes all of the disclosures that were previously in PAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in PAS 31 and PAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. The Group has no significant interests in joint arrangements, associates and structured entities that require disclosures. None of the majority owned subsidiaries are held by non-controlling interests that are considered material to the Group and which will require additional disclosures by PFRS 12. Refer to Basis of Consolidation, Notes 3 and 12 for disclosures related to subsidiaries and associates.

PFRS 13, *Fair Value Measurement*
PFRS 13 establishes a single source of guidance under PFRSs for all fair value measurements. PFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under PFRS when fair value is required or permitted. This standard has no significant impact in the fair value measurement of financial assets and liabilities at FVPL, AFS investments, land and buildings. Refer to Note 5 for the disclosures required by the standard.

PAS 19, *Employee Benefits* (Revised)
Amendments to PAS 19 range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and rewording. The revised standard also requires new disclosures such as, among others, a sensitivity analysis for each significant actuarial assumption, information on asset-liability matching strategies, duration of the defined benefit obligation, and disaggregation of plan assets by nature and risk.

The adoption of PAS 19 (Revised) which required restrospective application, resulted in the restatement of previously reported retirement obligation/asset of the Group. The adjustment amounts were determined by the Group with the assistance of an external actuary. The Parent Company and certain subsidiaries had chosen to close 'Surplus' the net effect of all transition adjustments as at January 1, 2011 (the transition date) upon retrospective application of PAS 19

(Revised). The Group will retain the remeasurements recognized in other comprehensive income and will not transfer these to other items in equity.

The effects of retroactive application of PAS 19 (Revised) and PFRS 10 are detailed below:

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | As previously reported | Effect of retroactive application of PAS 19R | Effect of retroactive application of PFRS 10 | As restated |
| **Consolidated statements of financial position** | | | | |
| **Assets** | | | | |
| Other assets-net | ₱2,994,425 | ₱429 | (₱816,217) | ₱2,178,637 |
| **Liabilities** | | | | |
| Other liabilities | 16,846,393 | 450,807 | (11,949) | 17,285,251 |
| **Equity** | | | | |
| Remeasurement losses on retirement plan | – | (781,900) | – | (781,900) |
| Surplus | 6,888 ,348 | 331,500 | 46,219 | 7,266,067 |
| **Non-controlling interests** | 904,693 | 22 | (850,487) | 54,228 |

| | January 1, 2012 | | | |
|---|---|---|---|---|
| | As previously reported | Effect of retroactive application of PAS 19R | Effect of retroactive application of PFRS 10 | As restated |
| **Consolidated statements of financial position** | | | | |
| **Assets** | | | | |
| Other assets-net | ₱3,897,388 | (₱1,217) | (₱514,002) | ₱3,382,169 |
| **Liabilities** | | | | |
| Other liabilities | 14,015,965 | 681,915 | (29,641) | 14,668,239 |
| **Equity** | | | | |
| Remeasurement losses on retirement plan | – | (1,004,057) | – | (1,004,057) |
| Surplus | 2,246,213 | 320,965 | – | 2,567,178 |
| **Non-controlling interests** | 531,247 | (39) | (484,361) | 46,847 |

Other income, other expenses, provision for income tax and income attributable to non-controlling interests decreased by ₱989.4 million, ₱623.3 million and ₱46.2 million, and ₱366.1 million for the year ended December 31, 2012.

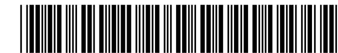
Basis of Consolidation

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

As of March 31, 2013

| **Subsidiaries** | **Nature of Business** | **Country of Incorporation** | **Percentage of Ownership** | | **Functional Currency** |
|---|---|---|---|---|---|
| | | | **Direct** | **Indirect** | |
| Allied Savings Bank* | Banking | Philippines | 100.00 | – | Php |
| PNB Capital and Investment Corporation (PNB Capital) | Investment | - do - | 100.00 | – | Php |
| PNB Forex, Inc. | FX trading | - do - | 100.00 | – | Php |
| PNB Holdings Corporation (PNB Holdings) | Investment | - do - | 100.00 | – | Php |

(Forward)



| Subsidiaries | Nature of Business | Country of Incorporation | Percentage of Ownership Direct | Percentage of Ownership Indirect | Functional Currency |
|---|---|---|---|---|---|
| PNB General Insurers, Inc. (PNB Gen) [(a)] | Insurance | - do - | – | 100.00 | Php |
| PNB Securities, Inc. (PNB Securities) | Securities Brokerage | - do - | 100.00 | – | Php |
| PNB Corporation – Guam | Remittance | USA | 100.00 | – | USD |
| PNB International Investments Corporation (PNB IIC) | Investment | - do - | 100.00 | – | USD |
| PNB Remittance Centers, Inc. (PNB RCC) [(b)] | Remittance | - do - | – | 100.00 | USD |
| PNB RCI Holding Co. Ltd. [(b)] | Holding Company of PNB RCC | - do - | – | 100.00 | USD |
| Allied Bank Philippines (UK) Plc* | Banking | United Kingdom | 100.00 | – | Great Britain Pound (GBP) |
| PNB Europe PLC | Banking | - do - | 100.00 | – | GBP |
| PNB Remittance Co. (Canada) [(c)] | Remittance | Canada | – | 100.00 | Canadian Dollar (CAD) |
| PNB Global Remittance & Financial Co. (HK) Ltd. (PNB GRF) | Remittance | Hong Kong | 100.00 | – | Hong Kong Dollar (HKD) |
| PNB Italy SpA | Remittance | Italy | 100.00 | – | Euro |
| Allied Commercial Bank* | Banking | People's Republic of China | 90.00 | – | USD |
| Japan - PNB Leasing and Finance Corporation (Japan-PNB Leasing) | Leasing/Financing | Philippines | 90.00 | – | Php |
| Japan -PNB Equipment Rentals Corporation[(d)] | Rental | - do - | – | 90.00 | Php |
| PNB Life Insurance, Inc. (PNB LII) * | Insurance | - do - | 80.00 | – | Php |
| Allied Leasing and Finance Corporation | Rental | - do - | 57.21 | – | Php |
| ACR Nominees Limited [(e)] * | Banking | Hong Kong | – | 51.00 | HKD |
| Allied Banking Corporation (Hong Kong) Limited * | Banking | - do - | 51.00 | – | HKD |
| Oceanic Holding (BVI) Ltd. * | Holding Company | British Virgin Islands | 27.78 | – | USD |

** Subsidiaries acquired as a result of the merger with Allied Banking Corporation*

As of December 31, 2012

| Subsidiaries | Nature of Business | Country of Incorporation | Percentage of Ownership Direct | Percentage of Ownership Indirect | Functional Currency |
|---|---|---|---|---|---|
| PNB Capital | Investment | Philippines | 100.00 | – | Php |
| PNB Forex, Inc. | FX trading | - do - | 100.00 | – | Php |
| PNB Holdings | Investment | - do - | 100.00 | – | Php |
| PNB Gen [(a)] | Insurance | - do - | – | 100.00 | Php |
| PNB Securities | Securities Brokerage | - do - | 100.00 | – | Php |
| PNB Corporation - Guam | Remittance | USA | 100.00 | – | USD |
| PNB IIC | Investment | - do – | 100.00 | – | USD |
| PNB RCC [(b)] | Remittance | - do - | – | 100.00 | USD |
| PNB RCI Holding Co. Ltd. [(b)] | Holding Company of PNB RCC | - do - | – | 100.00 | USD |
| PNB Remittance Co. (Canada) [(c)] | Remittance | Canada | – | 100.00 | CAD |
| PNB GRF | Remittance | Hong Kong | 100.00 | – | HKD |
| PNB Italy SpA | Remittance | Italy | 100.00 | – | Euro |
| PNB Europe PLC | Banking | United Kingdom | 100.00 | – | GBP |
| Japan-PNB Leasing | Leasing/Financing | Philippines | 90.00 | – | Php |
| Japan -PNB Equipment Rentals Corporation[(d)] | Rental | - do - | – | 90.00 | Php |

[(a)] Owned through PNB Holdings
[(b)] Owned through PNB IIC
[(c)] Owned through PNB RCI Holding Co. Ltd.
[(d)] Owned through Japan - PNB Leasing
[(e)] Owned through Allied Banking Corporation (Hong Kong) Limited

The financial statements of the subsidiaries are prepared on 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 is exposed, or has rights, to variable return from its involvement with an entity and has the ability to affect those returns through its power over the entity. The Group has power over the entity when it has existing rights that give it the current ability to direct the relevant activities (i.e., activities that significantly affect the entity's returns). 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.

If the Group loses control over a subsidiary, it:

- Derecognizes the assets (including goodwill) and liabilities of the subsidiary
- Derecognizes the carrying amount of any non-controlling interest
- Derecognizes the cumulative translation differences, recorded in equity
- Recognizes the fair value of the consideration received
- Recognizes the fair value of any investment retained
- Recognizes any surplus or deficit in profit or loss
- Reclassifies the parent's share of components previously recognized in other comprehensive income (OCI) to profit or loss or surplus, as appropriate

The Group accounts for its investments in OHBVI as a subsidiary although the Group holds less than 50.00% of OHBVI's issued share capital on the basis of the voting rights of 42.78% assigned by certain stockholders to the Parent Company. The Group has the ability to control the relevant activities and to affect its returns in OHBVI on the basis of the combined voting rights arising from its direct ownership and assigned voting rights of 70.56%.

Non-controlling Interests
Non-controlling 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, consolidated statement of comprehensive income and within equity in the consolidated statement of financial position, separately from equity attributable to the Parent Company. Acquisitions of non-controlling interests are accounted for as equity transactions, whereby the difference between the consideration paid and the share in the net assets acquired is recognized in equity.

**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 reporting date and for foreign currency-denominated income and expenses, at the exchange rates prevailing at transaction dates. 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 period 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.

*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 reporting date, and their income and expenses are translated at the average exchange rate for the period. Exchange differences arising on translation are taken directly to OCI under 'Accumulated translation adjustment'. On disposal of a foreign entity or upon actual remittance of FCDU profits to RBU, the deferred cumulative amount recognized in OCI relating to the particular foreign operation is recognized in the consolidated statement of income.

Product Classification
Insurance contracts are those contracts where the Group (the insurer) has accepted significant insurance risk from another party (the policyholders) by agreeing to compensate the policyholders if a specified uncertain future event (the insured event) adversely affects the policyholders. As a general guideline, the Group determines whether it has significant insurance risk, by comparing benefits paid with benefits payable if the insured event did not occur. Insurance contracts can also transfer financial risk.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire. Investment contracts can, however, be reclassified as insurance contracts after inception if insurance risk becomes significant.

Insurance and investment contracts are further classified as being with or without discretionary participation features (DPF).

DPF is a contractual right to receive, as a supplement to guaranteed contracts, additional benefits that are likely to be a significant portion of the total contractual benefits, whose amount or timing is contractually at the discretion of the issuer, and that are contractually based on the performance of a specified pool of contracts or a specified type of contract, realized and or unrealized investment returns on a specified pool of assets held by the issuer, or the profit or loss of the company, fund or other entity that issues the contract.

Investment contracts are those contracts that transfer significant financial risk. Financial risk is the risk of a possible future change in one or more of a specified interest rate, security price, commodity price, foreign currency exchange rate, index of price or rates, a credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

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.

*Initial recognition of financial instruments*
All financial instruments are initially recognized at fair value. Except for financial instruments at FVPL, the initial measurement of financial instruments 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.

As of March 31, 2013, December 31 and January 1, 2012, the Group has no HTM investments.

*Reclassification of financial assets*
The Group may choose to reclassify a non-derivative trading financial asset out of the held-for-trading (HFT) 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 HFT 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 which then 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 (EIR) 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 the EIR prospectively.

*Determination of fair value*
The fair value for financial instruments traded in active markets at the reporting 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 consolidated statement of income in 'Trading and investment securities gains - net' unless it qualifies for recognition as some other type of asset. In cases where data is not observable, the difference between the transaction price and model value is only recognized in the consolidated 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, interest rate swaps and warrants. 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 are taken directly to the consolidated statement of income and are included in 'Trading and investment securities gains - net'. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

*Embedded derivatives*
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. 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 clearly and 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 consolidated statement of financial position at fair value. Changes in fair value relating to the held-for-trading positions are recognized in 'Trading and investment securities gains - net'. Interest earned or incurred is recorded in 'Interest income' or '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 consolidated statement of financial position at fair value. Changes in fair value are recorded in 'Trading and investment securities gains - net'. Interest earned or incurred is recorded in 'Interest income' or '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.

*Loans and receivables*
Significant accounts falling under this category are loans and receivables, amounts due from BSP and other banks, interbank loans receivable, securities held under agreements to resell and receivable from SPV.

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 and other deferred income').

After initial measurement, 'Loans and receivables', 'Due from BSP', 'Due from other banks', 'Interbank loans receivable', 'Securities held under agreements to resell' and 'Receivable from SPV' 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 EIR. The amortization is included in 'Interest income' in the consolidated statement of income. The losses arising from impairment are recognized in 'Provision for impairment and credit losses' in the consolidated 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 consolidated 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 on AFS investments' in the statement of other comprehensive income.

When the security is disposed of, the cumulative gain or loss previously recognized in OCI is recognized as 'Trading and investment securities gains - net' in the consolidated statement of income. Interest earned on holding AFS debt investments are reported as 'Interest income' using the EIR. Dividends earned on holding AFS equity investments are recognized in the consolidated statement of income as 'Miscellaneous income' when the right of payment has been established.

The losses arising from impairment of such investments are recognized as 'Provision for impairment and credit losses' in the consolidated statement of income.

*Other financial liabilities*
Issued financial instruments or their components, which are not designated at FVPL, are classified as deposit liabilities, bills and acceptances payable, subordinated debt and other appropriate financial liability accounts, 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.

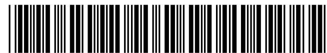
After initial measurement, other financial liabilities not qualified as and not designated at FVPL are subsequently measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any discount or premium on the issue and fees that are an integral part of the EIR.

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 consolidated 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 consolidated statement of financial position. The corresponding cash received, including accrued interest, is recognized in the consolidated statement of financial position 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 consolidated statement of financial position. The Group is not permitted to sell or repledge the securities in the absence of default by the owner of the collateral. The corresponding cash paid, including accrued interest, is recognized on the consolidated statement of financial position 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 reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is 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 financial assets carried at amortized costs such as loans and receivables, HTM investments, due from BSP and other banks, interbank loans receivable, securities held under agreements to resell and receivable from SPV, 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 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 EIR. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR, adjusted for the original credit risk premium. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

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.

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

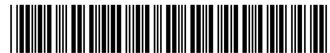
The carrying amount of the asset is reduced through use of an allowance account and the amount of loss is charged to the statement of income. Interest income continues to be recognized based on the original EIR of the asset. Loans and receivables, together with the associated allowance accounts, are 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.

*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 EIR. The difference between the recorded value of the original loan and the present value of the restructured cash flows, discounted at the original EIR, is recognized in ‘Provision for impairment and credit losses’ in the consolidated statement of income.

*AFS investments*
For AFS investments, the Group assesses at each reporting 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 OCI.

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. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortized cost and the current fair value, less any impairment loss on that investment previously recognized in profit or loss. Future interest income is based on the reduced carrying amount and is accrued based on the rate of interest used to discount future cash flows for the purpose of measuring impairment loss.



Such accrual is recorded as part of 'Interest income' in the consolidated 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 consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

Offsetting Financial Instruments

Financial instruments are offset and the net amount reported in the consolidated statement of financial position 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 consolidated statement of financial position.

Residual Value of Leased Assets and Deposits on Finance Leases

The residual 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 residual 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 consolidated statement of income in 'Provision for impairment and credit losses'. Any financial guarantee liability remaining is recognized in the consolidated 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 Group assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent. The Group has concluded that it is acting as a principal in all of its revenue arrangements except for their brokerage transactions. 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 HFT and AFS investments, interest income is recorded at the EIR, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options), includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses. The adjusted carrying amount is calculated based on the original EIR. The change in

carrying amount is recorded as 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 EIR 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, trust fees, portfolio and other management fees, and advisory fees.

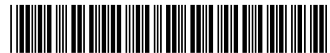
However, loan commitment fees for loans that are likely to be drawn down are deferred (together with any incremental costs) and recognized as an adjustment to the EIR of the loan.

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, remittance fees, brokerage fees, deposit-related and other credit-related 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 EIR as for the other participants.

*Interchange fee and awards revenue on credit cards*
Discounts lodged under 'Interchange fees' are taken up as income upon receipt from member establishments of charges arising from credit availments by the Group's cardholders. These discounts are computed based on certain agreed rates and are deducted from amounts remitted to the member establishments.

The Group operates a loyalty points program which allows customers to accumulate points when they purchase from member establishments using the issued card of the Group. The points can then be redeemed for free products subject to a minimum number of points being obtained. Consideration received is allocated between the discounts earned, interchange fee and the points earned, with the consideration allocated to the points equal to its fair value. The fair value is determined by applying statistical analysis. The fair value of the points issued is deferred and recognized as revenue when the points are redeemed.

*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 and other deferred income' account and is shown as a deduction from 'Loans and receivables' in the consolidated statement of financial position. The unearned and other deferred income is taken up to income over the installment terms and is computed using the effective interest method.



*Commission earned on reinsurance*
Reinsurance commissions are recognized as revenue over the period of the contracts. The portion of the commissions that relates to the unexpired periods of the policies at the end of the reporting period is accounted for as 'Other liabilities' in the consolidated statement of financial position.

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

*Trading and investment securities gains - net*
Trading and investment securities gains - net includes results arising from trading activities, 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 consolidated statement of income under 'Miscellaneous income'.

*Income on direct financing leases and receivables financed*
Income of the Group on loans and receivables financed is recognized using the effective interest method.

Unearned discounts included under 'Unearned and other deferred income' 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 residual value of the leased equipment over its cost.

*Premiums Revenue*
Gross insurance written premiums comprise the total premiums receivable for the whole period of cover provided by contracts entered into during the accounting period. Premiums include any adjustments arising in the accounting period for premiums receivable in respect of business written in prior periods. Premiums from short-duration insurance contracts are recognized as revenue over the period of the contracts using the 24th method except for marine cargo where the provision for unearned premiums pertains to the premiums for the last two months of the year. The portion of the premiums written that relate to the unexpired periods of the policies at end of reporting period are accounted for as provision for unearned premiums and presented as part of 'Other liabilities' in the consolidated statement of financial position. The related reinsurance premiums ceded that pertain to the unexpired periods at the end of the reporting periods are accounted for as deferred reinsurance premiums shown as part of 'Other assets' in the consolidated statement of financial position. The net changes in these accounts between end of the reporting periods are credited to or charged against the consolidated statement of income for the period.

*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 when the collectibility of the sales price is reasonably assured.

Expenses
Expenses encompass losses as well as those expenses that arise in the course of the ordinary activities of the Group. Expenses are recognized when incurred.

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.

Investments in Subsidiaries and Associates
*Investments in subsidiaries*
Subsidiaries pertain to entities over which the Group has control. The existence and effect of potential voting rights that are currently exercisable or convertible and qualitative criteria are considered when assessing whether the Group controls another entity (see Basis of Consolidation).

*Investment in an associate*
Associates pertain to entities 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 statement of financial position at cost plus post-acquisition changes in the Group's share of the net assets of the associates, less impairment in value, if any. 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 or other adjustments is recognized directly in equity. When the Group's share of losses in associates 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's separate financial statements, investments in subsidiaries and an associate are carried at cost, less any impairment in value.

Policy Loans
Policy loans included under loans and receivables are carried at their unpaid balances plus accrued interest and are fully secured by the policy values on which the loans are made.

Reinsurance
The Group cedes insurance risk in the normal course of business. Reinsurance assets represent balances due from reinsurance companies. Recoverable amounts are estimated in a manner consistent with the outstanding claims provision and are in accordance with the reinsurance contract.

An impairment review is performed at each end of the reporting period or more frequently when an indication of impairment arises during the reporting year. Impairment occurs when objective evidence exists that the Group may not recover outstanding amounts under the terms of the contract and when the impact on the amounts that the Group will receive from the reinsurer can be measured reliably. The impairment loss is charged against the consolidated statement of income.

Ceded reinsurance arrangements do not relieve the Group from its obligations to policyholders.

The Group also assumes reinsurance risk in the normal course of business for insurance contracts. Premiums and claims on assumed reinsurance are recognized as income and expenses in the same manner as they would be if the reinsurance were considered direct business, taking into account the product classification of the reinsured business. Reinsurance liabilities represent balances due to ceding companies. Amounts payable are estimated in a manner consistent with the associated reinsurance contract.

Premiums and claims are presented on a gross basis for both ceded and assumed reinsurance.

Reinsurance assets or liabilities are derecognized when the contractual rights are extinguished or expired or when the contract is transferred to another party.

Deferred Acquisition Cost (DAC)
Commission and other acquisition costs incurred during the financial period that vary with and are related to securing new insurance contracts and/or renewing existing insurance contracts, but which relates to subsequent financial periods, are deferred to the extent that they are recoverable out of future revenue margins. All other acquisition costs are recognized as an expense when incurred.

Subsequent to initial recognition, these costs are amortized using the 24th method except for marine cargo where the DAC pertains to the commissions for the last two months of the year. Amortization is charged to the consolidated statement of income. The unamortized acquisition costs are shown as 'Deferred acquisition costs' in the assets section of the statement of financial position.

An impairment review is performed at each end of the reporting period or more frequently when an indication of impairment arises. The carrying value is written down to the recoverable amount and the impairment loss is charged to the consolidated statement of income. The DAC is also considered in the liability adequacy test for each reporting period.

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 revalued amounts less any impairment in value while buildings are stated at revalued amount less accumulated depreciation and any impairment in value. The revalued amounts were determined by professionally qualified, independent appraisers. The revalued amounts take into account the market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use. The revaluation increment resulting from revaluation is credited to the 'Revaluation increment on land and buildings' in the consolidated statement of comprehensive income, net of applicable deferred income tax.

The Group has elected to transfer the revaluation increment to Surplus, in full, upon disposal of the asset.

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:

| | 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 from derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statement of income in the period the asset is derecognized.

<u>Investment Properties</u>

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. Any gain or loss on exchange is recognized in the statement of income under 'Net gain on sale or exchange of assets'. Foreclosed properties are classified under 'Investment properties' upon:

a. entry of judgment in case of judicial foreclosure;
b. execution of the Sheriff's Certificate of Sale in case of extra-judicial foreclosure; or
c. notarization of the Deed of Dacion in case of payment in kind (dacion en pago).

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

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.

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 'Net gain on sale or exchange of assets' 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.

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.

Other Properties Acquired
Other properties acquired include chattel mortgage properties acquired in settlement of loan receivables. These are carried at cost, which is the fair value at recognition date, less accumulated depreciation and any impairment in value.

The Group applies the cost model in accounting for other properties acquired. Depreciation is computed on a straight-line basis over the estimated useful life of five years. The estimated useful life and the depreciation method are reviewed periodically to ensure that the period and the method of depreciation are consistent with the expected pattern of economic benefits from items of other properties acquired.

The carrying values of other properties acquired are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amounts (see accounting policy on Impairment of Nonfinancial Assets).

Real Estate Inventories
Foreclosed properties that are being developed or constructed for sale rather than to be held for rental or capital appreciation, is held as real estate inventory. Real estate inventories consist of parcels of land that are carried at lower of cost or net realizable value.

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 consolidated statement of income (see accounting policy on Nonfinancial 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. The estimated useful life and the amortization method are reviewed periodically to ensure that the period and the method of amortization are consistent with the expected pattern of economic benefits from the software.

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

Impairment of Nonfinancial Assets

*Property and equipment, investment properties, other properties acquired, exchange trading right and software costs*

At each reporting date, the Group assesses whether there is any indication that its property and equipment, investment properties, other properties acquired and software costs 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 consolidated 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.

Exchange trading right which has an indefinite useful life is tested for impairment annually irrespective of any impairment indicators at year end either individually or at the cash generating unit level, as appropriate.

*Investment in an associate*

The Parent Company assesses at each reporting date whether there is any indication that its investment in an associate may be impaired. If any indication exists, the Parent Company estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash generating unit's (CGU) fair value less costs to sell and its value in use. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

*Goodwill*
Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

Impairment is determined for goodwill by assessing the recoverable amount of the cash-generating unit (or group of cash-generating units) to which the goodwill relates. Where the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount of the cash-generating unit (or group of cash-generating units) to which goodwill has been allocated (or to the aggregate carrying amount of a group of cash-generating units to which the goodwill relates but cannot be allocated), an impairment loss is recognized immediately in the consolidated statement of income. Impairment losses relating to goodwill cannot be reversed for subsequent increases in its recoverable amount in future periods. The Group performs its annual impairment test of goodwill at reporting date.

Business Combinations and Goodwill
Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interest in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group as an acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the Group as an acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date. During the measurement period, the Group as an acquirer shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the Group as an acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

If the business combination is achieved in stages, the previously held equity interest is remeasured at its acquisition date fair value and any resulting gain or loss is recognised in the consolidated statement of income. Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of PAS 39 *Financial Instruments: Recognition and Measurement*, is measured at fair value with changes in fair value recognised either in the consolidated statement of income or as a change to OCI. If the contingent consideration is not within the scope of PAS 39, it is measured in accordance with the appropriate PFRS. Contingent consideration that is classified as equity is not remeasured and subsequent settlement is accounted

for within equity. Goodwill is initially measured at cost, being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interest over the net identifiable assets acquired and liabilities assumed. If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the gain is recognised in the consolidated statement of income

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. Where goodwill has been allocated to a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the disposed operation is included in the carrying amount of the operation when determining the gain or loss on disposal. Goodwill disposed in these circumstance is measured based on the relative values of the disposed operation and the portion of the cash-generating unit retained.

Where there are business combinations in which all the combining entities within the Group are ultimately controlled by the same ultimate parent before and after the business combination and that the control is not transitory ("business combinations under common control"), the Group accounts such business combinations under the purchase method of accounting, if the transaction was deemed to have substance from the perspective of the reporting entity. In determining whether the business combination has substance, factors such as the underlying purpose of the business combination and the involvement of parties other than the combining entities such as the noncontrolling interest, shall be considered.

In cases where the business combination has no substance, the Group shall account for the transaction similar to a pooling of interests. The assets and liabilities of the acquired entities and that of the Group are reflected at their carrying values. The difference in the amount recognized and the fair value of the consideration given, is accounted for as an equity transaction, i.e., as either a contribution or distribution of equity. Further, when a subsidiary is disposed in a common control transaction, the difference in the amount recognized and the fair value consideration received, is also accounted for as an equity transaction.

Life Insurance Contract Liabilities

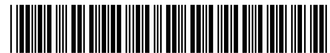
*Life insurance liabilities*

Life insurance liabilities refer to liabilities of the company that are recognized due to the obligations arising from policy contracts issued by PNB LII. The reserves for life insurance contracts are calculated based on prudent statutory assumptions in accordance with generally accepted actuarial methods that are compliant with existing regulations.

*Insurance contracts with fixed and guaranteed terms*

The liability is determined as the expected discounted value of the benefit payments less the expected discounted value of the theoretical premiums that would be required to meet the benefits based on the valuation assumptions used. The liability is based on mortality, morbidity and investment income assumptions that are established at the time the contract is issued.

For unpaid claims and benefits, a provision is made for the estimated cost of all claims and dividends notified but not settled at the reporting date less reinsurance recoveries, using the information available at the time.



Provision is also made for the cost of claims incurred but not reported (IBNR) until after the reporting date based on the PNB LII's experience and historical data. Differences between the provision for outstanding claims at the reporting date and subsequent revisions and settlements are included in the consolidated statement of income in later years. Policy and contract claims payable forms part of the liability section of the consolidated statement of financial position under 'Other liabilities - Insurance contract liabilities'.

Aggregate reserve for life policies represents the accumulated total liability for policies in force on the statement of financial position date. Such reserves are established at amounts adequate to meet the estimated future obligations of all life insurance policies in force. The reserves are calculated using actuarial methods and assumptions in accordance with statutory requirements and as approved by the Insurance Commission (IC), subject to the minimum liability adequacy test.

*Unit-linked insurance contracts*
PNB LLI issues unit-linked insurance contracts. Considerations received from unit-linked insurance contracts, in excess of the portion that is placed under a withdrawable segregated account, are recognized as revenue.

PNB LLI's revenue from unit-linked contracts consists of charges deducted from the policyholder's separate account, in accordance with the unit-linked policy contract. Since the segregated fund assets belong to the unit-linked policyholders, corresponding segregated fund liabilities are set-up equal to the segregated fund assets less redemptions outside the segregated funds. The segregated fund assets are valued at market price. Changes in the segregated fund assets due to investment earnings or market value fluctuations result in the same corresponding change in the segregated fund liabilities. Such changes in fund value have no effect in the consolidated statement of income. Collections received from unit-linked policies are separated to segregated fund assets from which PNB LLI withdraws administrative and cost of insurance charges in accordance with the policy provisions of the unit-linked insurance contracts. After deduction of these charges, the remaining amounts in the segregated fund assets are equal to the surrender value of the unit-linked policyholders, and are withdrawable anytime.

The equity of each unit-linked policyholder in the fund is monitored through the designation of outstanding units for each policy. Hence, the equity of each unit-linked insurance contract in the fund is equal to the total number of outstanding units of the policyholder multiplied by the net asset value per unit (NAVPU). The NAVPU is the market value of the fund divided by the total number of outstanding units.

Nonlife Insurance Contract Liabilities
*Provision for unearned premiums*
The proportion of written premiums, gross of commissions payable to intermediaries, attributable to subsequent periods or to risks that have not yet expired is deferred as provision for unearned premiums. Premiums from short-duration insurance contracts are recognized as revenue over the period of the contracts using the 24th method except for marine cargo where the provision for unearned premiums pertains to the premiums for the last two months of the year. The portion of the premiums written that relate to the unexpired periods of the policies at the end of reporting period are accounted for as provision for unearned premiums and presented as part of 'Insurance contract liabilities' in the liabilities section of the consolidated statement of financial position. The change in the provision for unearned premiums is taken to the consolidated statement of income in the order that revenue is recognized over the period of risk. Further provisions are made to cover claims under unexpired insurance contracts which may exceed the unearned premiums and the premiums due in respect of these contracts.

*Claims provision and incurred but not reported (IBNR) losses*
Outstanding claims provisions are based on the estimated ultimate cost to all claims incurred but not settled at the end of the reporting period, whether reported or not, together with related claims handling costs and reduction for the expected value of salvage and other recoveries. Delays can be experienced in the notification and settlement of certain types of claims, therefore the ultimate cost of which cannot be known with certainty at the end of the reporting period. The liability is not discounted for the time value of money and includes provision for IBNR. No provision for equalization or catastrophic reserves is recognized. The liability is derecognized when the contract has expired, is discharged or cancelled.

Liability Adequacy Test
Liability adequacy tests on life insurance contracts are performed annually to ensure the adequacy of the insurance contract liabilities. In performing these tests, current best estimates of future contractual cash flows, claims handling and policy administration expenses are used. Any deficiency is immediately charged against profit or loss initially by establishing a provision for losses arising from the liability adequacy tests.

For nonlife insurance contracts, liability adequacy tests are performed at the end of each reporting date to ensure the adequacy of insurance contract liabilities, net of related DAC assets. The provision for unearned premiums is increased to the extent that the future claims and expenses in respect of current insurance contracts exceed future premiums plus the current provision for unearned premiums.

Reserve for Policyholders' Dividends
A number of insurance contracts are participating and contain a DPF. This feature entitles the policy holder to receive, as a supplement to guaranteed benefits, annual policy dividends that are credited at each policy anniversary, as long as the policy is in force. These annual policy dividends represent a portion of the theoritical investment and underwriting gains from the pool of contracts. Policy dividends are not guaranteed and may change based on the periodic experience review of the Group. Further, in accordance with regulatory requirements, dividends payable in the following year are prudently set-up as a liability in the statement of financial position.

Local statutory regulations and the terms and conditions of these contracts set out the bases for the determination of the annual cash dividends at the time the product is priced. The Group may exercise its discretion to revise the dividend scale in consideration of the emerging actual experience on each block of participating policies. Reserve for dividends to policyholders on contracts with DPF is shown in the consolidated statement of financial position under 'Insurance provisions'.

There is no statutory requirement as to the level of eligible surplus that may be attributed to participating policyholders. The amount distributed to individual policyholders is at the discretion of the Group, subject to the endorsement of the Chief Finance Officer and approval by the BOD.

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.

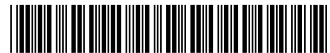
Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the consolidated statement of income on a straight-line basis over the lease term.

*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 consolidated statement of financial position 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 consolidated 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
*Defined benefit plan*
The net defined benefit liability or asset is the aggregate of the present value of the defined benefit obligation at the end of the reporting period reduced by the fair value of plan assets and adjusted for any effect of limiting a net defined benefit asset to the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The cost of providing benefits under the defined benefit plans is actuarially determined using the projected unit credit method.



Defined benefit costs comprise the following:
(a) service cost;
(b) net interest on the net defined benefit liability or asset; and
(c) remeasurements of net defined benefit liability or asset.

Service costs which include current service costs, past service costs and gains or losses on non-routine settlements are recognized as expense in profit or loss. Past service costs are recognized when plan amendment or curtailment occurs.

Net interest on the net defined benefit liability or asset is the change during the period in the net defined benefit liability or asset that arises from the passage of time which is determined by applying the discount rate based on high quality corporate bonds to the net defined benefit liability or asset. Net interest on the net defined benefit liability or asset is recognized as expense or income in profit or loss.

Remeasurements comprising actuarial gains and losses, return on plan assets and any change in the effect of the asset ceiling (excluding net interest on defined benefit liability) are recognized immediately in OCI in the period in which they arise. Remeasurements are not reclassified to profit or loss in subsequent periods.

Plan assets are assets that are held by a long-term employee benefit fund or qualifying insurance policies. Plan assets are not available to the creditors of the Group, nor can they be paid directly to the Group. Fair value of plan assets is based on market price information. When no market price is available, the fair value of plan assets is estimated by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligations).

The Group's right to be reimbursed of some or all of the expenditure required to settle a defined benefit obligation is recognized as a separate asset at fair value when and only when reimbursement is virtually certain.

*Employee leave entitlement*
Employee entitlements to annual leave are recognized as a liability when they are accrued to the employees. The undiscounted liability for leave expected to be settled wholly before twelve months after the end of the annual reporting period is recognized for services rendered by employees up to the end of the reporting period.

*Defined contribution plan*
For maximum benefits under the Plan, the Parent Company provides an Employee Investment and Savings Program (EISP) wherein an employee may invest monthly during his employment an amount not less than 1.00% of monthly salary but not more than 50.00% of his net monthly salary in the EISP. Upon retirement, an employee who has also availed of the EISP shall receive an additional benefit from the Plan plus a return of his investment in EISP including related interests.

The Parent Company also contributes to this contributory, defined-contribution type EISP 1 based on the shortfall in guaranteed return for employees of ABC who are members of EISP prior to July 2009 resulting from the business combination and as defined in the plan which is recorded as an expense under 'Compensation and fringe benefits' in the consolidated statement of income. Unpaid contributions, if any, are recorded as a liability.

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 consolidated 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
Income tax on profit and loss for the year comprises current and deferred tax. Income tax is determined in accordance with tax laws. Income tax is recognized in the statement of income, except to the extent that it relates to items directly recognized in OCI.

*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 reporting date.

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

Deferred tax liabilities are recognized for all taxable temporary differences, 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 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 reporting date and reduced to the extent that it is no longer probable that sufficient future 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 reporting 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 reporting date.

Current tax and deferred tax relating to items recognized directly in OCI are also recognized in OCI and not in the consolidated statement of income.

In the consolidated financial statements, 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 by subsidiaries (treasury shares) are deducted from equity and accounted for at weighted average cost. No gain or loss is recognized in the consolidated 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 by the weighted average number of common shares outstanding during the period adjusted for the effects of any dilutive 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 reporting date are dealt with as an event after the reporting 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 included in the measurement of the related carrying value of the debt instruments in the statement of financial position.

Borrowing Costs
Borrowing costs are recognized as expense in the year in which these costs are incurred. Borrowing costs consist of interest expense calculated using the effective interest method calculated in accordance with PAS 39 that the Group incurs in connection with borrowing of funds.

Events after the Reporting date
Any post-year-end event that provides additional information about the Group's position at the reporting 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 6 for the 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.

Equity
Capital stock is measured at par value for all shares issued and outstanding. When the shares are sold at a premium, the difference between the proceeds and the par value is credited to 'Capital paid-in excess of par value' account. Direct costs incurred related to equity issuance, such as underwriting, accounting and legal fees, printing costs and taxes are chargeable to 'Capital paid-in excess of par value' account. If the 'Capital paid-in excess of par value' is not sufficient, the excess is charged against the 'Surplus'.

'Surplus' represents accumulated earnings (losses) of the Group less dividends declared.

Equity Reserves
The reserves recorded in equity in the statement of financial position include:

'Revaluation increment on land and building' which comprises changes in fair value of land and building.

'Cumulative amount of actuarial losses' which pertains to remeasurement comprising actuarial losses net of return on plan assets.

'Accumulated translation adjustment' which is used to record exchange differences arising from the translation of the FCDU accounts and foreign operations to Philippine peso.

'Net unrealized gain on available-for-sale investments' reserve which comprises changes in fair value of AFS investments.

**Future Changes in Accounting Policies**

The Group will adopt the standards and interpretations enumerated below when these become effective. Except as otherwise indicated, the Group does not expect the adoption of these new and amended PFRS, PAS and Philippine Interpretations to have significant impact on its consolidated financial statements.

**New Standards and Interpretations**

PAS 32, *Financial Instruments: Presentation - Offsetting Financial Assets and Financial Liabilities* (Amendments)
The amendments clarify the meaning of "currently has a legally enforceable right to set-off" and also clarify the application of the PAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The amendments affect presentation only and have no impact on the Group's financial position or performance. The amendments to PAS 32 are to be retrospectively applied for annual periods beginning on or after January 1, 2014.

PFRS 9, *Financial Instruments*
PFRS 9, as issued, reflects the first phase on the replacement of PAS 39 and applies to the classification and measurement of financial assets and liabilities as defined in PAS 39, *Financial Instruments: Recognition and Measurement*. Work on impairment of financial instruments and hedge accounting is still ongoing, with a view to replacing PAS 39 in its entirety. PFRS 9 requires all financial assets to be measured at fair value at initial recognition.

A debt financial asset may, if the fair value option (FVO) is not invoked, be subsequently measured at amortized cost if it is held within a business model that has the objective to hold the assets to collect the contractual cash flows and its contractual terms give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal outstanding. All other debt instruments are subsequently measured at fair value through profit or loss. All equity financial assets are measured at fair value either through OCI or profit or loss. Equity financial assets held for trading must be measured at fair value through profit or loss. For FVO liabilities, the amount of change in the fair value of a liability that is attributable to changes in credit risk must be presented in OCI. The remainder of the change in fair value is presented in profit or loss, unless presentation of the fair value change in respect of the liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss. All other PAS 39 classification and measurement requirements for financial liabilities have been carried forward into PFRS 9, including the embedded derivative separation rules and the criteria for using the FVO. The adoption of the first phase of PFRS 9 will have an effect on the classification and measurement of the Group's financial assets, the Group is still evaluating the effects of the adoption of PFRS 9.

PFRS 9 is effective for annual periods beginning on or after January 1, 2015.

Philippine Interpretation IFRIC 15, *Agreements for the 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. The 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 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 reward of ownership are transferred to the buyer on a continuous basis will also be accounted for based on stage of completion. The SEC and the Financial Reporting Standards Council have deferred the effectivity of this interpretation until the final Revenue standard is issued by the International Accounting Standards Board and an evaluation of the requirements of the final Revenue standard against the practices of the Philippine real estate industry is completed.

3. **Significant Accounting Judgments and Estimates**

The preparation of the consolidated 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 consolidated 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) Leases*

Operating lease

*Group as lessor*

The Group has entered into commercial property leases on its investment properties and certain motor vehicles and items of machinery.

The Group has determined, based on an evaluation of the terms and conditions of the lease agreements (i.e., the lease does not transfer ownership of the asset to the lessee by the end of the lease term, the lessee has no option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option is exercisable and the lease term is not for the major part of the asset's economic life), that it retains all the significant risks and rewards of ownership of these properties and so accounts for these leases as operating leases.

*Group as lessee*

The Group has entered into lease on premises it uses for its operations. The Group has determined, based on the evaluation of the terms and conditions of the lease agreement (i.e., the lease does not transfer ownership of the asset to the lessee by the end of the lease term and lease term is not for the major part of the asset's economic life), that the lessor retains all the significant risks and rewards of ownership of these properties.

Finance leases

The Group has entered into lease arrangements on real estate, various machineries and other types of equipment. The Group has determined that it transfers all the significant risks and rewards of ownership of these properties and so accounts for these leases as finance lease.

*(b) Fair value of financial instruments*

Where the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using valuation techniques that include the use of mathematical models (see Note 5). 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) 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.

*(d) Embedded derivatives*
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.

*(e) 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 counsels handling the Group's defense in these matters and is based upon an analysis of potential results. Management does not believe that the outcome of these matters 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 the proceedings (see Note 33).

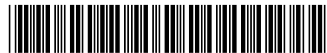
*(f) Functional currency*
PAS 21 requires management to use its judgment to determine the entity's functional currency such that it most faithfully represents the economic effects of the underlying transactions, events and conditions that are relevant to the entity.

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.

*(g) Product classification*
The Group classified its unit-linked products as insurance contracts due to the significant insurance risk at issue. All of the Group's products are classified and treated as insurance contracts.

*(h) Assessment of control over the entities for consolidation*
The Group has majority owned subsidiaries discussed in Note 2. Management concluded that the Group controls these majority owned subsidiaries arising from voting rights and, therefore, consolidates the entity in its consolidated financial statements. In addition, the Group accounts for its investments in OHBVI as a subsidiary although the Group holds less than 50.00% of OHBVI's issued share capital on the basis of the voting rights of 42.78% assigned by certain stockholders to the Parent Company. Management concluded that the Group has the ability to control the relevant activities and to affect its returns in OHBVI on the basis of the combined voting rights arising from its direct ownership and assigned voting rights of 70.56%.



Furthermore, PNB Venture Capital Corporation is 61%-owned by the Parent Company and carried at cost less any impairment in value. However, management concluded not to consolidate this subsidiary since it is for dissolution and considered insignificant to the Group.

Estimates

(a) *Credit losses on loans and receivables and receivables from SPV*
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.

Refer to Notes 9 and 10 for the carrying values of loans and receivables and receivable from SPVs, respectively.

(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 5 and 23 for information on the fair values of these instruments.

(c) *Valuation of unquoted AFS equity investments*
The Group's investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are carried at cost. Refer to Note 8 for the carrying value of unquoted AFS securities.

(d) *Impairment of AFS debt investments*
The Group reviews its debt investments classified as AFS investments at each reporting date to assess whether they are impaired. This requires similar judgment as applied to the individual assessment of loans and receivables.

As of March 31, 2013 and December 31, 2012, no allowance for impairment losses was provided on AFS debt investments. Refer to Note 8 for the carrying value of AFS debt 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 March 31, 2013 and December 31, 2012, allowance for impairment losses on AFS equity investments amounted to ₱928.4 million for the Group. Refer to Note 8 for the information on the carrying amounts of these investments.

(f) *Recognition of deferred tax assets*
Deferred tax assets are recognized for all unused tax losses and temporary differences to the extent that it is probable that future 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.

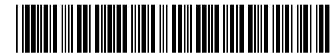
The Group's estimates of future taxable income indicate that certain temporary differences will be realized in the future. As discussed in Note 29, recognized net deferred tax assets as of March 31, 2013 and December 31, 2012 amounted to ₱0.9 billion and ₱1.8 billion for the Group, respectively. Refer to Note 29 for deferred tax assets not recognized since the Group believes that it is not probable that the related tax benefits will be realized in the future.

(g) *Fair valuation in business combination*
The Group determines the acquisition-date fair values of identifiable assets acquired and liabilities assumed from the acquiree without quoted market price based on the following:

- for assets and liabilities that are short term in nature, carrying values approximate fair values
- for financial assets and liabilities that are long term in nature, fair values are estimated through the discounted cash flow methodogy, using the appropriate market rates (e.g., current lending rates)
- for nonfinancial assets such as property and equipment and investment properties, fair values are determined based an appraisal valuation which follows sales comparison approach and depreciated replacement cost approach
- for deferred tax assets and liabilities, fair values are based on the tax benefit arising from future taxable income from the enlarged operations of the Bank and future deductible expenses of ABC which PNB can utilize

Refer to Note 14 for the details of the fair values of the identifiable assets and liabilities assumed from business combination.

(h) *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 March 31, 2013 and December 31, 2012, the present value of the defined benefit obligation of the Parent Company is disclosed in Note 27.

*(i) Revaluation of property and equipment*

The Group measures the land and buildings under property and equipment at revalued amounts with changes in fair value being recognized in the consolidated statement of comprehensive income. The Group engaged independent valuation specialists to determine the fair value of land and buildings as of March 31, 2013 and December 31, 2012. Refer to Note 11 for the carrying values of land and buildings.

*(j) Impairment of nonfinancial assets*

*Property and equipment, investment in a subsidiary and an associate, investment properties, other properties acquired, goodwill, exchange trading right and software costs*

An impairment exists when the carrying value of an asset or CGU exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The fair value less costs to sell calculation is based on available data from binding sales transactions in an arm's length transaction of similar assets or observable market prices less incremental costs for disposing of the asset. The value in use calculation is based on a discounted cash flow model. 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 uses fair value less cost to sell in determining recoverable amount of its nonfinancial assets except for investment in a subsidiary and an associate and goodwill, where recoverable amount is based on value in use.

Refer to Notes 11, 12, 13, 14 and 15 for the carrying values and allowance for impairment loss of property and equipment, investment in a subsidiary and an associate, investment properties, goodwill, other properties acquired, trading rights and software costs, respectively.

*(k) Aggregate reserves for life policies*

In determining the aggregate reserves for life policies estimates are made as to the expected number of deaths, illness or injury for each of the years in which PNB LII is exposed to risk. These estimates are based on standard mortality and morbidity tables as required by the Insurance Code (IC or the Code). The estimated number of deaths, illness or injury determines the value of possible future benefits to be paid out, which will be factored into ensuring sufficient cover by reserves, which in return is monitored against current and future premiums. Estimates are also made as to future investment income arising from the assets backing life insurance contracts. These estimates are based on current market returns, as well as expectations about future economic and financial developments.

In accordance with the provision of the Code, estimates for future deaths, illness or injury and investment returns are determined at the inception of the contract and are used to calculate the liability over the term of the contract. The interest rate used to discount future liabilities does not exceed 6.00% as required by the Code. Likewise, no lapse, surrender and expense assumptions are factored in the computation of the liability.

(l) *Valuation of insurance contracts*
Estimates have to be made both for the expected ultimate cost of claims reported at reporting date and for the expected ultimate cost of IBNR at the reporting date. It can take a significant period of time before the ultimate claim costs can be established with certainty. Nonlife insurance contract liabilities are not discounted for the time value of money.

The main assumption underlying the estimation of the claims provision is that a company's past claims development experience can be used to project future claims development and hence ultimate claims costs. Historical claims development is mainly analyzed by accident years as well as by significant business lines and claim types. Large claims are usually separately addressed, either by being reserved at the face value of loss adjuster estimates or separately projected in order to reflect their future development.

(m) *Estimated useful lives of property and equipment, investment properties, other properties acquired and software cost*
The Group estimates the useful lives of its property and equipment, investment properties and software cost. 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, investment properties, other properties acquired and software cost.

Refer to Note 2 for the estimated useful lives of property and equipment, investment properties, other properties acquired and software costs.

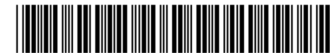
Refer to Notes 11, 13 and 15 for the carrying values of property and equipment, investment properties, other properties acquired and software cost, respectively.

## 4. **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.

The Group monitors its processes associated with the following overall risk categories:

- Credit Risk
- Market Risk
- 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
- Reputational Risk
- Concentration Risk
- Country Risk
- Risks arising from the Group'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 Oversight Committee (ROC) 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 ROC of the Parent Company is also responsible for the risk management of the Group.

The RMG provides the legwork for the ROC 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:

- Implementing the risk management framework of identifying, measuring, controlling and monitoring the various risk taking activities of the Group, inherent in all financial institutions;
- Providing services to the risk-taking units and personnel in the implementation of risk mitigation strategies; and
- Establishing 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 Group 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 ROC and Executive Committee. Credit risk assessment 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 Group 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;
- Pre-approval review of loan proposals;
- Post approval review of implemented loans;
- Work out system for managing problem credits;

- Regular review of the sufficiency of valuation reserves;
- Monitoring of the adequacy of capital for credit risk via the Capital Adequacy Ratio (CAR) report;
- Monitoring of breaches in regulatory and internal limits;
- Credit Risk Management Dashboard;
- Diversification;
- Internal Risk Rating System for corporate accounts;
- Credit Scoring for retail accounts; 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)

Continuous changes have been made in the policies, procedures, system and quality of people. The Group 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 Group and documentary/commercial LCs which are written undertakings by the Group. To mitigate this risk the Group 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.

*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 statement of financial position.

*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 Group 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
- For securities lending and reverse repurchase transactions - cash or securities

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

Management regularly monitors the market value of collateral and requests additional collateral in accordance with the underlying agreement. The existing market value of 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.

The table below shows the maximum exposure for loans and receivable to credit risk (amounts in millions):

| | **March 31, 2013** | | December 31, 2012 | |
|---|---|---|---|---|
| | **Maximum Exposure** | | Maximum Exposure | |
| | **Before Collateral** | **After Financial Effect of Collateral or Credit Enhancement** | Before Collateral | After Financial Effect of Collateral or Credit Enhancement |
| Securities Held Under Agreements to Resell (Note 35) | **₱20,000** | **₱30** | ₱18,300 | ₱– |
| Loans and receivables: | | | | |
| Receivable from customers*: | | | | |
| Business loans | **160,731** | **108,351** | 83,053 | 41,146 |
| GOCCs and National Government Agencies (NGAs) | **25,141** | **16,532** | 24,410 | 27,753 |
| Consumers | **7,823** | **5,478** | 7,157 | 4,794 |
| LGUs | **22,341** | **11,422** | 11,197 | 2,337 |
| Fringe benefits | **631** | **158** | 643 | 168 |
| Unquoted debt securities | **7,649** | **4,908** | 3,859 | 1,662 |
| Other receivable | **14,989** | **13,529** | 12,569 | 7,492 |
| | **₱259,305** | **₱160,408** | ₱161,188 | ₱85,352 |

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
*Receivables from customers exclude residual value of the leased asset.

Fair values of collateral held for securities held under agreements to resell and loans and receivables amounted to ₱20.0 billion and ₱300.2 billion, respectively as of March 31,2013 and ₱18.9 billion and ₱234.7 billion, respectively as of December 31, 2012.

The maximum exposure to credit risks for the other financial assets is limited to their carrying values as of March 31, 2013 and December 31, 2012.

*Excessive risk concentration*
Credit risk concentrations can arise whenever a significant number of borrowers have similar characteristics. The Group 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 Group 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.

a. Limit per Client or Counterparty
   For loans and receivables, the Group sets an internal limit for group exposures which is equivalent to 100.00% of the single borrower's limit (SBL) for loan accounts with credit risk rating (CRR) 1 to CRR 5 or 50.00% of SBL if rated below CRR 5.

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

b. Geographic concentration
The table below shows the credit risk exposures of the Group's financial assets, before taking into account any collateral held or other credit enhancements, categorized by geographic location (in millions):

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Philippines | **₱435,939** | ₱265,520 |
| USA and Canada | **10,546** | 4,238 |
| Asia (excluding the Philippines) | **17,948** | 6,107 |
| United Kingdom | **4,350** | 5,355 |
| Other European Union Countries | **8,538** | 3,706 |
| Middle East | **9** | 2 |
| | **₱477,330** | ₱284,928 |

c. Concentration by Industry
The table below shows the industry sector analysis of the Group's financial assets at amounts before taking into account the fair value of the loan collateral held or other credit enhancements (amounts in millions).

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| **Loans and Receivables** | | |
| Receivable from customers: | | |
| Primary target industry: | | |
| Wholesale and retail | **₱38,183** | ₱20,682 |
| Manufacturing | **28,709** | 11,637 |
| Electricity, gas and water | **26,066** | 18,104 |
| Public administration and defense | **24,113** | 22,623 |
| Transport, storage and communication | **23,755** | 16,335 |
| Financial intermediaries | **16,206** | 10,172 |
| Agriculture, hunting and forestry | **3,368** | 2,774 |
| Secondary target industry: | | |
| Real estate, renting and business activities | **27,378** | 9,568 |
| Construction | **5,016** | 2,345 |
| Others* | **23,874** | 12,222 |
| Unquoted debt securities: | | |
| Government | **6,858** | 3,699 |
| Financial intermediaries | **642** | – |
| Manufacturing | **149** | 160 |
| | **7,649** | 3,859 |
| Other receivables*** | **14,989** | 12,569 |
| | **239,306** | 142,890 |

(Forward)

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| **Trading and Investment Securities** | | |
| Government | **₱87,756** | ₱57,865 |
| Financial intermediaries | **13,063** | 7,096 |
| Real estate, renting and business activities | **2,493** | 1,225 |
| Electricity, gas and water | **829** | 2,461 |
| Manufacturing | **511** | 22 |
| Others | **6,765** | 2,352 |
| | **111,417** | 71,021 |
| **Other Financial Assets****** | | |
| Financial intermediaries | **117,837** | 71,016 |
| Government | **–** | – |
| Others | **8,770** | 1 |
| | **126,607** | 71,017 |
| | **₱477,330** | ₱284,928 |

* Receivables from customers exclude residual value of the leased asset.
** Others include the following sectors - Other community, social and personal services, private household, hotel and restaurant, education, mining and quarrying, and health and social work.
***Other receivables exclude receivables from Bureau of Internal Revenue.
****Other financial assets include the following financial assets: 'Due from BSP', 'Due from other bank', 'Interbank loans receivable', 'Securities held under agreements to resell', 'Receivable from SPV', 'Miscellaneous COCI'.

The internal limit of the Group based on the Philippine Standard Industry Classification (PSIC) sub-industry is 12.00% for priority industry, 8.00% for regular industry and 30.00% for power industry, versus total loan portfolio.

*Credit quality per class of financial assets*
The credit quality of financial assets is assessed and managed using external and internal ratings. For receivable from customers classified as business loans, the credit quality is generally monitored using the 14-grade Credit Risk Rating (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 individual internal risk rating is conducted by the Credit Management 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 such as industry outlook and market competition to provide the main inputs for the measurement of credit or counterparty risk.

The CRRs of the Group's Receivables from customers classified as business loans 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 from 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.

The Group is using the Credit Scoring for evaluating borrowers with assets size below ₱15.0 million. 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 Group’s receivable from customers, gross of allowance for credit losses and unearned and other deferred income, for each CRR as of March 31, 2013 and December 31, 2012 (in millions).

| | March 31, 2013 | | |
|---|---|---|---|
| | **Neither Past Due nor Individually Impaired** | **Past Due or Individually Impaired** | **Total** |
| **Rated Receivable from Customers** | | | |
| 1 – Excellent | **₱11,547** | **₱–** | **₱11,547** |
| 2 – Super Prime | **38,132** | **–** | **38,132** |
| 3 – Prime | **16,584** | **–** | **16,584** |
| 4 – Very Good | **7,636** | **–** | **7,636** |
| 5 – Good | **27,787** | **–** | **27,787** |
| 6 – Satisfactory | **22,052** | **–** | **22,052** |
| 7 – Average | **25,048** | **165** | **25,213** |
| 8 – Fair | **8,532** | **118** | **8,650** |
| 9 – Marginal | **4,587** | **36** | **4,623** |
| 10 – Watchlist | **9,849** | **67** | **9,916** |
| 11 – Special Mention | **2,683** | **82** | **2,765** |
| 12 – Substandard | **524** | **1,788** | **2,312** |
| 13 – Doubtful | **–** | **2,565** | **2,565** |
| 14 – Loss | **–** | **2,786** | **2,786** |
| | **174,961** | **7,607** | **182,568** |
| **Unrated Receivable from Customers** | | | |
| Consumers | **17,684** | **695** | **18,379** |
| Business Loans | **10,193** | **396** | **10,589** |
| LGUs | **7,633** | **263** | **7,896** |
| GOCCs and NGAs | **1,315** | **1,641** | **2,956** |
| Fringe Benefits | **594** | **53** | **647** |
| | **37,419** | **3,048** | **40,467** |
| | **₱212,380** | **₱10,655** | **₱223,035** |

| | December 31, 2012 | | |
|---|---|---|---|
| | Neither Past Due nor Individually Impaired | Past Due or Individually Impaired | Total |
| Rated Receivable from Customers | | | |
| 1 – Excellent | ₱10,948 | ₱– | ₱10,948 |
| 2 – Super Prime | 33,489 | – | 33,489 |
| 3 – Prime | 11,261 | – | 11,261 |
| 4 – Very Good | 6,418 | – | 6,418 |
| 5 – Good | 16,464 | 2 | 16,466 |
| 6 – Satisfactory | 4,897 | – | 4,897 |
| 7 – Average | 6,728 | 19 | 6,747 |
| 8 – Fair | 2,646 | 1 | 2,647 |
| 9 – Marginal | 1,820 | 5 | 1,825 |
| 10 – Watchlist | 4,353 | 6 | 4,359 |
| 11 – Special Mention | 2,321 | 9 | 2,330 |
| 12 – Substandard | 271 | 764 | 1,035 |
| 13 – Doubtful | – | 2,449 | 2,449 |
| 14 – Loss | – | 2,665 | 2,665 |
| | 101,616 | 5,920 | 107,536 |
| Unrated Receivable from Customers | | | |
| Consumers | 10,687 | 770 | 11,457 |
| LGUs | 6,868 | 419 | 7,287 |
| Business Loans | 2,562 | 237 | 2,799 |
| GOCCs and NGAs | 1,391 | 1,651 | 3,042 |
| Fringe Benefits | 622 | 37 | 659 |
| | 22,130 | 3,114 | 25,244 |
| | ₱123,746 | ₱9,034 | ₱132,780 |

Under PFRS 7, a financial asset is past due when a counterparty has failed to make a payment when contractually due. The table below shows the aging analysis of past due but not impaired loans receivables per class (in millions).

| | **March 31, 2013** | | | |
|---|---|---|---|---|
| | **Less than 30 days** | **31 to 90 days** | **91 to 180 days** | **Total** |
| Consumers | **₱81** | **₱103** | **₱264** | **₱448** |
| Business loans | **150** | **263** | **893** | **1,306** |
| Fringe benefits | **–** | **1** | **8** | **9** |
| LGUs | **–** | **–** | **–** | **–** |
| GOCCs and NGAs | **–** | **–** | **–** | **–** |
| Total | **₱231** | **₱367** | **₱1,165** | **₱1,763** |

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | Less than 30 days | 31 to 90 days | 91 to 180 days | Total |
| Consumers | ₱53 | ₱57 | ₱211 | ₱321 |
| Business loans | 6 | 39 | 460 | 505 |
| LGUs | 133 | – | – | 133 |
| Fringe benefits | 1 | 1 | 12 | 14 |
| GOCCs and NGAs | – | – | – | – |
| Total | ₱193 | ₱97 | ₱683 | ₱973 |

Below are the financial assets of the Group, excluding receivable from customers, which are monitored using external ratings (in millions).

| | March 31, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Rated | | | | | |
| | Aaa to Aa3 | A1 to A3 | Baa1 and below | Subtotal | Unrated[6/] | Total |
| Due from BSP [1/] | **₱–** | **₱–** | **₱–** | **₱–** | **₱83,306** | **₱83,306** |
| Due from other banks | **3,466** | **6,384** | **2,460** | **12,310** | **2,707** | **15,017** |
| Interbank loans receivables | **2,697** | **3,478** | **1,489** | **7,664** | **612** | **8,276** |
| Securities held under agreements to resell[2/] | **–** | **–** | **–** | **–** | **20,000** | **20,000** |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | **–** | **–** | **2,977** | **2,977** | **709** | **3,686** |
| Derivative assets[3/] | **8** | **212** | **30** | **250** | **205** | **455** |
| Equity securities | **–** | **–** | **–** | **–** | **301** | **301** |
| Private debt securities | **–** | **–** | **–** | **–** | **27** | **27** |
| Designated at FVPL: | | | | | | |
| Segregated fund assets | **–** | **4,091** | **–** | **4,091** | **–** | **4,091** |
| Private debt securities | **–** | **–** | **–** | **–** | **1,229** | **1,229** |
| Loans and receivables: | | | | | | |
| Unquoted debt securities[4/] | **–** | **–** | **34** | **34** | **7,615** | **7,649** |
| Others[5/] | **10** | **–** | **123** | **133** | **16,513** | **16,646** |
| AFS investments: | | | | | | |
| Government securities | **556** | **57** | **72,938** | **73,551** | **10,952** | **84,503** |
| Other debt securities | **369** | **908** | **4,278** | **5,555** | **9,905** | **15,460** |
| Quoted equity securities | **24** | **–** | **226** | **250** | **1,311** | **1,561** |
| Unquoted equity securities | **–** | **–** | **–** | **–** | **103** | **103** |
| Miscellaneous COCI | **–** | **–** | **–** | **–** | **8** | **8** |

| | December 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Rated | | | | | |
| | Aaa to Aa3 | A1 to A3 | Baa1 and below | Subtotal | Unrated[6/] | Total |
| Due from BSP [1/] | ₱– | ₱– | ₱– | ₱– | ₱37,175 | ₱37,175 |
| Due from other banks | 899 | 1,316 | 973 | 3,188 | 855 | 4,043 |
| Interbank loans receivables | 2,143 | 6,730 | 1,847 | 10,720 | 779 | 11,499 |
| Securities held under agreements to resell[2/] | – | – | – | – | 18,300 | 18,300 |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | – | – | 907 | 907 | 1,064 | 1,971 |
| Derivative assets[3/] | 2 | 274 | 114 | 390 | 65 | 455 |
| Equity securities | – | – | – | – | 250 | 250 |
| Private debt securities | – | – | – | – | 99 | 99 |
| Designated at FVPL: | | | | | | |
| Private debt securities | – | – | – | – | 1,248 | 1,248 |
| Loans and receivables: | | | | | | |
| Unquoted debt securities[4/] | – | – | 31 | 31 | 3,828 | 3,859 |
| Others[5/] | – | – | – | – | 14,057 | 14,057 |
| AFS investments: | | | | | | |
| Government securities | 748 | – | 44,771 | 45,519 | 10,039 | 55,558 |
| Other debt securities | 1,434 | – | 3,255 | 4,689 | 6,231 | 10,920 |
| Quoted equity securities | 13 | – | 134 | 147 | 293 | 440 |
| Unquoted equity securities | – | – | – | – | 79 | 79 |
| Miscellaneous COCI | – | – | – | – | 1 | 1 |

1/ '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 23).

4/ Unquoted debt securities represent investments in bonds and notes issued by financial intermediaries, government and private entities that are not quoted in the market.

5/ Loans and receivables - Others is composed of Accrued interest receivable, Accounts receivable, Sales contracts receivable and other miscellaneous receivables (see Note 9)

6/ As of March 31, 2013 and December 31, 2012, financial assets that are unrated are neither past due nor impaired.

*Impairment assessment*
The Group recognizes impairment/credit 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 Group in assessing and measuring impairment/credit losses include:

a. Specific (individual) assessment
   The Group assesses each individually significant credit exposure or advances for any objective evidence of impairment.

   Among the items and factors considered by the Group when assessing and measuring specific impairment/credit 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/credit 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 receivables and other financial assets.

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

The Group's liquidity management involves maintaining funding capacity to accommodate fluctuations in asset and liability levels due to changes in the Group's business operations or unanticipated events created by customer behavior or capital market conditions. The Group 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 Group on a daily basis through the Treasury Group. Likewise, the RMG monitors the static liquidity through the MCO under normal and stressed scenarios.

The table below shows the financial assets and financial liabilities' liquidity information which includes coupon cash flows categorized based on the expected date on which the asset will be realized and the liability will be settled. For other assets, the analysis into maturity grouping is based on the remaining period from the end of the reporting period to the contractual maturity date or if earlier than the expected date the assets will be realized (in millions).

| | March 31, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | **Up to 1 month** | **1 to 3 months** | **3 to 6 months** | **6 to 12 months** | **Beyond 1 year** | **Total** |
| **Financial Assets** | | | | | | |
| COCI | **₱7,918** | **₱–** | **₱–** | **₱–** | **₱–** | **₱7,918** |
| Due from BSP and other banks | **90,867** | **3,971** | **2,491** | **974** | **19** | **98,322** |
| Interbank loans receivable | **8,038** | **238** | – | – | – | **8,276** |
| Securities held under agreements to resell | **20,043** | – | – | – | – | **20,043** |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | **505** | **15** | **69** | **121** | **6,097** | **6,807** |
| Equity securities | **301** | – | – | – | – | **301** |
| Private debt securities | – | – | – | **1** | **33** | **34** |
| Derivative assets | | | | | | |
| Pay | **(13,581)** | **(9,902)** | **(1,598)** | **(881)** | – | **(25,962)** |
| Receive | **13,866** | **10,385** | **1,594** | **880** | – | **26,725** |
| | **285** | **483** | **(4)** | **(1)** | – | **763** |
| Designated at FVPL: | | | | | | |
| Segregated fund assets | – | – | – | – | **4,091** | **4,091** |
| Private debt securities | – | **1,231** | – | – | – | **1,231** |
| Loans receivables - gross | **36,618** | **33,256** | **7,336** | **7,679** | **183,511** | **268,400** |
| Unquoted debt securities - gross | **93** | **1** | **10** | **2,805** | **9,112** | **12,021** |
| Other receivables - gross | **20,933** | **149** | **25** | **332** | **563** | **22,002** |
| AFS investments | **5,093** | **2,569** | **1,290** | **3,019** | **128,410** | **140,381** |
| Miscellaneous COCI | **8** | – | – | – | – | **8** |
| Total financial assets | **₱190,702** | **₱41,913** | **₱11,217** | **₱14,930** | **₱331,836** | **₱590,598** |
| **Financial Liabilities** | | | | | | |
| Deposit liabilities: | | | | | | |
| Demand | **₱84,151** | **₱–** | **₱–** | **₱–** | **₱–** | **₱84,151** |
| Savings | **210,829** | **24,917** | **8,030** | **8,910** | **12,636** | **265,322** |
| Time | **20,172** | **7,524** | **4,020** | **6,408** | **11,905** | **50,029** |

(Forward)

| | March 31, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | **Up to 1 month** | **1 to 3 months** | **3 to 6 months** | **6 to 12 months** | **Beyond 1 year** | **Total** |
| Financial liabilities at FVPL: | | | | | | |
| Financial liabilities designated at FVPL | **₱838** | **₱797** | **₱338** | **₱436** | **₱15,618** | **₱18,027** |
| Derivative liabilities: | | | | | | |
| Pay | **13,900** | **3,059** | **203** | **163** | **–** | **17,325** |
| Receive | **(13,878)** | **(3,063)** | **(204)** | **(163)** | **–** | **(17,308)** |
| | **22** | **(4)** | **(1)** | **–** | **–** | **17** |
| Bills and acceptances payable | **9,895** | **1,823** | **1,419** | **603** | **1,411** | **15,151** |
| Subordinated debt | **–** | **114** | **275** | **436** | **11,428** | **12,253** |
| Accrued interest payable and other liabilities | **14,733** | **750** | **336** | **823** | **5,399** | **22,041** |
| Total financial liabilities | **₱340,640** | **₱35,921** | **₱14,417** | **₱17,616** | **₱58,397** | **₱466,991** |

| | December 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Up to 1 month | 1 to 3 months | 3 to 6 months | 6 to 12 months | Beyond 1 year | Total |
| **Financial Assets** | | | | | | |
| COCI | ₱5,599 | ₱– | ₱– | ₱– | ₱– | ₱5,599 |
| Due from BSP and other banks | 39,692 | 435 | – | 1,101 | – | 41,228 |
| Interbank loans receivable | 11,129 | 251 | 119 | – | – | 11,499 |
| Securities held under agreements to resell | 18,304 | – | – | – | – | 18,304 |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | 1,978 | 14 | 19 | 36 | 677 | 2,724 |
| Equity securities | 251 | – | – | – | – | 251 |
| Private debt securities | 100 | 1 | 1 | 3 | 29 | 134 |
| Derivative assets | | | | | | |
| Pay | (6,056) | (716) | (22) | (67) | (52) | (6,913) |
| Receive | 6,079 | 788 | 24 | 153 | 222 | 7,266 |
| | 23 | 72 | 2 | 86 | 170 | 353 |
| Designated at FVPL: | | | | | | |
| Private debt securities | 4 | 8 | 1,255 | – | – | 1,267 |
| Loans receivables - gross | 24,188 | 13,517 | 5,862 | 2,125 | 125,258 | 170,950 |
| Unquoted debt securities - gross | 3,962 | 44 | 9 | 17 | 3,950 | 7,982 |
| Other receivables - gross | 18,934 | – | – | – | – | 18,934 |
| AFS investments | 557 | 2,643 | 2,773 | 1,487 | 100,702 | 108,162 |
| Miscellaneous COCI | 1 | – | – | – | – | 1 |
| Total financial assets | ₱124,722 | ₱16,985 | ₱10,040 | ₱4,855 | ₱230,786 | ₱387,388 |
| **Financial Liabilities** | | | | | | |
| Deposit liabilities: | | | | | | |
| Demand | ₱28,164 | ₱– | ₱– | ₱– | ₱– | ₱28,164 |
| Savings | 151,002 | 17,838 | 7,979 | 4,892 | 12,636 | 194,347 |
| Time | 7,524 | 2,821 | 1,481 | 1,784 | 6,325 | 19,935 |
| Financial liabilities at FVPL: | | | | | | |
| Financial liability designated at FVPL | 43 | 85 | 6,311 | – | – | 6,439 |
| Derivative liabilities: | | | | | | |
| Pay | 9,798 | 1,162 | 476 | 608 | 213 | 12,257 |
| Receive | (9,677) | (1,123) | (452) | (518) | (52) | (11,822) |
| | 121 | 39 | 24 | 90 | 161 | 435 |
| Bills and acceptances payable | 7,753 | 4,182 | 806 | 40 | 309 | 13,090 |
| Subordinated debt | 54 | 107 | 161 | 322 | 11,742 | 12,386 |
| Accrued interest payable and other liabilities | 10,828 | 390 | 1 | 374 | 3,486 | 15,079 |
| Total financial liabilities | ₱205,489 | ₱25,462 | ₱16,763 | ₱7,502 | ₱34,659 | ₱289,875 |

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 Group's trading and structural portfolios.

*Trading market risk*

Trading market risk exists in the Group 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 Group is exposed to trading market risk in the course of market making as well as from taking advantage of market opportunities. The Group adopts the Parametric Value-at-Risk (VaR) methodology (with 99% confidence level, and one day holding period for FX and equity price risks VaR and ten day holding period for interest rate risk VaR) to measure the Group's trading market risk. Volatilities are updated monthly and are based on historical data for a rolling 260-day period. The RMG reports the VaR utilization and breaches to limits to the risk taking personnel on a daily basis and to the ALCO and Executive Committee (EXCOM) on a monthly basis. All risk reports discussed in the EXCOM meeting are noted by the BOD. The VaR figures are backtested 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 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.

*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.

*VaR limits*

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. Calculated VaR compared against the VaR limits are monitored. 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 that the aggregate daily losses were greater than the total VaR (in millions).

| Trading Portfolio | **Foreign Exchange*** | **Interest Rate** | **Equities Price** | **Total VaR**** |
|---|---|---|---|---|
| March 31, 2013 | **₱24.71** | **₱152.40** | **₱10.66** | **₱187.77** |
| Average Daily | **9.92** | **129.70** | **8.85** | **148.46** |
| Highest | **62.63** | **217.98** | **10.77** | **237.26** |
| Lowest | **0.65** | **62.50** | **6.69** | **70.60** |

| Trading Portfolio | Foreign Exchange* | Interest Rate | Equities Price | Total VaR** |
|---|---|---|---|---|
| December 31, 2012 | ₱4.84 | ₱80.22 | ₱7.80 | ₱92.86 |
| Average Daily | 6.61 | 131.09 | 8.95 | 146.64 |
| Highest | 16.85 | 340.31 | 11.17 | 354.65 |
| Lowest | 0.40 | 60.87 | 6.00 | 77.86 |

* FX VaR is the bankwide foreign exchange risk
** The high and low for the total portfolio may not equal the sum of the individual components as the highs and lows of the individual trading portfolios may have occurred on different trading days

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

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| End of period | **₱2,872.63** | ₱2,317.22 |
| Average Daily | **2,079.13** | 2,176.61 |
| Highest | **2,909.73** | 2,743.57 |
| Lowest | **1,648.25** | 1,522.48 |

**Structural Market Risk**

Non-trading Market Risk

*Interest rate risk*
The Group 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 Group to interest rate risk. The Group 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 statement of financial position 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 Group 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 Group (in millions):

| | March 31, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | **Up to 1 Month** | **1 to 3 Months** | **3 to 6 Months** | **6 to 12 months** | **Beyond 1 year** | **Total** |
| **Financial Assets** | | | | | | |
| COCI | **₱–** | **₱–** | **₱–** | **₱–** | **₱7,918** | **₱7,918** |
| Due from BSP and other banks | **35,146** | **30** | **–** | **–** | **63,147** | **98,323** |
| Interbank loans receivable | **8,146** | **130** | **–** | **–** | **–** | **8,276** |
| Securities held under agreements to resell | **20,000** | **–** | **–** | **–** | **–** | **20,000** |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | **–** | **–** | **–** | **–** | **3,686** | **3,686** |
| Derivative assets | **–** | **–** | **–** | **–** | **455** | **455** |
| Equity securities | **–** | **–** | **–** | **–** | **301** | **301** |
| Private debt securities | **–** | **–** | **–** | **–** | **27** | **27** |
| Designated at FVPL: | | | | | | |
| Segregated fund assets | **–** | **–** | **–** | **–** | **4,091** | **4,091** |
| Private debt securities | **–** | **1,229** | **–** | **–** | **–** | **1,229** |
| Receivable from customers and other receivables - gross* | **72,251** | **52,351** | **6,728** | **9,737** | **101,893** | **242,960** |
| Unquoted debt securities - gross | **300** | **60** | **–** | **2,785** | **8,463** | **11,608** |
| AFS investments | **6,761** | **395** | **41** | **544** | **94,815** | **102,556** |
| Miscellaneous COCI | **–** | **–** | **–** | **–** | **8** | **8** |
| Total financial assets | **₱142,604** | **₱54,195** | **₱6,769** | **₱13,066** | **₱284,804** | **₱501,438** |
| **Financial Liabilities** | | | | | | |
| Deposit liabilities: | | | | | | |
| Demand | **₱–** | **₱–** | **₱–** | **₱–** | **₱83,945** | **₱83,945** |
| Savings | **117,738** | **25,461** | **4,970** | **6,484** | **108,694** | **263,347** |
| Time | **18,303** | **9,379** | **3,179** | **6,539** | **9,920** | **47,320** |
| Financial liabilities at FVPL | **–** | **6,097** | **–** | **–** | **4,207** | **10,304** |
| Bills and acceptances payable | **10,970** | **840** | **1,352** | **587** | **1,372** | **15,121** |
| Subordinated debt | **–** | **–** | **–** | **–** | **9,942** | **9,942** |
| Accrued interest and other financial liabilities** | **–** | **–** | **–** | **–** | **22,789** | **22,789** |
| Total financial liabilities | **₱147,011** | **₱41,777** | **₱9,501** | **₱13,610** | **₱240,869** | **₱452,768** |
| **Repricing gap** | **(₱4,407)** | **₱12,418** | **(₱2,732)** | **(₱544)** | **₱43,935** | **₱48,670** |
| **Cumulative gap** | **(4,407)** | **8,011** | **5,279** | **4,735** | **48,670** | **–** |

Note: Non-interest bearing financial assets and liabilities are lumped in greater than 1 year bucket.
*Receivable from customers excludes residual value of leased assets.
**Accrued interest and other financial liabilities include 'Accrued interest payable', 'Accounts payable', 'Insurance contract liabilities', 'Bills purchased - contra', 'Due to other Banks', 'Manager's checks and demand drafts outstanding', 'Payment order payable', 'Deposit on lease contracts', 'Due to Treasurer of the Philippines', 'Margin deposits and cash letters of credit', 'Due to BSP' and other financial liabilities

| | December 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Up to 1 Month | 1 to 3 Months | 3 to 6 Months | 6 to 12 months | Beyond 1 year | Total |
| **Financial Assets** | | | | | | |
| COCI | ₱– | ₱– | ₱– | ₱– | ₱5,599 | ₱5,599 |
| Due from BSP and other banks | 12,737 | – | – | – | 28,481 | 41,218 |
| Interbank loans receivable | 11,499 | – | – | – | – | 11,499 |
| Securities held under agreements to resell | 18,300 | – | – | – | – | 18,300 |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | – | – | – | – | 1,971 | 1,971 |
| Derivative assets | – | – | – | – | 455 | 455 |
| Equity securities | – | – | – | – | 250 | 250 |
| Private debt securities | – | – | – | – | 99 | 99 |
| Designated at FVPL: | | | | | | |
| Private debt securities | – | – | 1,248 | – | – | 1,248 |
| Receivable from customers and other receivables - gross* | 55,186 | 21,406 | 7,303 | 6,716 | 59,616 | 150,227 |
| Unquoted debt securities - gross | 217 | 100 | – | 2 | 7,499 | 7,818 |
| AFS investments | 676 | 1,288 | 6,785 | 312 | 58,864 | 67,925 |
| Miscellaneous COCI | – | – | – | – | 1 | 1 |
| Total financial assets | ₱98,615 | ₱22,794 | ₱15,336 | ₱7,030 | ₱162,835 | ₱306,610 |
| **Financial Liabilities** | | | | | | |
| Deposit liabilities: | | | | | | |
| Demand | ₱– | ₱– | ₱– | ₱– | ₱28,152 | ₱28,152 |
| Savings | 63,839 | 14,859 | 4,517 | 3,156 | 106,422 | 192,793 |
| Time | 8,289 | 3,807 | 851 | 866 | 6,096 | 19,909 |
| Financial liabilities at FVPL | – | – | 6,196 | – | 284 | 6,480 |
| Bills and acceptances payable | 8,565 | 2,050 | 894 | 404 | 1,164 | 13,077 |
| Subordinated debt | – | – | – | – | 9,939 | 9,939 |
| Accrued interest and other financial liabilities** | – | – | – | – | 15,079 | 15,079 |
| Total financial liabilities | ₱80,693 | ₱20,716 | ₱12,458 | ₱4,426 | ₱167,136 | ₱285,429 |
| **Repricing gap** | ₱17,922 | ₱2,078 | ₱2,878 | ₱2,604 | (₱4,301) | ₱21,181 |
| **Cumulative gap** | 17,922 | 20,000 | 22,878 | 25,482 | 21,181 | – |

Note: Non-interest bearing financial assets and liabilities are lumped in greater than 1 year bucket.
*Receivable from customers excludes residual value of leased assets.
**Accrued interest and other financial liabilities include 'Accrued interest payable', 'Accounts payable', 'Insurance contract liabilities', 'Bills purchased – contra', 'Due to other Banks', 'Manager's checks and demand drafts outstanding', 'Payment order payable', 'Deposit on lease contracts', 'Due to Treasurer of the Philippines', 'Margin deposits and cash letters of credit', 'Due to BSP' and other financial liabilities

The following table sets forth the impact of changes in interest rates on the Group's repricing gap for the three-month ended March 31, 2013 and for the year ended December 31, 2012 (in millions):

| | **Three Months Ended March 31, 2013** | | For the Year Ended December 31, 2012 | |
|---|---|---|---|---|
| | **Statement of Income** | **Equity** | Statement of Income | Equity |
| +50bps | **₱21** | **₱21** | ₱104 | ₱104 |
| -50bps | **(21)** | **(21)** | (104) | (104) |
| +100bps | **42** | **42** | 209 | 209 |
| -100bps | **(42)** | **(42)** | (209) | (209) |

As one of the long-term goals in the risk management process, the Group 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 Group'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 Group and foreign currency-denominated borrowings appearing in the regular books of the Group.

Foreign currency deposits are generally used to fund the Group'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 Group 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. Included in the table are the financial assets and liabilities at carrying amounts, categorized by currency (amounts in millions and in Philippine peso equivalent).

| | March 31, 2013 | | |
|---|---|---|---|
| | **USD** | **Others** | **Total** |
| **Assets** | | | |
| COCI and due from BSP | **₱900** | **₱459** | **₱1,359** |
| Due from other banks | **6,243** | **1,652** | **7,895** |
| Interbank loans receivable and securities held under agreements to resell | **1,764** | **130** | **1,894** |
| Loans and receivables | **8,360** | **316** | **8,676** |
| Financial assets at FVPL | **2,383** | **98** | **2,481** |
| AFS investments | **5,525** | **1,990** | **7,515** |
| Other assets | **44** | **3** | **47** |
| Total assets | **25,219** | **4,648** | **29,867** |
| **Liabilities** | | | |
| Deposit liabilities | **6,171** | **1,898** | **8,069** |
| Financial liabilities at FVPL | **1,139** | **–** | **1,139** |
| Bills and acceptances payable | **5,553** | **138** | **5,691** |
| Accrued interest and other financial liabilities | **1,590** | **1** | **1,591** |
| Other liabilities | **2,704** | **141** | **2,845** |
| Total liabilities | **17,157** | **2,178** | **19,335** |
| **Net Exposure** | **₱8,062** | **₱2,470** | **₱10,532** |

| | December 31, 2012 | | |
|---|---|---|---|
| | USD | Others | Total |
| **Assets** | | | |
| COCI and due from BSP | ₱644 | ₱176 | ₱820 |
| Due from other banks | 2,776 | 622 | 3,398 |
| Interbank loans receivable and securities held under agreements to resell | 1,338 | – | 1,338 |
| Loans and receivables | 5,077 | 12,423 | 17,500 |
| Financial assets at FVPL | 1,261 | 102 | 1,363 |
| AFS investments | 3,315 | 1,205 | 4,520 |
| Other assets | 119 | 25 | 144 |
| Total assets | 14,530 | 14,553 | 29,083 |
| **Liabilities** | | | |
| Deposit liabilities | 2,702 | 1,583 | 4,285 |
| Bills and acceptances payable | 5,454 | 89 | 5,543 |
| Accrued interest and other financial liabilities | 1,586 | 1 | 1,587 |
| Other liabilities | 1,698 | 91 | 1,789 |
| Total liabilities | 11,440 | 1,764 | 13,204 |
| **Net Exposure** | ₱3,090 | ₱12,789 | ₱15,879 |

Information relating to the Parent Company's currency derivatives is contained in Note 23. The Parent Company has outstanding foreign currency spot transactions (in equivalent peso amounts) of ₱3.9 million (sold) and ₱4.4 million (bought) as of March 31, 2013 and ₱5.1 million (sold) and ₱4.8 million (bought) as of December 31, 2012.

*Prepayment risk*
The Parent Company projects prepayment ratio by way of using historical data on loan prepayment rate. The Parent Company's loans prepayment rate is less than 1.49% and 1.41% of the total loan portfolio in 2013 and 2012, respectively. In view of this, management believes that 1.49% and 1.41% are not material enough to warrant a separate set of cash flow analyses. All calculations related to asset and liability management (e.g., as net interest margin analysis) take into account the contractual terms of the financial instrument.

Capital management and management of insurance and financial risks

*Governance framework*
The Group has established a risk management function with clear terms of reference and with the responsibility for developing policies on market, credit, liquidity, insurance and operational risks. It also supports the effective implementation of policies at the overall company and individual business unit levels. The Chief Financial Officer (CFO) and Internal Audit Department performs procedures to identify various risks. The results of the procedures are reported to the BOD and necessary actions are taken to mitigate the risks identified.

The policies define the Group's identification of risk and its interpretation, limit structure to ensure the appropriate quality and diversification of assets, alignment of underwriting and reinsurance strategies to the corporate goals and specific reporting requirements.

*Regulatory framework*
Regulators are interested in protecting the rights of the policyholders and maintain close vigil to ensure that the Group is satisfactorily managing affairs for their benefit. At the same time, the regulators are also interested in ensuring that the Group maintains appropriate solvency position to meet liabilities arising from claims and that the risk levels are at acceptable levels.

The Group has an insurance business which is subject to the regulatory requirements of the IC. Such regulations not only prescribe approval and monitoring of activities but also impose certain restrictive provisions (e.g., margin of solvency to minimize the risk of default and insolvency on the part of the insurance companies to meet the unforeseen liabilities as these arise, fixed capitalization requirements, risk-based capital requirements).

*Capital management*
The Group maintains a certain level of capital to ensure sufficient solvency margins and to adequately protect the policyholders.

To ensure compliance with these externally imposed capital requirements, it is the Group's policy to assess its position against set minimum capital requirements.

Under the requirements of the IC and the Code, the Group should meet the minimum levels set for the following capital requirements: Margin of Solvency (MOS), Minimum Statutory Net Worth and Paid-up Capital, and the Risk-Based Capital (RBC).

Since PNB LII is now 100.00% Filipino-owned, the capital requirements have been reduced significantly and PNB LII's current capital now well exceeds the minimum requirements.

The required investments in government bonds and securities of at least 25.00% of the Minimum Paid-up Capital, under the Section 203 of the Insurance Code, are free from liens and encumbrances.

a) *MOS*
Under the Code, a life insurance company doing business in the Philippines shall maintain at all times a MOS equal to ₱0.50 million or ₱2.00 per thousand of the total amount of insurance in force as of the preceding calendar year in all policies (except term insurance), whichever is higher. On the other hand, a nonlife insurance company shall maintain at all times MOS equal to ₱0.50 million or 10% of the total amount of its net premiums written during the preceding year, whichever is higher.

The MOS shall be the excess of the value of its admitted assets as defined under the same Code, exclusive of the minimum paid-up capital, over the amount of its liabilities, unearned premiums, and reinsurance reserves.

The estimated amounts of the Group's non-admitted assets, as defined in the Code, are included in the accompanying statements of financial position. These assets are subject to final determination by the IC.

As of March 31, 2013, PNB LII's MOS based on its calculations amounted to ₱394.7 million.

As of March 31, 2013 and December 31, 2012, PNB Gen's MOS based on its calculations amounted to ₱647.1 million and ₱638.1 million, respectively.

The final amounts of the MOS can be determined only after the accounts of the PNB Life and PNB Gen have been examined by the IC specifically as to admitted and non-admitted assets as defined in the Code. The 2013 and 2012 MOS will be known only after the IC completes its examination of the accounts of the Group.

If an insurance company fails to meet the minimum required MOS, the IC is authorized to suspend or revoke all certificates of authority granted to such companies, its officers and agents, and no new business shall be done by and for such company until its authority is restored by the IC.

b) *Minimum statutory net worth and paid up capital*
The Department of Finance Order (DO) 27-06 provides for the capitalization requirements for life, nonlife and reinsurance companies on a staggered basis for the years ended December 31, 2006 up to 2011. Depending on the level of the foreign ownership in the insurance company, the minimum statutory net worth and minimum paid-up capital requirements vary. The statutory net worth shall include the company's paid-up capital, capital in excess of par value, contingency surplus, retained earnings and revaluation increments as may be approved by the IC. The minimum paid-up capital is pegged at 50.00% of the minimum statutory net worth.

On October 29, 2008, the IC issued the Circular Letter No. 26-2008, which recalls that in view of the compliance of insurance companies with the requirement of IMC No. 10-2006, the scheduled increases due December 31, 2007 have been deferred for a year. Hence, the IMC reiterates that by December 31, 2008, insurance companies should comply with the increase previously scheduled for December 31, 2007. Based on this Circular Letter, the required statutory net worth and minimum paid-up capital for December 31, 2011 shall be based on the increase previously scheduled for December 31, 2010.

On June 1, 2012, the Department of Finance issued DO No. 15-2012 which provides for minimum paid up capital requirements of all insurance and professional reinsurance companies to supplement the requirements of DO No. 27-06 after December 31, 2012. Under the said DO, the minimum paid up capital requirements for all existing insurance and professional reinsurers regardless of its citizenship is going to be on a staggered basis for the years December 31, 2012 up to 2020. The DO also allows all existing insurance and professional reinsurance companies a one-time one-year deferral in the compliance to minimum paid up capital requirements provided it has met the RBC hurdle rate based on the schedule set out in the said DO.

The table below shows the amount of minimum paid-up capital and the schedule of compliance per DO No. 15-2012:

| Paid up capital | Compliance date |
|---:|---|
| ₱250,000,000 | On or before December 31, 2012 (Pursuant to DO 27-06 and IMC No. 10-2006) |
| 400,000,000 | On or before December 31, 2014 |
| 600,000,000 | On or before December 31, 2016 |
| 800,000,000 | On or before December 31, 2018 |
| 1,000,000,000 | On or before December 31, 2020 |

On November 22, 2012, the IC issued an advisory to all insurance and reinsurance companies doing business in the Philippines regarding the implementation of DO No. 27-06. According to the advisory, the minimum paid-up capital for December 31, 2012 must at least be equal to ₱250.0 million.

On December 11, 2012, DO No. 15-2012 was issued with a temporary restraining order. Accordingly, the minimum paid up capital requirement would be ₱250.0 million by the end of 2012 as advised by the IC.

On February 5, 2013, the Senate of the Philippines approved the Amended Insurance Code which provides the new capitalization requirements of all existing insurance companies based on networth on a staggered basis starting June 30, 2013 up to December 31, 2022. The following presents the amount of required networth and the schedule of compliance per Amended Insurance Code:

| Networth | Compliance date |
|---|---|
| ₱250,000,000 | June 30, 2013 |
| 550,000,000 | December 31, 2016 |
| 900,000,000 | December 31, 2019 |
| 1,300,000,000 | December 31, 2022 |

As of March 20, 2013, the Amended Insurance Code has not been signed by the President of the Philippines for it to become a law.

The required minimum statutory net worth and minimum paid-up capital for PNB LII in 2012, being a wholly-owned Filipino life insurance company is ₱500.0 million and ₱250.0 million, respectively. PNB LII has complied with the minimum statutory net worth and paid-up capital requirements based on PNB LII's own calculation.

The required minimum statutory net worth and minimum paid-up capital for PNB Gen in 2012, being a wholly-owned Filipino nonlife insurance company is ₱500.00 million and ₱250.0 million, respectively. PNB Gen has complied with the minimum statutory net worth and paid-up capital requirements based on PNB Gen's own calculation.

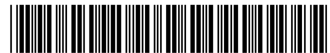
c) *RBC requirement*
Insurance Memorandum Circular (IMC) No. 6-2006 provides for the risk-based capital framework for the life insurance industry to establish the required amounts of capital to be maintained by the companies in relation to their investment and insurance risks. Every life and nonlife insurance company is annually required to maintain a minimum RBC ratio of 100.00% and not fail the trend test. Failure to meet the minimum RBC ratio shall subject the insurance company to the corresponding regulatory intervention which has been defined at various levels.

The RBC ratio shall be calculated as net worth divided by the RBC requirement. Net worth shall include the Group's paid-up capital, contributed and contingency surplus and unassigned surplus. Revaluation and fluctuation reserve accounts shall form part of net worth only to the extent authorized by the IC. The RBC requirement is the ratio of the number of insurers which are able to meet the corresponding RBC Hurdle Rate requirement for a given year to the total number of insurers in the industry.

The RBC ratio of PNB LII is 158.76% in 2013, while PNB Gen's RBC ratio is 177.68% in 2013 and 162.00% in 2012.

The final amount of RBC ratio can be determined only after the accounts of the Group have been examined by the IC specifically as to admitted and non-admitted assets as defined under the same Code.

d) *Consolidated compliance framework*
IMC 10-2006 integrated the compliance standards for the fixed capitalization and risk-based capital framework for insurers.



Subsequent to year 2006, the fixed capitalization requirement for a given year may be suspended for insurers that comply with the required RBC hurdle rate, provided that the industry complies with the required Industry RBC Ratio Compliance Rate. The IMC provides the annual schedule of progressive rates for the Industry RBC Ratio Compliance Rates and the RBC Hurdle Rates from 2007 to 2011. For the review year 2011which shall be based on the 2010 synopsis, the Industry RBC Ratio Compliance Rate is 90.00% and the RBC Hurdle Rate is 250.00%. Failure to achieve one of the rates will result in the imposition of the fixed capitalization requirement for the year under review.

e) *Unimpaired capital requirement*
IMC 22-2008 provided for the purposes of determining compliance with the law, rules and regulations requiring that the paid-up capital should remain intact and unimpaired at all times, the statement of financial position should show that the net worth or stockholders' equity is at least equal to the actual paid-up capital.

The Group has complied with all of the above capital requirements for the three-month period ended March 31, 2013 and for the year ended December 31, 2012.

<u>Insurance Risk</u>
The risk under an insurance contract is the risk that an insured event will occur, including the uncertainty of the amount and timing of any resulting claim. The principal risk the Group faces under such contracts is that the actual claims and benefit payments exceed the carrying amounts of insurance liabilities. This is influenced by the frequency of claims, severity of claims, whether actual benefits paid are greater than originally estimated, and subsequent development of long-term claims.

<u>Life Insurance Contracts</u>
To minimize insurance risks, PNB LII strictly adheres to prudent underwriting standards in assessing insurance applications. These underwriting standards include a schedule of medical and non-medical requirements for specific range of ages and sum assured. Some policyholders are charged with additional premium in the form of flat or multiple extra premiums due to extra risks resulting from the applicant's occupation, health and lifestyle. Applications for insurance may be denied or postponed for certain substandard cases. To guard against anti-selection, insurance applications that do not establish insurable interest are rejected. Statements of assets and liabilities may also be required from the applicant to justify the sum assured applied for, and his ability to pay the premium.

*Frequency of claims*
For contracts where death is the insured risk, the most significant factors that could increase the overall frequency of claims are epidemics or wide spread changes in lifestyle resulting in earlier or more claims than expected. In the Philippines, higher-than-expected claims also arise from typhoons, landslides, and other geological events.

For contracts with DPF, a portion of the insurance risk is effectively shared with the policy owner, as policy dividends may be reduced due to adverse claims and investment experience.

For unit-linked insurance policies where the cost of insurance charges is not guaranteed, insurance risk is borne mostly by the policyholders. PNB LII has the right to alter these charges based on its mortality experience and hence minimize its exposure to mortality risk. Delays in implementing increases in charges and market or regulatory restraints over the extent of the increases may reduce its mitigating effect.

PNB LII manages these risks through its underwriting strategy and reinsurance arrangements. The underwriting strategy is intended to ensure that the risks underwritten are pooled into a sufficiently large portfolio. Medical selection is also included in the underwriting procedures with premiums varied to reflect the health condition and family medical history of the applicants. PNB LII has a retention limit of ₱2.5 million on any standard risk. PNB LII reinsures the excess of the insured benefit over ₱2.5 million for standard risks (from a medical point of view) under an excess of loss reinsurance arrangement. PNB LII's risk retention is lower for medically impaired or substandard lives, which involves higher risks. PNB LII also has a Catastrophe Reinsurance agreement, which protects PNB LII in case of a catastrophic event resulting to multiple death claims.

The table below presents the concentration of individually insured benefits across different bands of insured ages as measured by the face amount (before reinsurance) and net amount at risk (NAAR), after reinsurance:

| | | March 31, 2013 | | | |
|---|---|---|---|---|---|
| | | Before reinsurance | | After reinsurance | |
| Age bands (in years) | Policy count | Face amount (in thousands) | Concentration (%) | NAAR (in thousands) | Concentration (%) |
| 0-15 | 12,553 | ₱3,268,517 | 18 | ₱1,735,147 | 16 |
| 16-25 | 6,026 | 2,175,767 | 12 | 1,375,306 | 13 |
| 26-35 | 7,855 | 3,005,865 | 16 | 1,995,275 | 18 |
| 36-45 | 8,472 | 3,892,400 | 21 | 2,470,321 | 23 |
| 46-55 | 7,314 | 3,671,620 | 20 | 2,017,508 | 19 |
| 56-65 | 3,102 | 1,846,143 | 10 | 968,478 | 9 |
| 66-75 | 399 | 361,568 | 2 | 253,247 | 2 |
| 76 and above | 7 | 19,000 | 1 | 18,984 | 0 |
| | 45,728 | ₱18,240,880 | 100 | ₱10,834,266 | 100 |

This table includes whole life, endowment, anticipated endowment, and term insurance contracts, thus the insured risk is a mixture of death and continued survival. NAAR is the net amount at risk, which is the difference between the face amount and the policy reserve. It is the net amount that would be payable upon death less liability released. The risk is spread over the younger through middle-aged bands.

*Sources of uncertainty in the estimation of future benefit payments and premium receipts*
Uncertainty in the estimation of future benefit payments and premium receipts for long-term insurance contracts arises from the unpredictability of long-term changes in overall levels of mortality and the variability in policyholder behavior.

PNB LII uses appropriate tables of standard mortality for pricing and valuation of liabilities. An investigation into the actual mortality experience of PNB LII is carried out annually, but the experience is not yet considered statistically significant.

PNB LII maintains persistency statistics to monitor actual lapse experience against pricing assumptions and performance standards. Statutory reserves are calculated using mortality decrement only, without considering possibility of lapses. This results in a more conservative liability as gains on surrender are not anticipated in the valuation method.

Nonlife Insurance Contracts

*Nature of risk*
PNB Gen principally issues the following types of general insurance contracts: fire, motor, accident, casualty, marine, engineering and surety. Risks under general insurance policies usually cover a twelve-month duration.

For general insurance contracts, the most significant risks arise from climate changes, natural disasters and terrorist activities.

These risks vary significantly in relation to the location of the risk insured by PNB Gen, type of risk insured and by industry. Undue concentration by amounts can have a further impact on the severity of benefit payments on a portfolio basis.

The above risk exposure is mitigated by diversification across a large portfolio of insurance contracts. The variability of risks is improved by careful selection and implementation of underwriting strategies, which are designed to ensure that risks are diversified in terms of type of risk and level of insured benefits. This is largely achieved through diversification across industry sectors and geography. Further, strict claim review policies to assess all new and ongoing claims, regular detailed review of claims handling procedures and frequent investigation of possible fraudulent claims are all policies and procedures put in place to reduce the risk exposure of PNB Gen. PNB Gen further enforce a policy of actively managing and promptly pursuing claims, in order to reduce its exposure to unpredictable future developments that can negatively impact the Company.

PNB Gen has also limited its exposure by imposing maximum claim amounts on certain contracts as well as the use of reinsurance arrangements in order to limit exposure to catastrophic events, for example hurricanes, earthquakes and flood damages.

The purpose of these underwriting and reinsurance strategies is to limit exposure to catastrophes to a predetermined maximum amount based on PNB Gen's risk appetite as decided by management.

The following table sets out the concentration of the claims liabilities by type of contract:

| | **March 31, 2013** | | | December 31, 2012 | | |
|---|---|---|---|---|---|---|
| | **Insurance Contract Liabilities** | **Reinsurers' Share of Liabilities** | **Net** | Insurance Contract Liabilities | Reinsurers' Share of Liabilities | Net |
| Fire | **₱2,094,614** | **₱1,934,003** | **₱160,611** | ₱2,125,786 | ₱1,985,235 | ₱140,551 |
| Marine | **98,034** | **97,605** | **429** | 100,400 | 96,394 | 4,006 |
| Engineering | **58,510** | **41,044** | **17,466** | 60,800 | 45,470 | 15,330 |
| Motorcar | **53,145** | **1,654** | **51,491** | 53,717 | 2,459 | 51,258 |
| Casualty | **69,825** | **59,471** | **10,354** | 36,276 | 24,894 | 11,382 |
| Surety | **26,066** | **9,868** | **16,198** | 24,389 | 8,309 | 16,080 |
| Accident | **8,277** | **75** | **8,202** | 5,526 | 48 | 5,478 |
| | **₱2,408,471** | **₱2,143,720** | **₱264,751** | ₱2,406,894 | ₱2,162,809 | ₱244,085 |

## 5. Fair Value Measurement

The Group has assets and liabilities that are measured at fair value on a recurring and non-recurring basis in the consolidated statement of financial position after initial recognition. Recurring fair value measurements are those that another PFRS requires or permits to be recognized in the consolidated statement of financial position at the end of each reporting period. These include financial assets and liabilities at FVPL and AFS investments. Non-recurring fair value measurements are those that another PFRS requires or permits to be recognized in the consolidated statement of financial position in particular circumstances. These include land and buildings measured at revalued amount and investment properties measured at cost but with fair value measurement disclosure.

The Group uses the following hierarchy for determining and disclosing the fair value of assets and liabilities by valuation technique. These levels are based in the inputs that are used to determine the fair value and can be summarized in:

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date

Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly

Level 3: inputs are unobservable inputs for the asset or liability

The Group held the following assets and liabilities measured at recurring and non-recurring fair value measurements and their corresponding level in fair value hierarchy:

| | March 31, 2013 | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| **Recurring Fair Value Measurements** | | | | |
| **Financial Assets** | | | | |
| Financial assets at FVPL: | | | | |
| Held-for-trading: | | | | |
| Government securities | **₱3,686,079** | **₱–** | **₱–** | **₱3,686,079** |
| Derivative assets | **429,523** | **25,430** | **–** | **454,953** |
| Private debt securities | **27,166** | **–** | **–** | **27,166** |
| Equity securities | **300,852** | **–** | **–** | **300,852** |
| Designated at FVPL: | | | | |
| Segregated fund assets | **1,324,171** | **–** | **2,767,183** | **4,091,354** |
| Private debt securities | **–** | **1,229,018** | **–** | **1,229,018** |
| | **₱5,767,791** | **₱1,254,448** | **₱2,767,183** | **₱9,789,422** |
| AFS investments: | | | | |
| Government securities | **₱84,503,408** | **₱–** | **₱–** | **₱84,503,408** |
| Other debt securities | **13,512,645** | **1,947,742** | **–** | **15,460,387** |
| Equity securities | **1,560,959** | **–** | **–** | **1,560,959** |
| | **₱99,577,012** | **₱1,947,742** | **₱–** | **₱101,524,754** |
| **Financial Liabilities** | | | | |
| Financial liabilities at FVPL: | | | | |
| Designated at FVPL: | | | | |
| Segregated fund liabilities | **₱1,400,636** | **₱–** | **₱2,767,183** | **₱4,167,819** |
| Private debt securities | **–** | **–** | **6,096,508** | **6,096,508** |
| Derivative liabilities | **34,626** | **5,370** | **–** | **39,996** |
| | **₱1,435,262** | **₱5,370** | **₱8,863,691** | **₱10,304,323** |
| | | | | |
| **Non-Recurring Fair Value Measurements** | | | | |
| Investment property* | | | | |
| Land | **₱–** | **₱23,867,325** | **₱–** | **₱23,867,325** |
| Buildings and imrprovements | **–** | **3,693,447** | **–** | **3,693,447** |
| | **–** | **27,560,772** | **–** | **27,560,772** |
| Property and equipment | **–** | | | |
| Land | **–** | **14,549,782** | **–** | **14,549,782** |
| Buildings | **–** | **6,923,769** | **–** | **6,923,769** |
| | **–** | **21,473,551** | **–** | **21,473,551** |
| | **₱–** | **₱49,034,323** | **₱–** | **₱49,034,323** |

** Based on the fair values from appraisal reports different from carrying amounts which are at cost. Refer to Note 13.*

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Financial Assets | | | | |
| Financial assets at FVPL: | | | | |
| Held-for-trading: | | | | |
| Government securities | ₱1,970,754 | ₱– | ₱– | ₱1,970,754 |
| Derivative assets | 59,044 | 395,457 | – | 454,501 |
| Private debt securities | 99,502 | – | – | 99,502 |
| Equity securities | 250,552 | – | – | 250,552 |
| Designated at FVPL: | | | | |
| Private debt securities | – | 1,247,756 | – | 1,247,756 |
| | ₱2,379,852 | ₱1,643,213 | ₱– | ₱4,023,065 |
| AFS investments: | | | | |
| Government securities | ₱55,558,527 | ₱– | ₱– | ₱55,558,527 |
| Other debt securities | 8,979,888 | 1,940,245 | – | 10,920,133 |
| Equity securities | 440,230 | – | – | 440,230 |
| | ₱64,978,645 | ₱1,940,245 | ₱– | ₱66,918,890 |
| Financial Liabilities | | | | |
| Financial liabilities at FVPL: | | | | |
| Designated at FVPL | ₱– | ₱– | ₱6,196,070 | ₱6,196,070 |
| Derivative liabilities | – | 283,751 | – | 283,751 |
| | ₱– | ₱283,751 | ₱6,196,070 | ₱6,479,821 |

The following table presents a comparison of the carrying amounts and fair values of assets and liabilities except those where carrying values approximate or equals their fair values (amounts in thousands):

| | **March 31, 2013** | | December 31, 2012 | |
|---|---|---|---|---|
| | **Carrying Value** | **Fair Market Value** | Carrying Value | Fair Market Value |
| **Financial Assets** | | | | |
| Loans and Receivables | | | | |
| Receivables from customers: | | | | |
| Business loans | **₱160,730,819** | **₱165,019,678** | ₱83,053,202 | ₱84,566,445 |
| GOCCs and NGAs | **25,141,326** | **25,146,436** | 24,410,497 | 24,410,497 |
| Consumers | **22,341,389** | **22,741,749** | 11,196,835 | 11,483,394 |
| LGUs | **7,822,549** | **7,924,346** | 7,157,470 | 7,215,785 |
| Fringe benefits | **631,085** | **656,530** | 643,608 | 648,299 |
| Unquoted debt securities | **7,649,427** | **9,071,990** | 3,859,268 | 5,131,586 |
| **Financial Liabilities** | | | | |
| Financial liabilities at amortized cost | | | | |
| Deposit liabilities: | | | | |
| Time | **47,319,272** | **47,593,654** | 19,908,821 | 20,134,885 |
| Subordinated debt | **9,942,407** | **10,921,768** | 9,938,816 | 10,956,745 |

The above assets and liabilities are measured at Level 2.

The methods and assumptions used by the Group in estimating the fair value of the assets and liabilities are:

Cash equivalents - 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 obtained from independent parties offering pricing services, estimated using 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 market prices. While fair values of unquoted equity securities are the same as the carrying value since the fair value 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.

Segregated fund assets and liabilities under financial assets and liabilities designated at FVPL - The fair values of equity and debt securities under level 1 of the fair value hierarchy are determined by reference to quoted market bid prices, at the close of business reporting date, or the last reporting date. The fair values of equity-linked notes under level 3 of the fair value hierarchy are determined by running simulations on the underlying indices to project the possible payouts of the instruments. Instruments included in Level 3 include the subordinated debt and segregated fund assets and liabilities for which there is currently no active market. In applying the discounted cash flow analysis to determine the fair value of the subordinated debt and segregated fund assets and liabilities designated at FVPL, the Group used discount rates ranging from 1.25% to 1.32% and from 1.38% to 3.63% as of March 31, 2013 and December 31, 2012, respectively.

Derivative instruments - Fair values are estimated based on quoted market prices or acceptable valuation models.

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. Other receivables do not have readily available quoted market prices. These are reported at cost and are not significant in relation to the Group's total loan and receivable portfolio. The discount rate used in estimating the fair value of loans and receivables ranges from 0.25% to 9.25% and from 0.30% to 9.25% as of March 31, 2013 and December 31, 2012 for peso-denominated receivables, respectively, and 3.25% both as of March 31, 2013 and December 31, 2012, for foreign currency-denominated receivables.

Liabilities - Except for time deposit liabilities and subordinated debt, the carrying values approximate fair values due to either the presence of a demand feature or the relatively short-term maturities of these liabilities.

Time deposit liabilities and subordinated debt including those designated at FVPL - Fair value is determined using the discounted cash flow methodology. The discount rate used in estimating the fair values of the subordinated debt and time deposits ranges from 0.23% to 4.70% and from 1.38% to 3.63% as of March 31, 2013 and December 31, 2012, respectively.

Land and buildings under property and equipment and Investment property - Fair value is determined based on the appraisal reports of external and internal appraised valuers.

As of March 31, 2013 and December 31, 2012, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

The following table shows a reconciliation of the beginning and closing amount of Level 3 financial assets and liabilities which are recorded at fair value of the Group:

| | **March 31, 2013 (Three Months)** | December 31, 2012 (One Year) |
|---|---|---|
| **Financial assets** | | |
| Balance at beginning of period | **₱–** | ₱– |
| Add acquisition arising from business combination | **2,755,232** | – |
| Add total gain recorded in profit or loss | **11,951** | – |
| Balance at end of period | **₱2,767,183** | ₱– |
| **Financial liabilities** | | |
| Balance at beginning of period | **6,196,070** | 6,479,170 |
| Add acquisition arising from business combination | **2,755,232** | – |
| Less total gain recorded in profit and loss | **(87,611)** | (283,100) |
| Balance at end of period | **₱8,863,691** | ₱6,196,070 |

The table below sets forth, the potential effect of reasonably possible change in interest rates (alternative valuation assumption) on the Group's valuation of Level 3 subordinated debt designated at FVPL (amounts in million pesos):

| | **March 31, 2013** | | December 31, 2012 | |
|---|---|---|---|---|
| | **Statement of Income** | **Equity** | Statement of Income | Equity |
| **Financial Liability** | | | | |
| +50bps | **₱7** | **₱7** | ₱14 | ₱14 |
| - 50bps | **(7)** | **(7)** | (14) | (14) |
| +100bps | **13** | **13** | 90 | 90 |
| -100bps | **(13)** | **(13)** | (90) | (90) |

Since the fair values of segregated fund assets and liabilities classified as Level 3 items are immaterial relative to the overall size of the Group's assets and liabilities, the Group did not present the potential effect of change in valuation assumptions to the value of segregated fund assets and liabilities.

## 6. 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.

Other Segments - include but not limited to insurance, leasing, remittances and other support services. 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.

For management purposes, business segment report is done on a quarterly basis. Business segment information provided to the board of directors, chief operating decision maker (CODM) is based on the Regulatory Accounting Principles (RAP) submitted to the BSP in compliance with the reportorial requirements under the Financial Reporting Package (FRP) for banks, which differ from PFRS. Significant differences arose from the manner of provisioning for impairment and credit losses and measurement of investment properties. The report submitted to CODM represents only the results of operation for each of the reportable segment.

Segment assets are those operating assets that are employed by a segment in its operating activities and that either directly attributable to the segment or can be allocated to the segment on a reasonable basis.

Segment liabilities are those operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

The Group has no significant customer which contributes 10.00% or more of the consolidated revenue.

Business segment information of the Group follows:

| | Three Months Ended March 31, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Retail Banking | Corporate Banking | Treasury | Others | Adjustments and Eliminations* | Total |
| Interest income | ₱501,613 | ₱2,298,028 | ₱1,271,444 | ₱107,182 | (₱79,225) | ₱4,099,042 |
| Interest expense | 781,062 | 212,360 | 472,736 | 4,660 | 5,937 | 1,476,755 |
| Net interest margin | (279,449) | 2,085,668 | 798,708 | 102,522 | (85,162) | 2,622,287 |
| Other income | 335,950 | 334,850 | 3,106,053 | 1,108,648 | 236,350 | 5,121,851 |
| Other expenses | 1,477,492 | 477,093 | 62,082 | 651,871 | (1,336,504) | 1,332,034 |
| Segment result | (1,420,991) | 1,943,425 | 3,842,679 | 559,299 | 1,487,692 | 6,412,104 |
| Inter-segment | | | | | | |
| Imputed income | 1,089,959 | – | – | – | – | 1,089,959 |
| Imputed cost | – | (399,213) | (690,746) | – | – | (1,089,959) |
| Segment result to third party | (₱331,032) | ₱1,544,212 | ₱3,151,933 | ₱559,299 | ₱1,487,692 | ₱6,412,104 |
| Unallocated expenses | | | | | | 2,915,588 |
| Net income before share in net income of an associate and income tax | | | | | | 3,496,516 |
| Share in net income of an associate | | | | | | 4,975 |
| Net income before income tax | | | | | | 3,501,491 |
| Income tax | | | | | | 661,892 |
| Net income | | | | | | 2,839,599 |
| Non-controlling interest | | | | | | 12,179 |
| Net income for the period attributable to equity holders of the Parent Company | | | | | | ₱2,827,420 |
| Other Segment Information | | | | | | |
| Capital expenditures | ₱165,111 | ₱17,675 | ₱720 | ₱2,613 | ₱– | ₱186,119 |

(Forward)

| | Three Months Ended ended March 31, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | **Retail Banking** | **Corporate Banking** | **Treasury** | **Others** | **Adjustments and Eliminations*** | **Total** |
| Depreciation and amortization | **₱44,578** | **₱69,004** | **₱1,671** | **₱113,307** | **₱–** | **₱228,560** |
| Unallocated depreciation and amortization | | | | | | **67,975** |
| Total depreciation and amortization | | | | | | **₱296,535** |
| Provision for (reversal of) impairment, credit and other losses | **₱57,262** | **₱120,910** | **(₱275)** | **₱400** | **₱1,751** | **₱180,048** |

**The eliminations and adjustments column mainly represent the RAP to PFRS adjustments.*

| | As of March 31, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | **Retail Banking** | **Corporate Banking** | **Treasury** | **Others** | **Adjustments and Eliminations*** | **Total** |
| Segment assets | **₱285,769,540** | **₱165,671,235** | **₱233,855,869** | **₱77,858,603** | **(₱214,611,939)** | **₱548,543,308** |
| Unallocated assets | | | | | | **1,856,586** |
| Total assets | | | | | | **₱550,399,894** |
| Segment liabilities | **₱512,323,797** | **₱41,974,389** | **₱45,656,716** | **₱41,231,860** | **(₱203,403,304)** | **₱437,783,458** |
| Unallocated liabilities | | | | | | **26,126,708** |
| Total liabilities | | | | | | **₱463,910,166** |

**The eliminations and adjustments column mainly represent the RAP to PFRS adjustments.*

| | Three Months Ended March 31, 2012 (As restated) | | | | | |
|---|---|---|---|---|---|---|
| | Retail Banking | Corporate Banking | Treasury | Others | Adjustments and Eliminations* | Total |
| Interest income | ₱224,417 | ₱1,666,469 | ₱892,183 | ₱48,247 | ₱112,530 | ₱2,943,846 |
| Interest expense | 553,501 | 123,672 | 415,768 | 522 | (12,673) | 1,080,790 |
| Net interest margin | (329,084) | 1,542,797 | 476,415 | 47,725 | 125,203 | 1,863,056 |
| Other income | 218,577 | 297,923 | 1,933,838 | 603,435 | 95,238 | 3,149,011 |
| Other expenses | 577,858 | 290,436 | 481,406 | 507,238 | 354,509 | 2,211,447 |
| Segment result | (688,365) | 1,550,284 | 1,928,847 | 143,922 | (134,068) | 2,800,620 |
| Inter-segment | | | | | | |
| Imputed income | 1,106,041 | – | – | – | – | 1,106,041 |
| Imputed cost | – | (542,362) | (563,679) | – | – | (1,106,041) |
| Segment result to third party | ₱417,676 | ₱1,007,922 | ₱1,365,168 | ₱143,922 | (₱134,068) | ₱2,800,620 |
| Unallocated expenses | | | | | | 1,291,510 |
| Net income before share in net income of an associate and income tax | | | | | | 1,509,110 |
| Share in net income of an associate | | | | | | 18,300 |
| Net income before income tax | | | | | | 1,527,410 |
| Income tax | | | | | | 238,084 |
| Net income | | | | | | 1,289,326 |
| Non-controlling interest | | | | | | 2,129 |
| Net income for the year attributable to equity holders of the Parent Company | | | | | | ₱1,287,197 |
| Other Segment Information | | | | | | |
| Capital expenditures | ₱109,483 | ₱2,311 | ₱1,415 | ₱5,267 | ₱– | ₱118,476 |
| Depreciation and amortization | ₱36,028 | ₱41,800 | ₱1,490 | ₱18,850 | ₱32,786 | ₱130,954 |
| Unallocated depreciation and amortization | | | | | | 80,269 |
| Total depreciation and amortization | | | | | | ₱211,223 |
| Provision for (reversal of) impairment, credit and other losses | (₱46,924) | ₱49,511 | ₱439,647 | ₱950 | (₱84,207) | ₱358,977 |

**The eliminations and adjustments column mainly represent the RAP to PFRS adjustments.*

| | As of December 31, 2012 (As restated) | | | | | |
|---|---|---|---|---|---|---|
| | Retail Banking | Corporate Banking | Treasury | Others | Adjustments and Eliminations* | Total |
| Segment assets | ₱50,745,189 | ₱95,365,478 | ₱147,433,116 | ₱ 38,395,849 | (₱4,754,067) | ₱327,185,565 |
| Unallocated assets | | | | | | 3,005,186 |
| Total assets | | | | | | ₱330,190,751 |
| Segment liabilities | ₱205,217,147 | ₱32,452,570 | ₱40,985,859 | ₱16,570,501 | (₱6,489,036) | ₱288,737,041 |
| Unallocated liabilities | | | | | | 2,961,465 |
| Total liabilities | | | | | | ₱291,698,506 |

**The eliminations and adjustments column mainly represent the RAP to PFRS adjustments.*

| | As of January 1, 2012 (As restated) | | | | | |
|---|---|---|---|---|---|---|
| | Retail Banking | Corporate Banking | Treasury | Others | Adjustments and Eliminations* | Total |
| Segment assets | ₱48,015,755 | ₱124,180,936 | ₱102,414,597 | ₱35,781,723 | (₱2,356,960) | ₱308,036,051 |
| Unallocated assets | | | | | | 3,515,369 |
| Total assets | | | | | | ₱311,551,420 |
| Segment liabilities | ₱187,646,586 | ₱32,584,614 | ₱44,265,932 | ₱10,478,857 | (₱1,129,538) | ₱273,846,451 |
| Unallocated liabilities | | | | | | 3,898,024 |
| Total liabilities | | | | | | ₱277,744,475 |

## 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 and credit commitments items as of March 31, 2013, December 31 and January 1, 2012, and capitalized expenditures and revenues for the three-month periods ended March 31, 2013 and 2012 by geographic region of the Group follows:

| | Assets | | | Liabilities | | | Credit Commitments | | |
|---|---|---|---|---|---|---|---|---|---|
| | **March 31, 2013** | December 31, 2012 (As restated) | January 1, 2012 (As restated) | **March 31, 2013** | December 31, 2012 (As restated) | January 1, 2012 (As restated) | **March 31, 2013** | December 31, 2012 (As restated) | January 1, 2012 (As Restated) |
| Philippines | **₱521,707,915** | ₱319,698,926 | ₱300,293,908 | **₱443,691,410** | ₱284,122,475 | ₱269,832,296 | **₱20,480,786** | ₱442,084 | ₱2,026,118 |
| Asia (excluding Philippines) | **21,447,311** | 4,786,765 | 5,136,569 | **16,077,975** | 4,120,423 | 4,320,174 | **1,685,815** | 515,684 | 70,893 |
| USA and Canada | **6,075,838** | 5,156,870 | 5,279,980 | **3,581,539** | 3,150,382 | 3,069,855 | **22,765** | 37,606 | 36,558 |
| United Kingdom | **928,873** | 308,233 | 541,984 | **507,996** | 76,051 | 275,895 | **–** | – | – |
| Other European Union Countries | **239,957** | 239,957 | 298,979 | **51,246** | 229,175 | 246,255 | **–** | – | – |
| | **₱550,399,894** | ₱330,190,751 | ₱311,551,420 | **₱463,910,166** | ₱291,698,506 | ₱277,744,475 | **₱22,189,366** | ₱995,374 | ₱2,133,569 |

| | Capital Expenditures | | Revenues | |
|---|---|---|---|---|
| | **March 31, 2013** | March 31, 2012 | **March 31, 2013** | March 31, 2012 |
| Philippines | **₱179,770** | ₱117,720 | **₱8,843,731** | ₱5,881,908 |
| Asia (excluding Philippines) | **2,283** | 203 | **185,953** | 123,716 |
| USA and Canada | **–** | 553 | **166,523** | 71,814 |
| United Kingdom | **4,047** | – | **26,293** | 33,379 |
| Other European Union Countries | **19** | – | **3,368** | 340 |
| | **₱186,119** | ₱118,476 | **₱9,225,868** | ₱6,111,157 |

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 business segments.

7. **Financial Assets at Fair Value Through Profit or Loss**

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Held-for-trading: | | |
| Government securities | **₱3,686,079** | ₱1,970,754 |
| Derivative assets (Notes 23 and 35) | **454,953** | 454,501 |
| Equity securities | **300,852** | 250,552 |
| Private debt securities | **27,166** | 99,502 |
| | **4,469,050** | 2,775,309 |
| Designated at FVPL: | | |
| Segregated fund assets (Note 18) | **4,091,354** | – |
| Private debt securities | **1,229,018** | 1,247,756 |
| | **5,320,372** | 1,247,756 |
| | **₱9,789,422** | ₱4,023,065 |

This account consists of:

Government and private debt securities of the Group include unrealized gain of ₱82.4 million and ₱50.1 million as of March 31, 2013 and December 31, 2012, respectively.

Equity securities of the Group include unrealized gain of ₱13.8 million as of March 31, 2013 and unrealized loss of ₱3.9 million as of December 31, 2012.

As of March 31, 2013 and December 31, 2012, the effective interest rates of government securities range from 0.34% to 5.49% and from 0.67% to 6.72%, respectively.

As of March 31, 2013 and December 31, 2012, the effective interest rates of private debt securities range from 3.71% to 7.20% and from 3.95% to 7.20%, respectively.

Segregated fund assets designated as financial asset at FVPL refer to the considerations received from unit-linked insurance contracts invested by PNB LII in designated funds. On March 15, 2005 and June 17, 2005, the Insurance Commission approved PNB LII's license to sell single-pay and regular-pay unit-linked insurance products, respectively.

Segregated fund assets and the corresponding segregated fund liabilities are designated as financial assets and liabilities at FVPL since they are managed and their performances are evaluated on a fair value basis, in accordance with a documented risk management or investment strategy. The equity of each policyholder in the segregated fund assets is determined by assigning a number of units to each policyholder, corresponding to the net amount deposited in relation to the market value at the time of contribution. The value per unit may increase or decrease depending on the market value of the underlying assets of the corresponding segregated funds.

As of March 31, 2013, the segregated fund assets consist of ₱2.95 billion peso funds and ₱1.14 billion dollar funds. The segregated fund assets include the following equity-linked notes:

| Equity-linked notes | Description |
|---|---|
| Asian Summit | A single-pay variable life insurance product which invests the single premium, net of premium charges, into a five (5)-Year PHP-Linked USD Participation Note which is linked to the performance of a basket of five Asian equity indices. |
| Summit Select | A single-pay variable life insurance product which invests the single premium, net of premium charges, into 5-Year PHP-Linked USD Participation Note which is linked to the performance of ING Emerging Markets Consumption VT 10.00% Index. |
| Dollar Income Optimizer | A single-pay variable life insurance product which invests the single premium, net of premium charges, into UBS seven (7)-Year Structured Note which is linked to the performance of a basket of high quality global funds chosen to offer income and potential for capital appreciation. |

Debt securities designated as financial assets at FVPL also include USD-denominated investments in CLN. The CLNs 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 of the Parent Company. As of March 31, 2013 and December 31, 2012, unrealized loss from financial assets designated at FVPL amounted to ₱11.1 million and unrealized gain of ₱16.3 million, respectively.

On March 22 and August 17, 2012, the Parent Company pre-terminated investments in CLN designated as financial assets at FVPL with a total face amount of USD47.5 million or ₱2.0 billion and USD15.0 million or ₱636.3 million, respectively, in which the Parent Company realized trading gain of USD0.2 million or ₱8.3 million. The carrying amount of the preterminated securities as of pre-termination dates amounted to USD48.1 million or ₱2.1 billion and USD14.8 million or ₱628.2 million, respectively.

## 8. Available-for-Sale Investments

This account consists of:

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Government securities (Notes 17, 19 and 31) | **₱84,503,408** | ₱55,558,527 |
| Other debt securities (Note 23) | **15,460,387** | 10,920,133 |
| Equity securities - net of allowance for impairment losses (Note 16) | **1,663,831** | 518,819 |
| | **₱101,627,626** | ₱66,997,479 |

As of March 31, 2013 and December 31, 2012, unquoted AFS equity securities of the Group amounted to ₱102.9 million and ₱78.6 million , respectively. No impairment loss has been recognized on these securities for the three-month periods ended March 31, 2013 and 2012.

Other debt securities consist of notes issued by private entities and the host contracts on the CLN.

As of March 31, 2013, effective interest rates range from 2.35% to 8.15% and from 0.75% to 6.98% for peso-denominated and foreign currency-denominated AFS investments, respectively. As of December 31, 2012, effective interest rates range from 2.35% to 8.15% and from 0.98% to 5.23% for peso-denominated and foreign currency-denominated AFS investments, respectively.

As of March 31, 2013 and December 31, 2012, the fair value of the AFS investments in the form of Fixed Rate Treasury Notes pledged to fulfill the Parent Company's collateral requirements for the peso rediscounting facility of BSP amounted to ₱2.9 billion and ₱2.8 billion, respectively (Note 35). BSP has an obligation to return the securities to the Parent Company once the obligations have been settled. There are no other significant terms and conditions associated with the pledged investments.

As of March 31, 2013 and December 31, 2012, the fair value of the AFS investments in the form of Republic of the Philippines bonds pledged to fulfill its collateral requirements with securities sold under repurchase agreements transactions with counterparties amounted to ₱6.3 billion and ₱3.5 billion, respectively (Note 35). The counterparties have an obligation to return the securities to the Parent Company once the obligations have been settled. There are no other significant terms and conditions associated with the pledged investments.

Interest income on trading and investment securities consists of:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| AFS investments | **₱662,548** | ₱633,831 |
| Financial assets at FVPL | **265,330** | 168,681 |
| | **₱927,878** | ₱802,512 |

Trading and investment securities gains - net consist of:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| Financial assets at FVPL: | | |
| Held-for-trading | **₱401,161** | ₱58,571 |
| Derivatives (Note 23) | **23,019** | 4,030 |
| Designated at FVPL | **(11,116)** | 17,310 |
| AFS investments | **2,590,049** | 1,506,817 |
| Financial liabilities at FVPL: | | |
| Derivative liabilities (Note 23) | **169,430** | 5,708 |
| Designated at FVPL | **99,562** | 157,393 |
| | **₱3,272,105** | ₱1,749,829 |

The movements in Net unrealized gains on AFS investments, gross of deferred tax, are as follows:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| Balance at the beginning of the period | **₱1,046,108** | ₱776,980 |
| Unrealized gains recognized in equity | **4,532,018** | 1,006,263 |
| Realized gains | **(2,590,049)** | (1,506,817) |
| Balance at end of period | **₱2,988,077** | ₱276,426 |

Included in AFS investments are pledged securities for the Surety Bond issued by PNB Gen. As of March 31, 2013 and December 31, 2012, the carrying value of these pledged securities amounted to ₱975.3 million and ₱817.1 million, respectively.

Reclassification of Financial Assets
On October 12, 2011, the Parent Company had identified a clear change of intent to exit or trade in the short term its HTM investments rather than to hold them until maturity, when it disposed of more than an insignificant amount of its HTM investments. This disposal necessitated the reclassification of the remaining HTM investments to AFS securities in accordance with PAS 39. As of the date of reclassification, the amortized cost of HTM investments reclassified to AFS investments amounted to ₱32.5 billion. Reclassified AFS investments are initially measured at its fair value amounting to ₱35.7 billion. Any difference between the amortized cost of HTM investments and its fair value at reclassification date is recognized in OCI.

As of March 31, 2013 and December 31, 2012, the carrying value of the securities reclassified out of HTM investments to AFS investments amounted to ₱2.0 billion and ₱1.9 billion, respectively.

For the three-month periods ended March 31, 2013 and 2012, the net unrealized (loss) gain reclassified from equity to profit or loss due to sale of investments reclassified to AFS amounted to(₱12.7) million and ₱299.6 million, respectively.

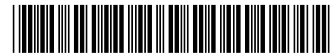
Under PAS 39, tainting of HTM investments due to disposal prohibits the Parent Company from classifying financial assets as HTM investments for three years starting from the tainting date.

## 9. Loans and Receivables

This account consists of:

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Receivable from customers: | | |
| Loans and discounts | **₱204,505,856** | ₱124,072,963 |
| Customers' liabilities on acceptances, letters of credit and trust receipts | **8,689,121** | 4,150,208 |
| Bills purchased | **3,844,940** | 2,556,211 |

(Forward)



| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Credit card receivables | **₱3,529,601** | ₱286,623 |
| Lease contracts receivable (Note 28) | **2,863,730** | 2,043,456 |
| | **223,433,248** | 133,109,461 |
| Less unearned and other deferred income | **1,117,894** | 910,617 |
| | **222,315,354** | 132,198,844 |
| Unquoted debt securities (Note 17) | **11,608,083** | 7,818,199 |
| Other receivables: | | |
| Accounts receivable | **8,669,857** | 7,517,056 |
| Accrued interest receivable | **7,289,293** | 6,190,680 |
| Sales contract receivables | **5,078,871** | 4,633,079 |
| Miscellaneous | **543,010** | 593,434 |
| | **255,504,468** | 158,951,292 |
| Less allowance for credit losses (Note 16) | **14,143,544** | 14,243,783 |
| | **₱241,360,924** | ₱144,707,509 |

The separate valuation allowance of acquired loans and receivables were not recognized by PNB on the effectivity date of the acquisition as these receivables were measured at fair value on acquisition date. Any uncertainties about future cash flows of these receivables were included in their fair value measurement (see Note 14).

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

| | **March 31, 2013** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Business Loans** | **GOCCs and NGAs** | **LGUs** | **Consumers** | **Fringe Benefits** | **Unquoted Debt Securities** | **Others** | **Total** |
| Receivable from customers: | | | | | | | | |
| Loans and discounts | **₱152,912,832** | **₱23,892,662** | **₱7,927,057** | **₱19,126,328** | **₱646,977** | **₱–** | **₱–** | **₱204,505,856** |
| Customers' liabilities on acceptances, letters of credit and trust receipts | **8,682,738** | **6,383** | – | – | – | – | – | **8,689,121** |
| Bills purchased | **2,353,272** | **1,314,938** | – | **176,730** | – | – | – | **3,844,940** |
| Credit card accounts | – | – | – | **3,529,601** | – | – | – | **3,529,601** |
| Lease contracts receivable (Note 28) | **2,862,007** | – | – | **1,723** | – | – | – | **2,863,730** |
| | **166,810,849** | **25,213,983** | **7,927,057** | **22,834,382** | **646,977** | – | – | **223,433,248** |
| Less unearned and other deferred income | **1,059,368** | – | – | **58,526** | – | – | – | **1,117,894** |
| | **165,751,481** | **25,213,983** | **7,927,057** | **22,775,856** | **646,977** | – | – | **222,315,354** |
| Unquoted debt securities | – | – | – | – | – | **11,608,083** | – | **11,608,083** |
| Other receivables: | | | | | | | | |
| Accounts receivable | – | – | – | – | – | – | **8,669,857** | **8,669,857** |
| Accrued interest receivable | – | – | – | – | – | – | **7,289,293** | **7,289,293** |
| Sales contract receivables | – | – | – | – | – | – | **5,078,871** | **5,078,871** |
| Miscellaneous | – | – | – | – | – | – | **543,010** | **543,010** |
| | **165,751,481** | **25,213,983** | **7,927,057** | **22,775,856** | **646,977** | **11,608,083** | **21,581,031** | **255,504,468** |
| Less allowance for credit losses (Note 16) | **4,622,605** | **72,657** | **104,508** | **434,467** | **15,892** | **3,958,656** | **4,934,759** | **14,143,544** |
| | **₱161,128,876** | **₱25,141,326** | **₱7,822,549** | **₱22,341,389** | **₱631,085** | **₱7,649,427** | **₱16,646,272** | **₱241,360,924** |

| | December 31, 2012 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Business Loans | GOCCs and NGAs | LGUs | Consumers | Fringe Benefits | Unquoted Debt Securities | Others | Total |
| Receivable from customers: | | | | | | | | |
| Loans and discounts | ₱83,058,722 | ₱21,598,814 | ₱7,287,123 | ₱11,469,948 | ₱658,356 | ₱– | ₱– | ₱124,072,963 |
| Customers' liabilities on acceptances, letters of credit and trust receipts | 2,658,590 | 1,491,618 | – | – | – | – | – | 4,150,208 |
| Bills purchased | 1,165,415 | 1,390,796 | – | – | – | – | – | 2,556,211 |
| Credit card accounts | – | – | – | 286,623 | – | – | – | 286,623 |
| Lease contracts receivable (Note 28) | 2,041,954 | – | – | 1,502 | – | – | – | 2,043,456 |
| | 88,924,681 | 24,481,228 | 7,287,123 | 11,758,073 | 658,356 | – | – | 133,109,461 |
| Less unearned and other deferred income | 910,511 | – | – | 106 | – | – | – | 910,617 |
| | 88,014,170 | 24,481,228 | 7,287,123 | 11,757,967 | 658,356 | – | – | 132,198,844 |
| Unquoted debt securities | – | – | – | – | – | 7,818,199 | – | 7,818,199 |
| Other receivables: | | | | | | | | |
| Accounts receivable | – | – | – | – | – | – | 7,517,056 | 7,517,056 |
| Accrued interest receivable | – | – | – | – | – | – | 6,190,680 | 6,190,680 |
| Sales contract receivables | – | – | – | – | – | – | 4,633,079 | 4,633,079 |
| Miscellaneous | – | – | – | – | – | – | 593,434 | 593,434 |
| | 88,014,170 | 24,481,228 | 7,287,123 | 11,757,967 | 658,356 | 7,818,199 | 18,934,249 | 158,951,292 |
| Less allowance for credit losses (Note 16) | 4,631,725 | 70,731 | 129,653 | 561,132 | 14,748 | 3,958,931 | 4,876,863 | 14,243,783 |
| | ₱83,382,445 | ₱24,410,497 | ₱7,157,470 | ₱11,196,835 | ₱643,608 | ₱3,859,268 | ₱14,057,386 | ₱144,707,509 |

Refer to Note 32 for the loans and receivables to related parties.

As of March 31, 2013 and December 31, 2012, 83.45% and 90.89%, respectively, of the total receivable from customers of the Group were subject to quarterly interest repricing. Remaining receivables carry annual fixed interest rates ranging from 1.65% to 19.75% and 2.25% to 12.97% as of March 31, 2013 and December 31, 2012, respectively, for foreign currency-denominated receivables, and from 1.00% to 25.00% and from 0.85% to 18.50% as of March 31, 2013 and December 31, 2012, respectively, for peso-denominated receivables.

Sales contract receivables bear fixed interest rate per annum ranging from 1.76% to 15.00% as of March 31, 2013 and December 31, 2012.

The EIR of 'Receivable from customers', 'Unquoted debt instruments' and 'Sales contract receivables' range from 1.65% to 12.97% and from 2.25% to 12.97% as of March 31, 2013 and December 31, 2012, repectively, for foreign currency-denominated receivables, and from 0.50% to 47.40% and from 0.85% to 47.40% as of March 31, 2013 and December 31, 2012, respectively, for peso-denominated receivables.

Loans amounting to ₱0.7 billion and ₱2.0 billion as of March 31, 2013 and December 31, 2012, respectively, have been pledged to the BSP to secure the Parent Company's availments under the BSP rediscounting privileges which are included in Bills payable (see Notes 19 and 35). The pledged loans will be released when the underlying transaction is terminated. In the event of the Parent Company's default, BSP is entitled to apply the collateral in order to settle the rediscounted bills.

*Unquoted debt instruments*
Unquoted debt instruments include the zero-coupon notes received by the Parent Company on October 15, 2004, 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 National Steel Corporation (NSC) of ₱5.3 billion. The notes are secured by a first ranking mortgage and security interest over the NSC Plant Assets. As of March 31, 2013 and December 31, 2012, these notes were fully impaired (See Note 33).

As of March 31, 2013 and December 31, 2012, unquoted debt instruments also include bonds issued by Philippine Sugar Corporation (PSC) amounting to ₱2.7 billion with accrued interest included 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 March 31, 2013 and December 31, 2012, the sinking fund amounted to ₱5.3 billion and ₱5.2 billion, respectively, earning an average rate of return of 8.82% per annum. Management expects that the value of the sinking fund by 2014 will be more than adequate to cover the full redemption value of the 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 receivable') and liabilities in connection with the sale of the Parent Company's 60.00% equity in Maybank. As of March 31, 2013 and December 31, 2012, the balance of these receivables amounted to ₱3.4 billion, and the transferred liabilities (included under 'Bills payable to BSP and local banks' - see Note 19 and 'Accrued interest payable') amounted 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 ₱262.5 million as of March 31, 2013 and December 31, 2012. The remaining 40.00% equity ownership of the Parent Company in Maybank was sold in June 2000 (see Note 33).

*Finance lease receivable*
An analysis of the Group's finance lease receivables as of March 31, 2013 and December 31, 2012 is presented as follows (amounts in thousands):

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Gross investment in finance lease receivables | | |
| Due within one year | **₱1,091,550** | ₱778,749 |
| Due beyond one year but not over five years | **1,374,122** | 935,464 |
| | **2,465,672** | 1,714,213 |
| Residual value of leased equipment | | |
| Due within one year | **133,670** | 110,562 |
| Due beyond one year but not over five years | **264,388** | 218,681 |
| | **398,058** | 329,243 |
| Less unearned lease income | **250,495** | 232,096 |
| Net investment in finance lease receivables | **₱2,613,235** | ₱1,811,360 |

BSP Reporting
The table below shows the industry sector analysis of the Group's receivable from customers before taking into account the allowance for credit losses (amounts in millions):

| | **March 31, 2013** | | December 31, 2012 | |
|---|---|---|---|---|
| | **Carrying Amount** | **%** | Carrying Amount | % |
| **Loans and Receivables** | | | | |
| Receivable from customers: | | | | |
| Primary target industry: | | | | |
| Wholesale and retail | **₱38,941** | **17.43** | ₱21,496 | 16.15 |
| Manufacturing | **31,305** | **14.01** | 13,317 | 10.00 |
| Electricity, gas and water | **26,143** | **11.70** | 18,180 | 13.66 |
| Public administration and defense | **24,233** | **10.84** | 22,766 | 17.10 |
| Transport, storage and communication | **23,975** | **10.73** | 17,051 | 12.81 |
| Financial intermediaries | **16,280** | **7.29** | 10,207 | 7.67 |
| Agriculture, hunting and forestry | **3,491** | **1.56** | 2,899 | 2.18 |
| Secondary target industry: | | | | |
| Real estate, renting and business activities | **28,950** | **12.96** | 11,434 | 8.59 |
| Construction | **5,065** | **2.27** | 2,349 | 1.77 |
| Others | **25,050** | **11.21** | 13,410 | 10.07 |
| | **₱223,433** | **100.00** | ₱133,109 | 100.00 |

The information (gross of unearned and other deferred income) relating to receivable from customers as to secured and unsecured and as to collateral follows:

| | **March 31, 2013** | | December 31, 2012 | |
|---|---|---|---|---|
| | **Amount** | **%** | Amount | % |
| Secured: | | | | |
| Real estate mortgage | **₱51,292,582** | **22.96** | ₱21,457,030 | 16.12 |
| Chattel mortgage | **6,013,561** | **2.69** | 4,336,447 | 3.26 |
| Bank deposit hold-out | **2,170,522** | **0.97** | 1,615,415 | 1.21 |
| Shares of stocks | **1,479,993** | **0.66** | 358,267 | 0.27 |
| Others | **31,047,089** | **13.90** | 21,660,562 | 16.27 |
| | **92,003,747** | **41.18** | 49,427,721 | 37.13 |
| Unsecured | **131,429,501** | **58.82** | 83,681,740 | 62.87 |
| | **₱223,433,248** | **100.00** | ₱133,109,461 | 100.00 |

Non-performing Loans (NPLs) classified as secured and unsecured as reported to BSP follows:

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Secured | **₱7,179,566** | ₱3,801,846 |
| Unsecured | **3,519,783** | 2,662,759 |
| | **₱10,699,349** | ₱6,464,605 |

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. Effective January 1, 2013, the exclusion of NPLs classified as loss but are fully covered by allowance was removed by the BSP through Circular No. 772. Previous 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 NPLs not fully covered by allowance for credit losses of the Parent Company as of December 31, 2012 follow:

| | December 31, 2012 |
|---|---|
| Total NPLs | ₱6,464,605 |
| Less NPLs fully covered by allowance for credit losses | 2,697,422 |
| | ₱3,767,183 |

As of March 31, 2013, based on the revised definition of NPL under Circular No. 772, NPLs of the Parent Company as reported to BSP amounted to ₱10.7 billion. Most of these loans are secured by real estate or chattel mortgages. Gross and net NPL ratios of the Group are 4.47% and 1.33%, respectively.

Restructured loans of the Group as of March 31, 2013 and December 31, 2012 amounted to ₱2.6 billion.

Interest income on loans and receivables consists of:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| Receivable from customers and sales contract receivables | **₱2,874,817** | ₱1,925,293 |
| Unquoted debt securities | **39,315** | 18,962 |
| | **₱2,914,132** | ₱1,944,255 |

Interest income accrued on impaired loans and receivable of the Group amounted to ₱64.8 million and ₱94.6 million for the three-month periods ended March 31, 2013 and 2012, respectively (Note 16).

## 10. Receivable from Special Purpose Vehicle

The Group has receivable from SPV, OPII, which was deconsolidated under PFRS 10 (see Note 2).

As of March 31, 2013 and December 31, 2012, receivable from SPV represents fully provisioned subordinated notes received by the Parent Company from Golden Dragon Star Equities and its assignee, OPII, relative to the sale of the first pool and second pool of its NPAs in December 2006 and March 2007, respectively. The asset sale and purchase agreements (ASPA) between the Parent Company, Golden Dragon Star Equities and OPII for the sale of the NPAs were executed on December 19, 2006. OPII was specifically organized to hold, manage, service and resolve the non-performing assets sold to Golden Dragon Star Equities. OPII has been financed through the issuance of equity securities and subordinated debt securities. No income was recognized from OPII in 2013.

The more significant terms of the sale are as follows:

a. Certain NPAs of the Parent Company were 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 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.

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 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 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. In case of insufficiency of funds for payment of the SPV Notes, the buyer of the NPAs, with the consent of the Parent Company, which consent shall not be unreasonably withheld, may write-off the SPV Notes, including all interest, fees and charges outstanding and payable.

11. **Property and Equipment**

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

| | **March 31, 2013 (Three Months)** | | |
|---|---|---|---|
| | **Furniture, Fixtures and Equipment** | **Leasehold Improvements** | **Total** |
| **Cost** | | | |
| Balance at beginning of period | **₱3,121,098** | **₱458,529** | **₱3,579,627** |
| Additions | **117,925** | **41,651** | **159,576** |
| Acquired from business combination (Note 14) | **467,156** | **119,458** | **586,614** |
| Disposals/others | **(86,076)** | **(10,052)** | **(96,128)** |
| Balance at end of period | **3,620,103** | **609,586** | **4,229,689** |
| **Accumulated Depreciation and Amortization** | | | |
| Balance at beginning of period | **2,410,507** | **232,045** | **2,642,552** |
| Depreciation and amortization | **94,406** | **27,466** | **121,872** |
| Disposals/others | **(27,066)** | **(4,848)** | **(31,914)** |
| Balance at end of period | **2,477,847** | **254,663** | **2,732,510** |
| **Net Book Value at End of Period** | **₱1,142,256** | **₱354,923** | **₱1,497,179** |

| | December 31, 2012 (One Year) | | |
|---|---|---|---|
| | Furniture, Fixtures and Equipment | Leasehold Improvements | Total |
| **Cost** | | | |
| Balance at beginning of period | ₱3,042,550 | ₱354,065 | ₱3,396,615 |
| Additions | 269,349 | 131,910 | 401,259 |
| Disposals/others | (190,801) | (27,446) | (218,247) |
| Balance at end of period | 3,121,098 | 458,529 | 3,579,627 |
| **Accumulated Depreciation and Amortization** | | | |
| Balance at beginning of period | 2,330,702 | 199,900 | 2,530,602 |
| Depreciation and amortization | 237,322 | 60,853 | 298,175 |
| Disposals/others | (157,517) | (28,708) | (186,225) |
| Balance at end of period | 2,410,507 | 232,045 | 2,642,552 |
| **Net Book Value at End of Period** | ₱710,591 | ₱226,484 | ₱937,075 |

The composition of and movements in land and buildings of the Group which are carried at revalued amount follow:

| | **March 31, 2013 (Three Months)** | | |
|---|---|---|---|
| | **Land** | **Buildings** | **Total** |
| **Revalued amount** | | | |
| Balance at beginning of period | **₱11,296,469** | **₱6,892,115** | **₱18,188,584** |
| Additions | **16** | **48,911** | **48,927** |
| Acquired from business combination (Note 14) | **3,444,747** | **2,515,637** | **5,960,384** |
| Disposals/others | – | **(15,584)** | **(15,584)** |
| Balance at end of period | **14,741,232** | **9,441,079** | **24,182,311** |

(Forward)

| | March 31, 2013 (Three Months) | | |
|---|---|---|---|
| | **Land** | **Buildings** | **Total** |
| **Accumulated Depreciation** | | | |
| Balance at beginning of period | **₱–** | **₱2,383,948** | **₱2,383,948** |
| Depreciation | **–** | **89,486** | **89,486** |
| Disposals/others | **–** | **(2,660)** | **(2,660)** |
| Balance at end of period | **–** | **2,470,774** | **2,470,774** |
| **Allowance for Impairment Losses** (Note 16) | **191,450** | **46,536** | **237,986** |
| **Net Book Value at End of Period** | **₱14,549,782** | **₱6,923,769** | **₱21,473,551** |

| | December 31, 2012 (One Year) | | |
|---|---|---|---|
| | Land | Buildings | Total |
| **Revalued amount** | | | |
| Balance at beginning of period | ₱11,295,469 | ₱6,870,978 | ₱18,166,447 |
| Additions | 1,000 | 302,068 | 303,068 |
| Disposals/others | – | (280,931) | (280,931) |
| Balance at end of period | 11,296,469 | 6,892,115 | 18,188,584 |
| **Accumulated Depreciation** | | | |
| Balance at beginning of period | – | 2,230,309 | 2,230,309 |
| Depreciation | – | 175,642 | 175,642 |
| Disposals/others | – | (22,003) | (22,003) |
| Balance at end of period | – | 2,383,948 | 2,383,948 |
| **Allowance for Impairment Losses** (Note 16) | 191,450 | 46,536 | 237,986 |
| **Net Book Value at End of Period** | ₱11,105,019 | ₱4,461,631 | ₱15,566,650 |

The revalued amount of land and building was determined by independent appraisers based on highest and best use of property being appraised. 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 and comparability of similar properties sold with the property being valued.

Depreciation on the revaluation increment of the buildings of the Group amounted to ₱17.4 million for the three-month periods ended March 31, 2013 and 2012.

Had the land and buildings been carried at cost, the net book value of the land and buildings of the group would have been ₱10.6 billion and ₱4.7 billion as of March 31, 2013 and December 31, 2012.

Depreciation and amortization consists of:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| Property and equipment | **₱211,358** | ₱112,640 |
| Investment properties (Note 13) | **72,592** | 94,074 |
| Other foreclosed properties | **12,585** | 4,509 |
| | **₱296,535** | ₱211,223 |

As of March 31, 2013 and December 31, 2012, property and equipment of the Group with acquisition costs of ₱749.1 million and ₱736.7 million, respectively, is fully depreciated but is still being used.

## 12. Investments in a Subsidiary and an Associate

The details of this account follow:

| | **March 31, 2013 (Three Months)** | December 31, 2012 (One Year) |
|---|---|---|
| Acquisition cost: | | |
| Subsidiary: | | |
| PNB Venture Capital Corporation (61% owned) | **₱5,061** | ₱5,061 |
| Associate: | | |
| ACB (39% owned in 2012) | **2,763,903** | 2,763,903 |
| | **2,768,964** | 2,768,964 |
| Accumulated equity in net earnings: | | |
| Balance at beginning of period | **136,330** | 132,816 |
| Equity in net earnings for the period (Note 26) | **4,975** | 10,309 |
| Equity in accumulated translation adjustments | **(21,296)** | – |
| Equity in net unrealized loss on AFS investments of an associate | – | (6,795) |
| Balance at end of period | **120,009** | 136,330 |
| Disposal of previously held interest in an associate due to step-up acquisition of control over investee | **(2,883,912)** | – |
| | **₱5,061** | ₱2,905,294 |

With its business combination with ABC (Note 1), the Parent Company's equity interest in ACB increased from 39.41% to 90.41%. This resulted in change in accounting for such investment from an associate to a subsidiary. In accordance with PFRS 3, *Business Combination*, the step-up acquisition of investment in ACB is accounted for as a disposal of the equity investment in ACB and the line by line consolidation of ACB's assets and liabilities in the Group's financial statements. The disposal resulted in a gain of ₱83.9 million, which included recycling to profit or loss of the cumulative translation adjustment of ₱21.3 million arising from the translation of the equity investment to the presentation currency of the Group.

PNB Venture Capital Corporation is 61%-owned by the Parent Company and carried at cost less any impairment in value. This subsidiary is considered insignificant to the Group.

## 13. **Investment Properties**

The composition of and movements in this account follow:

| | **March 31, 2013 (Three Months)** | | |
|---|---|---|---|
| | **Land** | **Buildings and Improvements** | **Total** |
| **Cost** | | | |
| Balance at beginning of period | **₱16,017,778** | **₱4,025,748** | **₱20,043,526** |
| Additions | **139,443** | **65,465** | **204,908** |
| Acquired from business combination (Note 14) | **4,357,158** | **658,031** | **5,015,189** |
| Disposals/others | **(435,775)** | **(212,284)** | **(648,059)** |
| Balance at end of period | **20,078,604** | **4,536,960** | **24,615,564** |
| **Accumulated Depreciation** | | | |
| Balance at beginning of period | **–** | **2,112,673** | **2,112,673** |
| Depreciation (Note 11) | **–** | **72,592** | **72,592** |
| Disposals/others | **–** | **(104,953)** | **(104,953)** |
| Balance at end of period | **–** | **2,080,312** | **2,080,312** |
| **Accumulated Impairment Losses** (Note 16) | | | |
| Balance at beginning of period | **2,842,164** | **610,341** | **3,452,505** |
| Provision for impairment losses | **29,772** | **307** | **30,079** |
| Disposals/others | **(431,952)** | **462,170** | **30,218** |
| Balance at end of period | **2,439,984** | **1,072,818** | **3,512,802** |
| **Net Book Value at End of Period** | **₱17,638,620** | **₱1,383,830** | **₱19,022,450** |

| | December 31, 2012 (One Year) | | |
|---|---|---|---|
| | Land | Buildings and Improvements | Total |
| **Cost** | | | |
| Balance at beginning of period | ₱17,319,875 | ₱5,429,337 | ₱22,749,212 |
| Additions | 608,996 | 197,270 | 806,266 |
| Disposals/others | (1,911,093) | (1,600,859) | (3,511,952) |
| Balance at end of period | 16,017,778 | 4,025,748 | 20,043,526 |
| **Accumulated Depreciation** | | | |
| Balance at beginning of period | – | 2,645,744 | 2,645,744 |
| Depreciation | – | 227,802 | 227,802 |
| Disposals/others | – | (760,873) | (760,873) |
| Balance at end of period | – | 2,112,673 | 2,112,673 |
| **Accumulated Impairment Losses** (Note 16) | | | |
| Balance at beginning of period | 2,798,435 | 1,204,920 | 4,003,355 |
| Provision for (recovery from) impairment losses | (161,725) | 11,742 | (149,983) |
| Disposals/others | 205,454 | (606,321) | (400,867) |
| Balance at end of period | 2,842,164 | 610,341 | 3,452,505 |
| **Net Book Value at End of Period** | ₱13,175,614 | ₱1,302,734 | ₱14,478,348 |

Investment properties include real properties foreclosed or acquired in settlement of loans. The fair value of the investment properties of the Group as of March 31, 2013 and December 31, 2012 as determined by independent and/or in-house appraisers amounted to ₱27.6 billion and ₱21.9 billion, respectively. 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 and comparability of similar properties sold with the property being valued.

Foreclosed investment properties of the Group still subject to redemption period by the borrowers amounted to ₱345.1 million and ₱437.2 million as of March 31, 2013 and December 31, 2012, respectively.

Direct operating expenses on investment properties that generated rental income during the period (other than depreciation and amortization), included under 'Miscellaneous expenses - Foreclosure and other Real and Other Properties Acquired (ROPA) - related expenses' in Note 26, amounted to ₱7.4 million and ₱11.8 million for the three-month periods ended March 31, 2013 and 2012, respectively. While direct operating expenses on investment properties that did not generate rental income included under 'Miscellaneous expenses - Foreclosure and other ROPA - related expenses' in Note 26, amounted to ₱56.3 million and ₱37.4 million for the three-month periods ended March 31, 2013 and 2012, respectively.

## 14. Business Combinations

As discussed in Note 1, on February 9, 2013, the Parent Company acquired 100.00% of voting common stocks of ABC, a listed universal bank. The acquisition of ABC was made to strengthen the Parent Company's financial position and enlarge its operations.

The Parent Company accounted for the business combination with ABC under the acquisition method of PFRS 3. The Group has elected to measure the non-controlling interest in the acquiree at proportionate share of identifiable assets and liabilities.

*Assets acquired and liabilities assumed*
In accordance with PFRS 3, the Parent Company determined the assets acquired and liabilities assumed from the business combination and provisionally made an assessment of their fair values. The fair values of the identifiable assets and liabilities of ABC and its subsidiaries as at the date of acquistion follow:

| | Fair value of the net assets recognized on acquistion date |
|---|---|
| **Assets** | |
| Cash and other cash items | ₱3,138,220 |
| Due from Bangko Sentral ng Pilipinas | 44,481,495 |
| Due from other banks | 12,514,443 |
| Interbank loans receivable | 4,310,711 |
| Financial assets at fair value through profit or loss | 6,502,108 |
| Available-for-sale investments | 18,693,504 |
| Loans and receivables | 92,168,568 |
| Property and equipment (Note 11) | 6,546,998 |
| Investment properties (Note 13) | 5,015,189 |
| Deferred tax assets | 52,574 |
| Other assets (Note 15) | 1,875,509 |
| Total assets | ₱195,299,319 |

(Forward)

| | Fair value of the net assets recognized on acquistion date |
|---|---|
| **Liabilities** | |
| Deposit liabilities | |
| Demand | ₱52,098,658 |
| Savings | 61,989,407 |
| Time | 27,101,791 |
| | 141,189,856 |
| Financial liabilities at fair value through profit or loss | 3,877,768 |
| Bills and acceptances payable | 3,480,045 |
| Accrued taxes, interest and other expenses | 1,653,681 |
| Subordinated debt | 4,498,919 |
| Income tax payable | 25,975 |
| Deferred tax liabilities | 916,006 |
| Other liabilities | 8,336,261 |
| Total liabilities | 163,978,511 |
| Fair values of identifiable assets and liabilities assumed | ₱31,320,808 |

The total gross contractual amounts of receivables acquired as of February 9, 2013 was ₱97.4 billion, while the corresponding allowance for probable losses and unearned interest discount amounted to ₱5.1 billion and ₱0.1 billion, respectively. Deferred tax liability on fair value adjustments amounted to ₱711.9 million was offset on a per entity basis against the deferred tax asset carried by PNB.

The proportionate share and measurement of the non-controlling interests and previously held interest in PNB LII, ACB, ALFC, ABCHK and OHBVI have been determined using the fair values of the respective net assets of these subsidiaries.

The business combination resulted in recognition of goodwill which is provisionally determined as follows:

| | | |
|---|---|---|
| Purchase consideration transferred | | ₱41,505,929 |
| Add: | Proportionate share of the non-controlling interest in the net assets of ABC | 2,762,937 |
| | Acquisition-date fair value of previously held interest in subsidiaries | 3,069,442 |
| Less: | Fair values of identifiable assets and liabilities assumed | 31,320,808 |
| Goodwill | | ₱16,017,500 |

The goodwill amounting to ₱16.0 billion is provisional pending receipt of the final valuation of the identifiable intangible assets. The goodwill arising from acquisition consists largely of the synergies and economies of scale expected from combining the operations of PNB and ABC. Goodwill is allocated entirely to the banking and insurance segments. None of the goodwill recognized is expected to be deductible for income tax purposes.

From the date of acquistion, ABC and its subsidiaries have contributed ₱1.0 billion to the Group's revenue and ₱20.6 million loss to the Group's income before income tax. If the combination had taken place at the beginning of the year, contribution to the Group revenue and the income before income tax would have been ₱2.6 billion and ₱0.6 billion, respectively.

An analysis of cash flows arising from the business combination follows:

| | |
|---|---|
| Net cash acquired arising from the business combination (under investing activities) | ₱64,444,869 |
| Less transaction costs attributable to issuance of shares (under financing activities) | 84,792 |
| Net cash in flow from the business combination | ₱64,360,077 |

The fair value of the 423,962,500 common shares issued as consideration for the net assets of ABC and its subsidiaries was determined on the basis of the closing market price of PNB common shares as of February 9, 2013.

On April 26, 2013, the Group filed a request for a ruling from the Bureau of Internal Revenue (BIR) seeking confirmation that the statutory merger of PNB and ABC is a tax-free merger under Section 40(C)(2) of the National Internal Revenue Code of 1997 as amended (Tax Code). As of March 31, 2013, the ruling request is still pending with the Law Division of the BIR. The Group believes that the BIR will issue such confirmation on the basis of BIR Preliminary Ruling No. 01-2008 (dated September 28, 2008) whereby the BIR held that the statutory merger of PNB and ABC complies with Revenue Memorandum Ruling (RMR) No. 1-2001, subject to the submission of the merger documents and documents pertaining to the assets and liabilities transferred. RMR No. 1-2001 provides the fact pattern that should be present in order to secure BIR confirmation for a tax-free Section 40(C)(2) transaction.

## 15. **Other Assets**

This account consists of:

| | **March 31, 2013** | December 31, 2012 (As restated - Note 2) | January 1, 2012 (As restated - Note 2) |
|---|---|---|---|
| Investment in Heritage Park (Note 14) | **₱1,120,601** | ₱– | ₱– |
| Real estate inventories | **1,014,678** | 1,014,678 | 2,419,610 |
| Software costs | **412,342** | 376,055 | 409,390 |
| Creditable withholding taxes | **247,856** | – | – |
| Deferred reinsurance premiums | **215,992** | 211,151 | 230,685 |
| Prepaid expenses | **183,822** | 85,629 | 116,981 |
| Chattel properties - net | **115,609** | 116,159 | 69,339 |
| Documentary stamps on hand | **111,719** | 28,284 | 78,908 |
| Deferred charges | **95,684** | 81,400 | 82,039 |
| Stationeries and supplies | **73,114** | 34,547 | 35,479 |
| Returned checks and other cash items | **62,656** | 158,002 | 106,706 |
| Security deposits | **57,498** | – | – |
| Sundry debits | **36,235** | – | 86,445 |

(Forward)

| | March 31, 2013 | December 31, 2012 (As restated - Note 2) | January 1, 2012 (As restated - Note 2) |
|---|---|---|---|
| Other investments | **₱25,134** | ₱17,382 | ₱15,086 |
| Miscellaneous COCI | **8,330** | 808 | 5,220 |
| Retirement benefit asset | **7,435** | – | – |
| Revolving fund and petty cash fund | **834** | 845 | 771 |
| Shortages | **404** | 45 | 423 |
| Postage stamps on hand | **303** | 110 | 128 |
| Miscellaneous | **307,792** | 151,858 | 271,187 |
| | **4,098,038** | 2,276,953 | 3,928,397 |
| Less allowance for impairment losses (Note 16) | **97,706** | 98,316 | 546,228 |
| | **₱4,000,332** | ₱2,178,637 | ₱3,382,169 |

*Investment in Heritage Park*
Investment in Heritage Park which formed part of net the assets acquired from ABC represents the Group's portfolio holdings in Heritage Park investment certificates.

*Real Estate Inventories*
This comprise of land contributed to the Joint Venture Agreement (JVA) of the Parent Company with Eton Properties Philippines, Inc. (EPPI) which are carried at cost. Refer to Note 32 for the terms of the JVA.

*Software Costs*
Movements in software costs are as follows:

| | March 31, 2013 (Three Months) | December 31, 2012 (One Year) |
|---|---|---|
| Balance at beginning of period | **₱376,055** | ₱409,390 |
| Additions | **79,233** | 120,215 |
| Amortization (Note 26) | **(42,946)** | (153,550) |
| Balance at end of period | **₱412,342** | ₱376,055 |

*Chattel Mortgage*
As of March 31, 2013 and December 31, 2012, accumulated depreciation on chattel mortgage properties acquired by the Group and the Parent Company in settlement of loans amounted to ₱58.8 million and ₱56.6 million, respectively.

*Miscellaneous*
Miscellaneous assets of the Group include postages, security fund 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 March 31, 2013 and December 31, 2012, the latest transacted price of the exchange trading right (as provided by the PSE) amounted to ₱8.5 million.

As of March 31, 2013, miscellaneous assets of the Group include a security fund amounting to ₱0.2 million which is maintained by PNB LII in compliance with Sections 365 and 367 of the Insurance Code. The amount of such fund is determined by and deposited with the IC for the payment of benefit claims against insolvent companies.

## 16. **Allowance for Impairment and Credit Losses**

Movements in the allowance for impairment losses on non-financial assets follow:

| | **March 31, 2013 (Three Months)** | December 31, 2012 (As restated - Note 2) (One Year) | January 1, 2012 (As restated - Note 2) (One Year) |
|---|---|---|---|
| Balance at beginning of period: | | | |
| Property and equipment (Note 11) | **₱237,986** | ₱237,624 | ₱209,142 |
| Investment properties (Note 13) | **3,452,505** | 4,003,355 | 5,334,805 |
| Other assets (Note 15) | **98,316** | 546,228 | 591,426 |
| | **3,788,807** | 4,787,207 | 6,135,373 |
| Provisions (reversals) during the period | **30,209** | (451,791) | (264,911) |
| Disposals, transfers and others | **29,478** | (546,609) | (1,083,255) |
| Balance at end of period: | | | |
| Property and equipment (Note 11) | **237,986** | 237,986 | 237,624 |
| Investment properties (Note 13) | **3,512,802** | 3,452,505 | 4,003,355 |
| Other assets (Note 15) | **97,706** | 98,316 | 546,228 |
| | **₱3,848,494** | ₱3,788,807 | ₱4,787,207 |

Movements in the allowance for impairment and credit losses on financial assets follow:

| | **March 31, 2013 (Three Months)** | December 31, 2012 (As restated - Note 2) (One Year) | January 1, 2012 (As restated - Note 2) (One Year) |
|---|---|---|---|
| Balance at beginning of period: | | | |
| Loans and receivables | **₱14,243,783** | ₱13,541,340 | ₱13,046,309 |
| AFS investments | **928,408** | 927,488 | 697,052 |
| Receivable from SPV | **258,848** | 833,848 | 736,624 |
| | **15,431,039** | 15,302,676 | 14,479,985 |
| Provisions during the period | **149,839** | 551,233 | 1,125,306 |
| Accretion, accounts charged off, transfers and others | **(455,078)** | (422,870) | (302,615) |
| Balance at end of period: | | | |
| Loans and receivables (Note 9) | **14,143,544** | 14,243,783 | 13,541,340 |
| AFS investments (Note 8) | **928,408** | 928,408 | 927,488 |
| Receivable from SPV | **53,848** | 258,848 | 833,848 |
| | **₱15,125,800** | ₱15,431,039 | ₱15,302,676 |

Provision for impairment and credit losses consists of:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| Provision for (reversal of) impairment | **₱30,209** | (₱31,767) |
| Provision for credit losses | **149,839** | 390,744 |
| | **₱180,048** | ₱358,977 |

Below is the breakdown of provision for credit losses by type of loans and receivable.

| | Three Months Ended | | | | | |
|---|---|---|---|---|---|---|
| | **March 31, 2013** | | | March 31, 2012 | | |
| | **Individual Impairment** | **Collective Impairment** | **Total** | Individual Impairment | Collective Impairment | Total |
| Receivable from customers | **₱92,917** | **₱38,305** | **₱131,222** | ₱199,342 | ₱– | ₱199,342 |
| Unquoted debt securities | **–** | **–** | **–** | (2,723) | – | (2,723) |
| Other receivables | **16,168** | **2,449** | **18,617** | 194,125 | – | 194,125 |
| | **₱109,085** | **₱40,754** | **₱149,839** | ₱390,744 | ₱– | ₱390,744 |

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

| | **March 31, 2013 (Three Months)** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Business Loans** | **GOCCs and NGAs** | **LGUs** | **Consumers** | **Fringe Benefits** | **Unquoted Debt Securities** | **Others** | **Total** |
| Balance at beginning of period | **₱4,631,725** | **₱70,731** | **₱129,653** | **₱561,132** | **₱14,748** | **₱3,958,931** | **₱4,876,863** | **₱14,243,783** |
| Provisions (reversals) during the period | **271,007** | **1,969** | **(21,218)** | **(121,838)** | **1,302** | **–** | **18,617** | **149,839** |
| Accretion on impaired loans (Note 9) | **(56,810)** | **(43)** | **(3,927)** | **(3,879)** | **(158)** | **–** | **–** | **(64,817)** |
| Accounts charged off, transfers and others | **(223,317)** | **–** | **–** | **(948)** | **–** | **(275)** | **39,279** | **(185,261)** |
| Balance at end of period | **₱4,622,605** | **₱72,657** | **₱104,508** | **₱434,467** | **₱15,892** | **₱3,958,656** | **₱4,934,759** | **₱14,143,544** |

| | December 31, 2012 (One Year) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Business Loans | GOCCs and NGAs | LGUs | Consumers | Fringe Benefits | Unquoted Debt Securities | Others | Total |
| Balance at beginning of period | ₱4,653,994 | ₱89,648 | ₱74,998 | ₱586,329 | ₱14,858 | ₱3,772,632 | ₱4,348,881 | ₱13,541,340 |
| Provisions (reversals) during the period | 424,835 | (18,748) | 78,800 | 31,413 | 948 | 186,299 | (153,234) | 550,313 |
| Accretion on impaired loans (Note 9) | (261,780) | (169) | (24,145) | (15,731) | (953) | – | – | (302,778) |
| Accounts charged off, transfers and others | (185,324) | – | – | (40,879) | (105) | – | 681,216 | 454,908 |
| Balance at end of period | ₱4,631,725 | ₱70,731 | ₱129,653 | ₱561,132 | ₱14,748 | ₱3,958,931 | ₱4,876,863 | ₱14,243,783 |

The movements in allowance for credit losses on AFS investments and receivable from SPV for the Group follow:

| | **March 31, 2013 (Three Months)** | | December 31, 2012 (As restated) (One Year) | | January 1, 2012 (As restated) (One Year) | |
|---|---|---|---|---|---|---|
| | **AFS Investments-Equity Securities** | **Receivable from SPV** | AFS Investments-Equity Securities | Receivable from SPV | AFS Investments-Equity Securities | Receivable from SPV |
| Balance at beginning of period | **₱928,408** | **₱258,848** | ₱927,488 | ₱833,848 | ₱697,052 | ₱736,624 |
| Provisions during the period | **–** | **–** | 920 | – | 249,869 | 97,224 |
| Disposals, transfers and others | **–** | **(205,000)** | – | (575,000) | (19,433) | – |
| Balance at end of period | **₱928,408** | **₱53,848** | ₱928,408 | ₱258,848 | ₱927,488 | ₱833,848 |

## 17. Deposit Liabilities

Of the total deposit liabilities of the Group, ₱18.6 billion and ₱12.9 billion are noninterest-bearing as of March 31, 2013 and December 31, 2012, respectively. Remaining deposit liabilities generally earned annual fixed interest rates ranging from 0.09% to 2.41% in 2013 and from 0.09% to 2.55% in 2012 for foreign currency-denominated deposit liabilities, and from 0.24% to 6.08% in 2013 and from 0.25% to 4.32% in 2012 for peso-denominated deposit liabilities.

On March 29, 2012, BSP Circular No. 753 was issued providing unification of the statutory and liquidity reserve requirement, non-remuneration of the unified reserve requirement, exclusion of cash in vault and demand deposits as eligible forms of reserve requirement compliance, and reduction in the unified reserve requirement ratios.

Under existing BSP regulations, non-FCDU deposit liabilities of the Parent Company and ASB are subject to reserves equivalent to 18.00% and 6.00%, respectively. Available reserves follow:

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Due from BSP | **₱81,851,218** | ₱36,531,047 |
| AFS investments | **5,397,494** | 6,965,950 |
| Unquoted debt securities | **2,775,022** | 3,092,529 |
| | **₱90,023,734** | ₱46,589,526 |

As of March 31, 2013 and December 31, 2012, the Parent Company and ASB were in compliance with such regulations.

Time deposit of the Group includes the following Long-term Negotiable Certificates of Time Deposits (LTNCDs):

<u>5.18% ₱3.1 Billion LTNCD</u>
On November 18, 2011, the Parent Company issued ₱3.1 billion worth of LTNCDs which will mature on February 17, 2017.

Among the significant terms and conditions of the LTNCDs are:

a. Issue price at 100.00% of the face value of each LTNCD.

b. The LTNCDs bear interest at the rate of 5.18% per annum from and including the issue date, up to and excluding the call option date or the maturity date. Interest will be payable quarterly in arrears on the 17th of February, May, August and November of each year, commencing on February 17, 2012.

c. The Parent Company may redeem the LTNCDs in whole but not in part at a redemption price equal to 100.00% of the principal amount together with accrued and unpaid interest before maturity date on any interest payment date. The LTNCDs may not be redeemed at the option of the holders.

d. The LTNCDs will constitute direct, unconditional, unsecured and unsubordinated obligations of the Parent Company. The LTNCDs will at all times rank pari passu and without any preference among themselves, and at least pari passu with all other direct, unconditional, unsecured and unsubordinated obligations of the Parent Company, except for any obligation enjoying a statutory preference or priority established under Philippine laws.

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

6.50% ₱3.3 Billion LTNCD

On March 25, 2009, the Parent Company issued ₱3.3 billion worth of LTNCDs which will mature on March 31, 2014.

Among the significant terms and conditions of the LTNCDs are:

a. Issue price at 100.00% of the face value of each LTNCD.

b. The LTNCDs bear interest at the rate of 6.50% per annum from and including the issue date, up to and excluding the early redemption date or the maturity date. Interest will be payable quarterly in arrears on the 19th of March, June, September and December of each year, commencing on June 30, 2009.

c. The Parent Company may redeem the LTNCDs in whole but not in part at a redemption price equal to 100.00% of the principal amount together with accrued and unpaid interest before maturity date on any interest payment date. The LTNCDs may not be redeemed at the option of the holders.

d. The LTNCDs will constitute direct, unconditional, unsecured and unsubordinated obligations of the Parent Company. The LTNCDs will at all times rank pari passu and without any preference among themselves, and at least pari passu with all other direct, unconditional, unsecured and unsubordinated Peso-denominated obligations of the Parent Company, present and future, other than obligations mandatorily preferred by law.

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

7.00% ₱3.5 Billion LTNCD

The ₱3.5 billion worth of LTNCD arising from the business combination was issued on October 22, 2009 with an interest rate of 7.00% per annum which shall be payable quarterly, commencing on January 23, 2010. The LTNCD is insured with PDIC and will mature on October 23, 2014.

Interest expense on deposit liabilities consists of:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| Savings | **₱828,458** | ₱649,674 |
| LTNCDs | **129,918** | 94,848 |
| Time | **66,056** | 24,416 |
| Demand | **34,536** | 24,198 |
| | **₱1,058,968** | ₱793,136 |

For the three-month periods ended March 31, 2013 and 2012, interest expense on LTNCDs include amortization of transaction costs amounting to ₱3.4 million and ₱2.3 million, respectively.

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

This account consists of :

| | **March 31, 2013** | December 31, 2012 |
|---|---:|---:|
| Designated at FVPL | | |
| Subordinated notes | **₱6,096,509** | ₱6,196,070 |
| Segregated fund liabilities | **4,167,818** | – |
| Derivative liabilities (Notes 23 and 35) | **39,996** | 283,751 |
| | **₱10,304,323** | ₱6,479,821 |

Financial liability designated at FVPL includes the ₱6.0 billion subordinated notes due in 2008 (2008 Notes) which the Parent Company issued on June 19, 2008 and segregated fund liabilities. The subordinated note and segregated fund liabilities are part of a group of financial instruments that together are managed on a fair value basis, in accordance with the Group's 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;

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 2.01% per annum or (ii) the difference of interest rate and five-year PDST-F FXTN as of issue date multiplied by 150.00% 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 2008 Notes will mature on June 19, 2018, if not redeemed earlier;

(b) 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;

(c) 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

(d) 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.

As of March 31, 2013 and December 31, 2012, change in the fair value of the designated subordinated debt at FVPL that is attributable to changes in credit risk is not significant.

The balance of segregated fund liabilities consists of:

| | **March 31, 2013** |
|---|---|
| Segregated funds (Note 7) | **₱4,091,354** |
| Subscriptions outside segregated funds | **76,465** |
| Segregated fund liabilities | **₱4,167,819** |

## 19. Bills and Acceptances Payable

This account consists of:

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Bills payable to: | | |
| BSP and local banks | **₱4,938,623** | ₱6,998,633 |
| Foreign banks | **4,055,019** | 2,870,946 |
| GOCC and other private entities | **5,762,079** | 3,173,463 |
| | **14,755,721** | 13,043,042 |
| Acceptances outstanding | **365,676** | 33,859 |
| | **₱15,121,397** | ₱13,076,901 |

As of March 31, 2013, the annual interest rates range from 0.15% to 1.77% for foreign currency-denominated borrowings, and from 1.27% to 16.00% for peso-denominated borrowings of the Group.

As of December 31, 2012, the annual interest rates range from 0.06% to 1.77% for foreign currency-denominated borrowings, and from 0.03% to 12.00% for peso-denominated borrowings of the Group.

The Parent Company's bills payable to BSP includes the transferred liabilities from Maybank amounting to ₱1.6 billion as of March 31, 2013 and December 31, 2012 (see Note 9).

Bills payable - GOCC includes funding from 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).

As of March 31, 2013 and December 31, 2012, bills payable with a carrying value of ₱4.9 billion and ₱3.0 billion is secured by a pledge of certain AFS investments with face value of ₱5.3 billion and ₱2.8 billion, respectively. Refer to Note 8 for further details.

As of March 31, 2013, bills payable under the BSP rediscounting facility with a carrying value of ₱0.7 billion and ₱559.3 million is secured by a pledge of loans amounting to ₱0.7 billion and certain AFS investments with face value of ₱2.4 billion, respectively (Note 35). As of December 31, 2012, bills payable under the BSP rediscounting facility with a carrying value of ₱1.9 billion and ₱1.0 billion is secured by a pledge of loans amounting to ₱2.0 billion and certain

AFS investments with face value of ₱2.6 billion, respectively (Note 35). Refer to Notes 8 and 9 for further details.

Following are the significant terms and conditions of the agreements entered into by the Parent Company:
(a) Each party represents and warrants to the other that it is duly authorized to execute and deliver the Agreement, and to perform its obligations and has taken all the necessary action to authorize such execution, delivery and performance;
(b) The term or life of this borrowing is up to one year;
(c) Some borrowings bear a fixed interest rate while others have floating interest rate;
(d) The Parent Company has pledged its AFS investments, in form of US Treasury Notes and ROP Global bonds, in order to fulfill its collateral requirement;
(e) Haircut from market value ranges from 20.00% to 30.00% depending on the tenor of the bond;
(f) Substitution of pledged securities is allowed if one party requested and the other one so agrees.

Interest expense on bills payable and other borrowings consists of:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| Subordinated debt* (Note 21) | **₱318,210** | ₱237,530 |
| Bills payable | **53,036** | 49,404 |
| Others | **46,541** | 720 |
| | **₱417,787** | ₱287,654 |

*Consist of interest on subordinated debt at amortized cost and designated at FVPL

## 20. Accrued Taxes, Interest and Other Expenses

This account consists of:

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Interest | **₱2,212,562** | ₱1,987,231 |
| Other benefits - monetary value of leave credits | **978,467** | 508,719 |
| Employee benefits | **635,107** | 365,480 |
| Other taxes and licenses | **259,784** | 170,798 |
| PDIC insurance premiums | **226,980** | 264,294 |
| Management, directors and other professional fees | **178,664** | 52,583 |
| Information technology-related expenses | **148,207** | 175,901 |
| Rent expenses | **52,162** | 38,206 |
| Promotional expense | **44,325** | 25,754 |
| Other expenses | **576,995** | 325,324 |
| | **₱5,313,253** | ₱3,914,290 |

'Other expenses' includes janitorial, security, repairs and maintenance, representation and entertainment, communication and other operating expenses.

## 21. **Subordinated Debt**

5.88% ₱3.5 Billion Subordinated Notes
On May 9, 2012 , the Parent Company's BOD approved the issuance of unsecured subordinated notes of ₱3.5 billion that qualify as Lower Tier 2 capital.

The 2012 Notes which bear nominal interest of 5.88% and due in 2022 was issued pursuant to the authority granted by the BSP to the Bank on May 27, 2011. EIR on this note is 6.04%.

Among the significant terms and conditions of the issuance of such 2012 Notes are:

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

(b) The 2012 Notes bear interest at the rate of 5.88% per annum from and including May 09, 2012 to but excluding May 09, 2022. Interest will be payable quarterly in arrears on the 9th of August, November, February and June of each year, commencing on August 09, 2012. Unless previously redeemed, the 2012 Notes will be redeemed at their principal amount on maturity date or May 09, 2022.

(c) The 2011 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 2012 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 15th 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 2012 Notes may not be redeemed at the option of the noteholders; and

(e) Each noteholder, by accepting the 2012 Notes, irrevocably agrees and acknowledges that 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 2012 Notes.

6.75% ₱6.5 Billion Subordinated Notes
On May 15, 2011 , the Parent Company's BOD approved the issuance of unsecured subordinated notes of ₱6.5 billion that qualify as Lower Tier 2 capital.

The 2011 Notes which bear nominal interest of 6.75% and due in 2021, pursuant to the authority granted by the BSP to the Bank on May 27, 2011. EIR on this note is 6.94%.

Among the significant terms and conditions of the issuance of such 2011 Notes are:

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

(b) The 2011 Notes bear interest at the rate of 6.75% per annum from and including June 15, 2011 to but excluding June 15, 2021. Interest will be payable quarterly in arrears on the 15th of September, December, March and June of each year, commencing on September 15, 2011. Unless previously redeemed, the 2011 Notes will be redeemed at their principal amount on maturity date or June 15, 2021;

(c) The 2011 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 2011 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 15th 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 2011 Notes may not be redeemed at the option of the noteholders; and

(e) Each noteholder, by accepting the 2011 Notes, irrevocably agrees and acknowledges that 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 2011 Notes.

7.13% ₱4.5 Billion Subordinated Notes
On July 25, 2007, the BOD of the Parent Company approved and authorized the management to conduct capital raising activity by way of issuance of Lower Tier 2 capital up to the maximum amount of ₱5.0 billion through a public offering subject to the provisions of BSP Circular No. 280 and BSP Memorandum to all banks and financial institutions dated February 17, 2003.

The issuance of the foregoing subordinated debt was approved by the Monetary Board (MB) in its Resolution No. 98 dated January 24, 2008.

Relative to this, on March 6, 2008, the Parent Company issued ₱4.5 billion, 7.13% Subordinated Notes due on 2018, callable with step-up in 2013. Among the significant terms and conditions of the issuance of the subordinated notes are:

a) Issue price is at 100.00% of the Principal amount.

   The Subordinated Notes bear interest at 7.13% per annum, payable to the noteholder for the period from and including the issue date up to the maturity date if the call option is not exercised on the call option date. Interest shall be payable quarterly in arrears on March 6, June 6, September 6 and December 6 of each year, commencing June 6, 2008. The Subordinated Notes will mature on March 6, 2018, if not redeemed earlier.

b) The Subordinated Notes will constitute direct, unconditional, unsecured and subordinated obligations of the Parent Company. The Subordinated Notes will, at all times, rank pari passu and without any preference among themselves, but in priority to the rights and claims of holders of all classes of equity securities of the Parent Company, including holders of preferences shares.

c) The Parent Company may redeem the notes in whole, but not in part, at a redemption price equal to 100.00% of the principal amount of the Notes together with accrued and unpaid interest at first banking day after the 20th interest period from issue date subject to at least 30-day prior written notice to noteholders and prior approval of the BSP, subject to the following conditions: (i) the capital adequacy ratio of the Parent Company is at least equal to the required minimum ratio; and (ii) the Subordinated Note is simultaneously replaced with the issues of new capital which are neither smaller in size nor lower in quality than the Subordinated Notes.

d) The Subordinated Note shall not be redeemable or terminable at the instance of any noteholder before maturity date.

On March 6, 2013, the 2018 Notes were redeemed by the Parent Company at par/face value.

As of March 31, 2013 and December 31, 2012, subordinated debt is net of unamortized transaction cost of ₱57.6 million and ₱61.2 million, respectively.

For the three-month periods ended March 31, 2013 and 2012, amortization of transaction costs amounting to ₱4.7 million and ₱2.3 million, respectively, were charged to 'Interest expense - bills payable and other borrowings' in the statements of income.

## 22. Other Liabilities

This account consists of:

| | **March 31, 2013** | December 31, 2012 (As restated-note 2) | January 1, 2012 (As restated-note 2) |
|---|---|---|---|
| Insurance contract liabilities | **₱6,718,640** | ₱2,623,901 | ₱1,612,946 |
| Accounts payable | **6,562,939** | 4,693,074 | 3,659,636 |
| Retirement benefit liability (Note 27) | **3,843,554** | 1,854,458 | 2,095,205 |
| Bills purchased - contra (Note 8) | **3,464,344** | 2,553,891 | 2,296,039 |
| Provisions (Note 33) | **1,971,242** | 1,575,433 | 874,950 |
| Manager's checks and demand drafts outstanding | **1,075,964** | 623,621 | 475,041 |
| Reserve for unearned premiums | **544,951** | 509,488 | 458,178 |
| Deposits on lease contracts | **544,609** | 487,770 | 429,487 |
| Accounts payable - electronic money | **361,844** | 379,981 | 396,162 |
| Payment order payable | **329,992** | 174,406 | 152,810 |
| Margin deposits and cash letters of credit | **317,523** | 31,358 | 212,390 |
| Due to Treasurer of the Philippines | **315,097** | 290,649 | 220,053 |
| Due to other banks | **272,306** | 142,212 | 98,671 |
| Deferred credits | **271,686** | 181,473 | 207,484 |
| Other dormant credits | **251,762** | 252,218 | 275,030 |
| Withholding tax payable | **145,395** | 127,123 | 137,215 |
| Due to BSP | **142,401** | 102,616 | 102,965 |
| Deferred tax liabilities (Note 29) | **140,915** | 3,873 | 20,873 |
| Sundry credits | **69,639** | 26,535 | 180 |
| Advanced rentals on building, bank premises and equipment | **49,694** | 1,652 | 1,503 |
| SSS, Philhealth, Employer's Compensation Premiums and Pag-IBIG Contributions Payable | **26,045** | 15,742 | 15,129 |
| Deposit for keys on safety deposit boxes | **13,642** | 4,941 | 4,917 |
| Overages | **1,552** | 458 | 769 |
| Miscellaneous | **1,014,502** | 628,378 | 920,606 |
| | **₱28,450,238** | ₱17,285,251 | ₱14,668,239 |

Miscellaneous liabilities of the Group include contribution and payments for compensation premiums and remittance - related payable.

## 23. Derivative Financial Instruments

The table below shows the fair values of derivative financial instruments entered into by the Group, 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 March 31, 2013 and December 31, 2012 and are not indicative of either market risk or credit risk (amounts in thousands, except average forward rate).

| | **March 31, 2013** | | | |
|---|---|---|---|---|
| | **Assets** | **Liabilities** | **Average Forward Rate** | **Notional Amount*** |
| **Freestanding derivatives:** | | | | |
| Currency forwards | | | | |
| BUY | | | | |
| USD | **₱60,743** | **₱21,924** | **40.91** | **374,729** |
| EUR | **66** | **1,549** | **53.56** | **1,172** |
| CAD | **129** | – | **40.10** | **407** |
| GBP | **45** | – | **61.81** | **100** |
| SELL | | | | |
| USD | **45,152** | **13,624** | **40.85** | **521,086** |
| EUR | **1,614** | **154** | **53.38** | **2,402** |
| SGD | – | **139** | **32.61** | **500,450** |
| AUD | – | **193** | **39.20** | **2,060** |
| JPY | – | **1,528** | **0.43** | **500,000** |
| CHF | **19** | **39** | **43.04** | **500** |
| GBP | **458** | **648** | **59.13** | **3,753** |
| CAD | – | **72** | **39.78** | **200** |
| HKD | **1,474** | – | **5.26** | **15,522** |
| CAD | – | **126** | **40.11** | **407** |
| Cross currency swaps | **219,944** | – | | **86,000** |
| Interest rate swaps (Php) | **35,106** | – | | **2,329,000** |
| Warrants | **89,286** | – | | **306** |
| **Embedded derivatives:** | | | | |
| Credit default swaps (USD) | **917** | – | | **47,500** |
| | **₱454,953** | **₱39,996** | | |

*The notional amounts pertain to the original currency except for the embedded derivatives, which represent the equivalent USD amounts.

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | Assets | Liabilities | Average Forward Rate | Notional Amount* |
| Freestanding derivatives: | | | | |
| Currency forwards | | | | |
| BUY | | | | |
| JPY | ₱– | ₱3,706 | 0.49 | 300,000 |
| USD | 20 | 185,391 | 42.01 | 165,043 |
| EUR | – | 2 | 54.48 | 63 |
| SGD | 74 | – | 33.65 | 1,958 |
| SELL | | | | |
| USD | 25,214 | 10,400 | 41.11 | 285,064 |
| EUR | – | 43 | 54.18 | 800 |
| SGD | – | 73 | 33.65 | 1,958 |

(Forward)

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | Assets | Liabilities | Average Forward Rate | Notional Amount* |
| AUD | ₱430 | ₱– | 43.15 | 700 |
| JPY | 983 | 573 | 0.48 | 540,000 |
| CHF | 10 | 24 | 45.05 | 1,050 |
| GBP | 133 | 23 | 66.11 | 1,790 |
| CAD | 208 | – | 41.39 | 510 |
| HKD | – | 2 | 5.30 | 200 |
| SEK | – | 4 | 6.32 | 300 |
| Cross currency swaps | 201,970 | – | | 86,000 |
| Interest rate swaps (Php) | 162,556 | 83,510 | | 6,109,000 |
| Warrants | 59,044 | – | | 262 |
| Embedded derivatives: | | | | |
| Credit default swaps (USD) | 3,859 | – | | 47,500 |
| | ₱454,501 | ₱283,751 | | |

*The notional amounts pertain to the original currency except for the embedded derivatives, which represent the equivalent USD amounts.

In May and June of 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 Parent Company renewed some of these agreements with various counterparty banks in May and June of 2011 with terms to maturities of two years. The aggregate notional amount of these cross currency swaps is USD79.0 million or ₱3.4 billion while its positive fair value amounted to ₱206.4 million and ₱190.3 million as of March 31, 2013 and December 31, 2012, respectively.

On June 21, 2011, the Parent Company entered into a cross currency swap agreement with a notional amount of USD7.0 million or ₱299.0 million and will mature on June 17, 2013. Proceeds of the 2011 Notes were swapped for USD. As of March 31, 2013 and December 31, 2012, its positive fair value amounted to ₱13.5 million and ₱11.7 million, respectively. In order to fulfill collateral requirements, the Parent Company has pledged its cash amounting to nil and USD2.0 million or ₱82.1 million as of March 31, 2013 and December 31, 2012 (Note 35).

As of March 31, 2013 and December 31, 2012, the Parent Company holds 306,405 and 261,515 shares of ROP Warrants Series B1 which are carried at fair values of USD2.2 million or ₱89.3 million and USD1.4 million or ₱59.0 million, respectively.

Embedded derivatives that have been bifurcated are credit derivatives in structured notes presented under other debt securities under AFS investments with a notional reference of USD47.5 million and with positive fair value of ₱0.9 million and ₱3.9 million as of March 31, 2013 and December 31, 2012, respectively.

The table below shows the rollforward analysis of net derivatives assets (liabilities) for the three-month period ended March 31, 2013 and for the year ended December 31, 2012 (in millions):

| | **March 31, 2013 (Three Months)** | December 31, 2012 (One Year) |
|---|---|---|
| Balance at beginning of period | **₱171** | ₱283 |
| Changes in fair value (Note 8) | **192** | 82 |
| Availments/(settlements) | **52** | (194) |
| | **₱415** | ₱171 |

The changes in fair value of the derivatives are included in 'Trading and investments securities gains - net' in the statements of income.

## 24. Maturity Analysis of Assets and Liabilities

The following table shows an analysis of assets and liabilities of the Group analyzed according to whether they are expected to be recovered or settled within one year and beyond one year from reporting date:

| | March 31, 2013 | | |
|---|---|---|---|
| | Less than Twelve Months | Over Twelve Months | Total |
| **Financial Assets** | | | |
| COCI | **₱7,918,010** | **₱–** | **₱7,918,010** |
| Due from BSP | **83,305,615** | **–** | **83,305,615** |
| Due from other banks | **14,833,236** | **183,555** | **15,016,791** |
| Interbank loans receivable | **8,275,969** | **–** | **8,275,969** |
| Securities held under agreements to resell | **20,000,000** | **–** | **20,000,000** |
| Financial assets at FVPL | **9,789,422** | **–** | **9,789,422** |
| AFS investments - gross (Note 8) | **8,536,632** | **94,019,402** | **102,556,034** |
| Receivable from customers - gross (Note 9) | **86,267,879** | **136,767,311** | **223,035,190** |
| Unquoted debt securities classified as loans (Note 9) | **2,819,980** | **8,788,103** | **11,608,083** |
| Other receivables - gross (Note 9) | **19,041,155** | **882,992** | **19,924,147** |
| Miscellaneous COCI (Note 15) | **8,330** | **–** | **8,330** |
| | **260,796,228** | **240,641,363** | **501,437,591** |
| **Nonfinancial Assets** | | | |
| Property and equipment - net | | | |
| At cost | **–** | **1,497,179** | **1,497,179** |
| At revalued amount | **–** | **21,473,551** | **21,473,551** |
| Investments in a subsidiary and an associate - net | **–** | **5,061** | **5,061** |
| Investment properties - net | **–** | **19,022,450** | **19,022,450** |
| Deferred tax assets | **–** | **1,089,464** | **1,089,464** |
| Goodwill (Note 14) | **–** | **16,017,500** | **16,017,500** |
| Residual value of leased assets | **133,670** | **264,388** | **398,058** |
| Other receivables - gross (Note 9) | **1,656,884** | **–** | **1,656,884** |
| Other assets - gross (Note 15)* | **1,833,825** | **2,255,883** | **4,089,708** |
| | **3,624,379** | **61,625,476** | **65,249,855** |
| Less: Allowance for impairment and credit losses (Note 16) | **–** | **–** | **15,169,658** |
| Unearned and other deferred income (Note 9) | **–** | **–** | **1,117,894** |
| | | | **16,287,552** |
| | **₱264,420,607** | **₱302,266,839** | **₱550,399,894** |

*Includes deferred charges, prepaid expense and intangibles (software and exchange trading right)
**Includes withholding taxes payable

| | March 31, 2013 | | |
|---|---|---|---|
| | Less than Twelve Months | Over Twelve Months | Total |
| **Financial Liabilities** | | | |
| Deposit liabilities | **₱373,663,925** | **₱20,947,941** | **₱394,611,866** |
| Financial liabilities at FVPL | **10,304,323** | **–** | **10,304,323** |
| Bills and acceptances payable | **13,714,226** | **1,407,171** | **15,121,397** |
| Subordinated debt | **–** | **9,942,407** | **9,942,407** |
| Accrued interest payable (Note 20) | **2,212,116** | **446** | **2,212,562** |
| Other liabilities (Note 22): | | | |
| Insurance contract liabilities | **2,511,195** | **4,207,445** | **6,718,640** |
| Accounts payable | **5,958,292** | **604,647** | **6,562,939** |
| Bills purchased - contra | **3,464,344** | **–** | **3,464,344** |

(Forward)

| | March 31, 2013 | | |
|---|---|---|---|
| | **Less than Twelve Months** | **Over Twelve Months** | **Total** |
| Managers' checks and demand drafts outstanding | **₱1,075,964** | **₱–** | **₱1,075,964** |
| Deposit on lease contracts | **20,612** | **523,997** | **544,609** |
| Payment order payable | **329,992** | **–** | **329,992** |
| Margin deposits and cash letters of credit | **317,523** | **–** | **317,523** |
| Due to TOP | **2,268** | **312,829** | **315,097** |
| Due to other banks | **272,306** | **–** | **272,306** |
| Due to BSP | **142,401** | **–** | **142,401** |
| Other liabilities | **603,154** | **228,343** | **831,497** |
| | **414,592,641** | **38,175,226** | **452,767,867** |
| **Nonfinancial Liabilities** | | | |
| Accrued taxes and other expenses | **2,357,103** | **743,588** | **3,100,691** |
| Income tax payable | **166,682** | **–** | **166,682** |
| Other liabilities** | **897,010** | **6,977,916** | **7,874,926** |
| | **3,420,795** | **7,721,504** | **11,142,299** |
| | **₱418,013,436** | **₱45,896,730** | **₱463,910,166** |

*Includes deferred charges, prepaid expense and intangibles (software and exchange trading right)
**Includes withholding taxes payable

| | December 31, 2012 (As restated) | | |
|---|---|---|---|
| | Less than Twelve Months | Over Twelve Months | Total |
| **Financial Assets** | | | |
| COCI | ₱5,599,088 | ₱– | ₱5,599,088 |
| Due from BSP | 37,175,399 | – | 37,175,399 |
| Due from other banks | 4,042,769 | – | 4,042,769 |
| Interbank loans receivable | 11,498,756 | – | 11,498,756 |
| Securities held under agreements to resell | 18,300,000 | – | 18,300,000 |
| Financial assets at FVPL | 4,023,065 | – | 4,023,065 |
| AFS investments - gross (Note 8) | 4,449,652 | 63,476,235 | 67,925,887 |
| Receivable from customers - gross (Note 9) | 45,314,788 | 87,465,430 | 132,780,218 |
| Unquoted debt securities classified as loans (Note 9) | 3,997,264 | 3,820,935 | 7,818,199 |
| Other receivables - gross (Note 9) | 17,445,962 | – | 17,445,962 |
| Miscellaneous COCI (Note 15) | 808 | – | 808 |
| | 151,847,551 | 154,762,600 | 306,610,151 |
| **Nonfinancial Assets** | | | |
| Property and equipment - net | | | |
| At cost | – | 937,075 | 937,075 |
| At revalued amount | – | 15,566,650 | 15,566,650 |
| Investments in a subsidiary and an associate - net | – | 2,905,294 | 2,905,294 |
| Investment properties - net | – | 14,478,348 | 14,478,348 |
| Deferred tax assets | – | 1,780,682 | 1,780,682 |
| Residual value of leased asset | – | 329,243 | 329,243 |
| Other receivables - gross (Note 9) | 1,488,287 | – | 1,488,287 |
| Other assets - gross (Note 15)* | 694,836 | 1,581,309 | 2,276,145 |
| | 2,183,123 | 37,578,601 | 39,761,724 |
| Less: Allowance for impairment and credit losses (Note 16) | – | – | 15,270,507 |
| Unearned and other deferred income (Note 9) | – | – | 910,617 |
| | – | – | 16,181,124 |
| | ₱154,030,674 | ₱192,341,201 | ₱330,190,751 |

| | December 31, 2012 (As restated) | | |
|---|---|---|---|
| | Less than Twelve Months | Over Twelve Months | Total |
| **Financial Liabilities** | | | |
| Deposit liabilities | ₱223,150,780 | ₱17,703,597 | ₱240,854,377 |
| Financial liabilities at FVPL | 6,479,821 | – | 6,479,821 |
| Bills and acceptances payable | 12,768,365 | 308,536 | 13,076,901 |
| Subordinated debt | – | 9,938,816 | 9,938,816 |
| Accrued interest payable (Note 20) | 1,987,231 | – | 1,987,231 |
| Other liabilities (Note 22): | | | |
| Accounts payable | 4,693,074 | – | 4,693,074 |
| Insurance contract liabilities | 2,623,901 | – | 2,623,901 |
| Bills purchased - contra | 2,553,891 | – | 2,553,891 |
| Managers' checks and demand drafts outstanding | 623,621 | – | 623,621 |
| Deposit on lease contracts | 180,700 | 307,070 | 487,770 |
| Due to TOP | – | 290,649 | 290,649 |
| Payment order payable | 174,406 | – | 174,406 |
| Due to other banks | 142,212 | – | 142,212 |
| Margin deposits and cash letters of credit | 31,358 | – | 31,358 |
| Due to BSP | 102,616 | – | 102,616 |
| Other liabilities | 384,924 | 983,499 | 1,368,423 |
| | 255,896,900 | 29,532,167 | 285,429,067 |
| **Nonfinancial Liabilities** | | | |
| Accrued taxes and other expenses | 557,914 | 1,369,145 | 1,927,059 |
| Income tax payable | 149,050 | – | 149,050 |
| Other liabilities** | 1,389,294 | 2,804,036 | 4,193,330 |
| | 2,096,258 | 4,173,181 | 6,269,439 |
| | ₱257,993,158 | ₱33,705,348 | ₱291,698,506 |

*Includes deferred charges, prepaid expense and intangibles (software and exchange trading right)
**Includes withholding taxes payable

| | January 1, 2012 (As restated) | | |
|---|---|---|---|
| | Less than Twelve Months | Over Twelve Months | Total |
| **Financial Assets** | | | |
| COCI | ₱5,404,110 | ₱– | ₱5,404,110 |
| Due from BSP | 38,152,795 | – | 38,152,795 |
| Due from other banks | 6,423,981 | – | 6,423,981 |
| Interbank loans receivable | 17,097,648 | – | 17,097,648 |
| Securities held under agreements to resell | 18,300,000 | – | 18,300,000 |
| Financial assets at FVPL | 2,824,994 | 4,050,671 | 6,875,665 |
| AFS investments - gross (Note 8) | 1,727,769 | 51,523,527 | 53,251,296 |
| Receivable from customers - gross (Note 9) | 40,972,474 | 74,305,845 | 115,278,319 |
| Unquoted debt securities classified as loans (Note 9) | 4,362,294 | 3,998,835 | 8,361,129 |
| Other receivables - gross (Note 9) | 15,470,587 | – | 15,470,587 |
| Miscellaneous COCI (Note 15) | 5,220 | – | 5,220 |
| | 150,741,872 | 133,878,878 | 284,620,750 |
| **Nonfinancial Assets** | | | |
| Property and equipment - net | | | |
| At cost | – | 866,013 | 866,013 |
| At revalued amount | – | 15,698,514 | 15,698,514 |
| Investments in a subsidiary and an associate - net | – | 2,901,780 | 2,901,780 |
| Investment properties - net | – | 16,100,113 | 16,100,113 |
| Deferred tax assets | – | 1,775,789 | 1,775,789 |
| Residual value of leased asset | – | 271,489 | 271,489 |
| Other receivables - gross (Note 9) | 1,318,531 | – | 1,318,531 |
| Other assets - gross (Note 15)* | 978,134 | 2,945,043 | 3,923,177 |
| | 2,296,665 | 40,558,741 | 42,855,406 |

(Forward)

| | January 1, 2012 (As restated) | | |
|---|---|---|---|
| | Less than Twelve Months | Over Twelve Months | Total |
| Less: Allowance for impairment and credit losses (Note 16) | ₱– | ₱– | ₱15,015,056 |
| Unearned and other deferred income (Note 9) | – | – | 909,680 |
| | – | – | 15,924,736 |
| | ₱153,038,537 | ₱174,437,619 | ₱311,551,420 |

| | January 1, 2012 (As restated) | | |
|---|---|---|---|
| | Less than Twelve Months | Over Twelve Months | Total |
| **Financial Liabilities** | | | |
| Deposit liabilities | ₱219,183,534 | ₱18,350,404 | ₱237,533,938 |
| Financial liabilities at FVPL | 171,013 | 6,479,170 | 6,650,183 |
| Bills and acceptances payable | 7,129,369 | 1,329,056 | 8,458,425 |
| Subordinated debt | – | 6,452,473 | 6,452,473 |
| Accrued interest payable (Note 20) | 450,070 | 1,555,417 | 2,005,487 |
| Other liabilities (Note 22): | | | |
| Accounts payable | 3,659,636 | – | 3,659,636 |
| Bills purchased - contra | 2,296,039 | – | 2,296,039 |
| Insurance contract liabilities | 1,612,946 | – | 1,612,946 |
| Managers' checks and demand drafts outstanding | 475,041 | – | 475,041 |
| Deposit on lease contracts | 308,088 | 121,399 | 429,487 |
| Due to TOP | – | 220,053 | 220,053 |
| Margin deposits and cash letters of credit | 212,390 | – | 212,390 |
| Payment order payable | 152,810 | – | 152,810 |
| Due to BSP | 102,965 | – | 102,965 |
| Due to other banks | 98,671 | – | 98,671 |
| Other liabilities | 4,916 | – | 4,916 |
| | 235,857,488 | 34,507,972 | 270,365,460 |
| **Nonfinancial Liabilities** | | | |
| Accrued taxes and other expenses | 326,092 | 1,407,471 | 1,733,563 |
| Income tax payable | 242,169 | – | 242,169 |
| Other liabilities** | 1,869,277 | 3,534,006 | 5,403,283 |
| | 2,437,538 | 4,941,477 | 7,379,015 |
| | ₱238,295,026 | ₱39,449,449 | ₱277,744,475 |

*Includes deferred charges, prepaid expense and intangibles (software and exchange trading right)
**Includes withholding taxes payable

## 25. Equity

Capital stock consists of (amounts in thousands, except for par value and number of shares):

| | **Shares** | | **Amount** | |
|---|---|---|---|---|
| | **March 31, 2013 (Three Months)** | December 31, 2012 (One Year) | **March 31, 2013 (Three Months)** | December 31, 2012 (One Year) |
| **Preferred - ₱40 par value** | | | | |
| Authorized | – | 195,175,444 | | |
| **Common - ₱40 par value** | | | | |
| Authorized | **1,250,000,001** | 1,054,824,557 | | |
| Issued and Outstanding | | | | |
| Balance at the beginning of the period | **662,245,916** | 662,245,916 | **₱26,489,837** | ₱26,489,837 |
| Issued during the period | **423,962,500** | – | **16,958,500** | – |
| | **1,086,208,416** | 662,245,916 | **43,448,337** | 26,489,837 |
| Parent Company Shares Held by a Subsidiary | **(200,112)** | (200,112) | **(4,740)** | (4,740) |
| | **1,086,008,304** | 662,045,804 | **₱43,443,597** | ₱26,485,097 |

The Parent Company shares are listed in the PSE.

Pursuant to the 1986 Revised Charter of the Parent Company, the Parent Company's authorized capital stock was ₱10.0 billion divided into 100,000,000 common shares with a par value of ₱100.00 per share. Its principal stockholder was the NG which owned 25,000,000 common shares. On the other hand, private stockholders owned 8,977 common shares.

To foster a financial intermediations system that is both competitive and efficient, the partial privatization of the Parent Company was carried out through the following public offerings:

| Date of Offering | Type of Offering | No. of Shares Offered | Par Value | Offer Price | Authorized Number of Shares | Issued and Outstanding Shares |
|---|---|---|---|---|---|---|
| June 1989 | Initial Public Offering | 10,800,000 common shares | ₱100.00 | ₱100.00 | 250,000,000 common shares | 36,011,569 common shares |
| April 1992 | Second Public Offering | 8,033,140 common shares | ₱100.00 | ₱265.00 | 250,000,000 common shares | 80,333,350 common shares |
| December 1995 | Third Public Offering | 7,200,000 common shares and 2,400,000 covered warrants | ₱100.00 | ₱260.00 | 250,000,000 common shares | 99,985,579 common shares |

After the three (3) public offerings, the NG sold a total of 54.41% of its shareholdings to both the Philippine public and international investors.

On May 27, 1996, the privatization of the Parent Company was completed when the Parent Company's new Articles of Incorporation and By-Laws were approved by the SEC under SEC Registration No. ASO96-005555. As of May 27, 1996, the NG owned 45.59% of the outstanding shares of the Parent Company. The Parent Company's authorized capital stock was increased to ₱25.0 billion pesos divided into 250,000,000 common shares with a par value of ₱100.00 per share.

As part of the Parent Company's capital build-up program, the Parent Company also completed the following right offerings:

| Date of Offering | Type of Offering | No. of Shares Offered | Basis of Subscription | Par Value | Offer Price | Authorized Number of Shares | Issued and Outstanding Shares |
|---|---|---|---|---|---|---|---|
| September 1999 | Stock Rights Offering | 68,740,086 common shares | One (1) Right Share for every two common shares | ₱100.00 | ₱137.80 | 250,000,000 common shares | 206,220,257 common shares |
| September 2000 | Pre-emptive Rights Offering | 71,850,215 common shares with 170,850,215 warrants | Five (5) Right Shares for every Six (6) common shares | ₱100.00 | ₱60.00 | 833,333,334 common shares | 206,220,257 common shares |

On August 18, 2000, the SEC approved the decrease of the capital stock of the Parent Company from ₱25.0 billion divided into 250,000,000 common shares with a par value of ₱100.00 per share to ₱15.0 billion divided into 250,000,000 common shares with a par value of ₱60.00 per share.

Subsequently on November 7, 2000, the SEC approved the increase of the capital stock of the Parent Company from ₱15.0 billion divided into 250,000,000 common shares with a par value of ₱60.00 per share to ₱50,000,000,040 divided into 833,333,334 shares with a par value of ₱60.00 per share.

On July 23, 2002, the SEC approved the decrease of the capital stock of the Parent Company from ₱50,000,000,040.00 divided into 833,333,334 shares with a par value of ₱60.00 per share to ₱33,333,333,360.00 divided into 833,333,334 shares with a par value of ₱40.00 per share. On the same day, the SEC also approved the increase of the capital stock of the Parent Company from ₱33,333,333,360.00 divided into 833,333,334 shares with a par value of ₱40.00 per share to ₱50,000,000,040.00 divided into 1,054,824,557 common shares and 195,175,444 preferred shares both with a par value of ₱40.00 each.

In July 2007, the Parent Company made a primary and secondary offering of up to 160,811,091 common shares. The Offer consisted of: (i) primary offer by the Parent Company of up to 89,000,000 new shares from the Parent Company's authorized but unissued common share capital, and (ii) secondary offer of up to an aggregate of 71,811,091 existing shares, comprising (a) 17,453,340 shares offered by the NG, and (b) 54,357,751 shares which were owned by the Philippine Deposit Insurance Corporation (PDIC) in the form of convertible preferred shares. The Primary Offer Shares and Secondary Offer Shares were offered at the Offer Price of ₱59.00 per share.

On January 17, 2013, the SEC approved the conversion of the Parent Company's 195,175,444 authorized preferred shares into common shares, thereby increasing its authorized common shares to 1,250,000,001. The increase in authorized common shares is intended to accommodate the issuance of the Parent Company of common shares to ABC shareholders relative to the business combination.

As of March 31, 2013 and December 31, 2012, the Parent Company had 30,729 and 30,825 stockholders, respectively.

Surplus and Capital Paid in Excess of Par Value of the Parent Company amounting to ₱9.8 billion as of March 31, 2013 and December 31, 2012 which represents the balances of accumulated translation adjustment, accumulated equity in net earnings and revaluation increment from land that have been applied to eliminate the Parent Company's deficit through a quasi-reorganization in 2002 and 2000, are not available for dividend declaration without prior approval from the Philippine SEC and the BSP.

Accumulated Translation Adjustment
As part of the Group's rehabilitation program in 2002, 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 statement of financial position) 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.

Surplus Reserves
The surplus reserves consist of:

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Reserve for trust business (Note 31) | **₱444,003** | ₱298,253 |
| Reserve for contingencies and other accounts | **191,634** | 191,634 |
| Reserve for self-insurance | **80,000** | 80,000 |
| | **₱715,637** | ₱569,887 |

Reserve for self-insurance, contingencies and other account represents the amount set aside to cover losses due to fire, defalcation by and other unlawful acts of the Parent Company's personnel or third parties.

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. Risk-weighted assets consist of total assets less cash on hand, due from BSP, loans covered by hold-out on or assignment of deposits, loans or acceptances under letters of credit to the extent covered by margin deposits and other non-risk items determined by the Monetary Board (MB) of the BSP.

The BSP approved the booking of additional appraisal increment of ₱431.8 million in 2002 on properties and recognition of the same in determining the capital adequacy ratio, and booking of translation adjustment of ₱1.6 billion in 2002 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.

The CAR, which is based on consolidated CAR combined credit, market and operational risks (BSP Circular No. 538), as of March 31, 2013 and December 31, 2012 as reported to the BSP are shown in the table below (amounts in millions).

| | **March 31, 2013** | | December 31, 2012 | |
|---|---|---|---|---|
| **Consolidated** | **Actual** | **Required** | Actual | Required |
| Tier 1 capital | **₱57,999.9** | | ₱26,508.6 | |
| Tier 2 capital | **18,563.0** | | 14,707.2 | |
| Gross qualifying capital | **76,562.9** | | 41,215.8 | |
| Less required deductions | **584.1** | | 3,122.7 | |
| **Total qualifying capital** | **₱75,978.8** | **₱35,040.8** | ₱38,093.1 | ₱21,023.9 |
| **Risk weighted assets** | **₱350,407.8** | | ₱210,239.2 | |
| Tier 1 capital ratio | **16.47%** | | 11.87% | |
| Total capital ratio | **21.68%** | | 18.12% | |

Merger Incentives

In connection with the merger of the Parent Company with ABC, the BSP gave certain incentives and the more relevant incentives are:

(a) Recognition of the fair value adjustments under GAAP and RAP books;
(b) Full recognition of appraisal increment from the revaluation of premises, improvements and equipment in the computation of CAR.

The Parent Company and its individually regulated subsidiaries/operations have complied with all externally imposed capital requirement throughout the period.

Internal Capital Adequacy Assessment Process (ICAAP) Implementation

In compliance with BSP Circular 639, the Parent Company has adopted its live ICAAP Document for 2011 to 2013. However, the BOD and the Management recognized that ICAAP is beyond compliance, i.e. it is about how to effectively run the Parent Company's operations by ensuring that the Parent Company maintains at all times an appropriate level and quality of capital to meet its business objective and commensurate to its risk profile. In line with its ICAAP principles, the Bank shall maintain a capital level that will not only meet the BSP CAR requirement but will also cover all material risks that it may encounter in the course of its business. The ICAAP process highlights close integration of capital planning/strategic management with risk management. The Parent Company has in place a risk management framework that involves a collaborative process for assessing and managing identified Pillar 1 and Pillar 2 risks. The Parent Company complies with the required annual submission of updated ICAAP.

Fixed capitalization requirements

Department of Finance (DOF) issued Order 27-06 which provides for the capitalization requirements for life, non-life and reinsurance companies. Under this order, the minimum statutory net worth and minimum paid-up capital requirements vary depending on the level of the foreign ownership in the insurance company. The statutory net worth shall include the company's paid-up capital, capital in excess of par value, contingency surplus, retained earnings and revaluation increments as may be approved by the IC. On June 1, 2012, the DOF issued Order 15-2012 which serves as a supplement to Order 27-06 which provides capitalization requirements beyond December 31, 2012.

On October 29, 2008, the IC issued Circular Letter No. 26-2008, which recalls that in view of the compliance of insurance companies with the requirement of Insurance Memorandum Circular (IMC) No. 10-2006, the scheduled increases due December 31, 2007 (i.e. ₱150 million) have been deferred for a year. Hence, the IMC reiterates that by December 31, 2008, insurance companies should comply with the increase previously scheduled for December 31, 2007.

As of March 31, 2013, the required minimum statutory net worth and minimum paid-up capital for PNB LII, being a Filipino-owned life insurance company, is ₱500.0 million and ₱250.0 million, respectively. PNB LII has complied with the minimum statutory net worth and paid-up capital requirements as of March 31, 2013 based on PNB LII's own calculation.

As of March 31, 2013 and December 31, 2012, the required minimum statutory net worth and minimum paid-up capital for PNB Gen, being Filipino-owned nonlife insurance company is ₱500.0 million and ₱250.0 million, respectively, in 2013 and 2012. The PNB Gen has complied with the minimum statutory net worth and paid-up capital requirements as of March 31, 2013 and December 31, 2012 based on PNB Gen's own calculation.

Financial Performance

The following basic ratios measure the financial performance of the Group for the periods ended March 31, 2013 and December 31, 2012 (amounts in millions):

| | **March 31, 2013 (Three Months)** | December 31, 2012 (As restated - Note 2) (One Year) |
|---|---|---|
| Return on average equity (a/b) | **4.54%** | 3.57% |
| a.) Net income | **₱2,840** | ₱1,289 |
| b.) Average total equity | **62,491** | 36,150 |
| | | |
| Return on average assets (c/d) | **0.64%** | 0.40% |
| c.) Net income | **₱2,840** | ₱1,289 |
| d.) Average total assets | **440,295** | 320,871 |
| | | |
| Net interest margin on average earning assets (e/f) | **0.70%** | 0.66% |
| e.) Net interest income | **₱2,622** | ₱1,863 |
| f.) Average interest earning assets | **374,595** | 283,626 |

Note: Average balances were the sum of beginning and ending balances of the respective statement of financial position accounts as of the end of the period divided by two.

## 26. Income and Expenses

Service fees and commission income consists of:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| Deposit-related | **₱255,675** | ₱209,686 |
| Credit-related | **199,369** | 30,737 |
| Remittance | **114,724** | 45,368 |
| Trust fees (Note 31) | **99,335** | 209,629 |
| Miscellaneous | **93,339** | 25,631 |
| | **₱762,442** | ₱521,051 |

Miscellaneous income consists of:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| Recoveries | **₱173,085** | ₱5,664 |
| Rental (Notes 28 and 32) | **107,415** | 76,430 |
| Penalty charges | **10,943** | 2,103 |
| Referral and trust fees | **6,133** | – |
| Share in net income of associate | **4,975** | 18,300 |
| Others | **69,555** | 18,853 |
| | **₱372,106** | ₱121,350 |

Net gains on sale or exchange of assets of the Group include net gains from sale of investment properties for the three-month periods ended March 31, 2013 and 2012 amounting to ₱92.7 million and ₱99.3 million, respectively.

The gain on step-up acquisition includes ₱83.9 million (see Note 12) and ₱57.1 million gain arising from the step-up acquisition of investments in ACB and PNB Life which were accounted for as disposals of equity investments.

The details of net premiums on life insurance contracts for the three-month period ended March 31, 2013 are shown below:

| | |
|---|---|
| **Insurance contract premiums revenue** | |
| Ordinary life insurance | ₱144,152 |
| Group life insurance | 63,227 |
| Unit-linked | 29,142 |
| | 236,521 |
| **Reinsurers' share of insurance contract premiums revenue** | 1,686 |
| | ₱234,835 |

The details of net premiums on nonlife insurance contracts are shown below:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| **Insurance contract premiums revenue** | | |
| Direct | **₱395,889** | ₱344,579 |
| Assumed | **21,277** | 25,166 |
| Total nonlife insurance contract premiums revenue | **417,166** | 369,745 |
| Gross change in provisions for unearned premiums | **(52,934)** | (35,330) |
| | **364,232** | 334,415 |

(Forward)

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| **Insurers' share of insurance contract premiums revenue** | | |
| Direct | **₱200,174** | ₱186,541 |
| Assumed | **45,206** | 39,188 |
| Total nonlife insurance contract premiums revenue | **245,380** | 225,729 |
| Gross change in provisions for unearned premiums | **(17,487)** | (5,881) |
| | **227,893** | 219,848 |
| | **₱136,339** | ₱114,567 |

Miscellaneous expenses consist of:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| Insurance | **₱316,672** | ₱247,803 |
| Litigation | **211,477** | 10,469 |
| Increase in aggregate reserve for life policies | **142,906** | – |
| Security, clerical, messengerial | **142,628** | 98,744 |
| Promotional | **102,013** | 96,427 |
| Management and professional fees | **75,175** | 42,117 |
| Transportation and travel | **70,380** | 47,552 |
| Information technology | **68,828** | 36,124 |
| Foreclosure and other ROPA related expenses (Note 13) | **63,674** | 49,111 |
| Stationery and supplies used | **51,498** | 34,772 |
| Amortization of software costs (Note 15) | **42,946** | 38,053 |
| EARE (Note 29) | **36,378** | 31,210 |
| Postage, telephone and telegram | **32,399** | 27,449 |
| Repairs and maintenance | **22,830** | 14,748 |
| Membership dues and fees | **2,479** | 3,300 |
| Others | **171,958** | 593,835 |
| | **₱1,554,241** | ₱1,371,714 |

Miscellaneous - others include amortization of deferred charges, loss on property destroyed, periodicals and magazines, fines, penalties and other charges.

## 27. **Retirement Plan**

*Defined benefit plan*

The Parent Company and certain subsidiaries of the Group have 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%) of plan salary per month for every year of credited service.

The following table shows the actuarial assumptions as of March 31, 2013, December 31, 2012 and January 1, 2012 used in determining the retirement benefit obligation of the Parent Company:

| | **March 31, 2013** | December 31, 2012 | January 1, 2012 |
|---|---|---|---|
| Discount rate | **3%-4%** | 6% | 6% |
| Salary rate increase | **5%-8%** | 8% | 8% |
| Estimated working lives | **11-14 years** | 14 years | 14 years |

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.

The latest actuarial valuation was made as of March 31, 2013. As of March 31, 2013, the Parent Company has two separate retirement plans for the employees of PNB and ABC.

The amount of retirement liability recognized for the Parent Company in the Group's statements of financial position (included under 'Other liabilities') follows:

| | **March 31, 2013** | December 31, 2012 (As restated - Note 2) | January 1, 2012 (As restated - Note 2) |
|---|---|---|---|
| Present value of defined benefit obligation | **₱6,071,817** | ₱3,141,154 | ₱2,828,807 |
| Fair value of plan assets | **2,284,378** | 1,317,810 | 797,883 |
| Retirement liability | **₱3,787,439** | ₱1,823,344 | ₱2,030,924 |

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

| | **March 31, 2013 (Three Months)** | December 31, 2012 (As restated- Note 2) (One Year) | January 1, 2012 (As restated- Note 2) (One Year) |
|---|---|---|---|
| Balance at beginning of period | **₱3,141,154** | ₱2,828,807 | ₱1,827,591 |
| Effect of business combinations | **1,589,861** | – | – |
| Current service cost | **85,854** | 265,458 | 160,225 |
| Interest cost | **59,001** | 175,165 | 143,754 |
| Benefits paid | **(74,623)** | (140,457) | (191,951) |
| Remeasurement (gains) losses: | | | |
| Experience adjustments | **303,433** | (216,253) | (66,200) |
| Actuarial losses arising from changes in financial assumptions | **967,137** | 228,434 | 955,388 |
| Balance at end of period | **₱6,071,817** | ₱3,141,154 | ₱2,828,807 |

There are no actuarial gains and losses arising from changes in demographic assumptions.

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

| | **March 31, 2013 (Three Months)** | December 31, 2012 (As restated - Note 2) (One Year) | January 1, 2012 (As restated - Note 2) (One Year) |
|---|---|---|---|
| Balance at beginning of period | **₱1,317,810** | ₱797,883 | ₱973,864 |
| Effect of business combination | **839,976** | – | – |
| Contributions | **40,783** | 363,390 | 50,000 |
| Return on assets excluding amount in net interest cost | **136,928** | 238,887 | (111,355) |
| Benefits paid | **(74,623)** | (140,457) | (191,951) |
| Interest income | **23,504** | 58,107 | 77,325 |
| Balance at end of period | **₱2,284,378** | ₱1,317,810 | ₱797,883 |

The fair value of the plan assets as of March 31, 2013, December 31, 2012 and January 1, 2012 includes investments in the Parent Company shares of stock with fair value amounting to ₱791.2 million, ₱712.9 million and ₱441.8 million, respectively.

The actual return on plan assets of the Parent Company amounted to gains of ₱160.4 million and ₱296.9 million for the three-month period ended March 31, 2013 and for the year ended December 31, 2012, respectively.

There were no changes in the effect of asset ceiling as of March 31, 2013 and December 31, 2012.

The amounts pertaining to the Parent Company that is included in the Group's statements of income are as follows:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 (As restated - Note 2) |
| Net interest cost* | **₱35,497** | ₱29,264 |
| Current service cost** | **85,854** | 66,365 |
| | **₱121,351** | ₱95,629 |

**Included under interest expense in the statements of income*
***Included under compensation and fringe benefits in the statements of income*

The amounts of defined benefit cost of the Parent Company which is included in the Group's statements of other comprehensive income from actuarial losses (gains) follow:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 (As restated - Note 2) |
| Actuarial loss on present value of retirement obligation | **₱1,270,570** | ₱3,045 |
| Return on plan assets | **(136,928)** | (59,722) |
| | **1,133,642** | (56,677) |
| Income tax effect | **4,865** | – |
| | **₱1,138,507** | (₱56,677) |

The fair values of plan assets of the Parent Company by each class as at the end of the reporting periods are as follow:

| | **March 31, 2013** | December 31, 2012 | January 1, 2012 |
|---|---|---|---|
| Cash and cash equivalents | **₱453,559** | ₱306,412 | ₱16,004 |
| Equity instruments | | | |
| Financial Institutions | **791,213** | 712,875 | 441,826 |
| Manufacturing | **23,668** | 5,100 | – |
| Debt instruments | | | |
| Government securities | **660,034** | 92,486 | 156,280 |
| Below AAA and not rated private debt securities | **66,397** | – | – |
| Investment in Mutual Funds | **111,131** | 97,077 | 78,150 |
| | **2,106,002** | 1,213,950 | 692,260 |
| Loans and receivables | | | |
| Financial Institutions | **66,825** | 58,000 | 43,000 |
| Power | **19,701** | 33,611 | 34,650 |
| Real Estate | **10,890** | 10,000 | 10,000 |
| Consumption | **10,692** | – | – |
| Industrial | **5,940** | – | – |
| Commercial | **5,346** | – | – |
| Others | **31,763** | – | 15,000 |
| Interest and other receivables | **27,219** | 2,249 | 2,973 |
| | **178,376** | 103,860 | 105,623 |
| Fair value of plan assets | **₱2,284,378** | ₱1,317,810 | ₱797,883 |

All equity and debt instruments held have quoted prices in active market. The remaining plan assets do not have quoted market prices in active market, thus, their fair value is determined using the discounted cash flow methodology, using the Parent Company's current incremental lending rates for similar types of loans and receivables.

The plan assets have diverse investments and do not have any concentration risk.

The sensitivity analysis below has been determined based on reasonably possible changes of each significant assumption on the defined benefit obligation as of the end of the reporting period, assuming if all other assumptions were held constant:

| | **March 31, 2013** | |
|---|---|---|
| | Possible fluctuations | Increase (decrease) |
| Discount Rates | -1.00% | ₱719,456 |
| Future Salary Increase Rate | +2.00% | 1,203,991 |

The movements in the retirement liability of the Parent Company recognized under 'Other liabilities' in the Group's statements of financial position follow:

| | **March 31, 2013 (Three Months)** | December 31, 2012 (As restated - Note 2) (One Year) | January 1, 2012 (As restated - Note 2) (One Year) |
|---|---|---|---|
| Balance at beginning of period | **₱1,823,344** | ₱2,030,924 | ₱853,727 |
| Retirement liability assumed from business combination | **749,885** | – | – |
| Retirement expense | **121,351** | 382,516 | 226,654 |
| Actual contributions | **(40,783)** | (363,390) | (50,000) |
| Remeasurement losses (gains): | | | |
| Experience adjustments | **303,433** | (216,253) | (66,200) |
| Actuarial gains and losses arising from changes in financial assumptions | **967,137** | 228,434 | 955,388 |
| Return on assets excluding amount in net interest cost | **(136,928)** | (238,887) | 111,355 |
| Balance at end of period | **₱3,787,439** | ₱1,823,344 | ₱2,030,924 |

There are no actuarial gains and losses arising from changes in demographic assumptions.

The Parent Company believes that the plan has sufficient funds to pay any retiring employee in the near future. Accordingly, it does not expect to contribute to the plan in 2013.

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

| | **March 31, 2013** | December 31, 2012 | January 1, 2012 |
|---|---|---|---|
| Debt securities and others | **36%** | 39% | 25% |
| Parent Company's own common shares | **35** | 54 | 55 |
| Government securities | **29** | 7 | 20 |
| | **100%** | 100% | 100% |

The carrying values of the plan assets of the Parent Company amounted to ₱2.3 billion, ₱1.3 billion and ₱0.8 billion as of March 31, 2013, December 31, 2012 and January 1, 2012, respectively.

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

| | **March 31, 2013** | December 31, 2012 | December 31, 2011 | December 31, 2010 | December 31, 2009 |
|---|---|---|---|---|---|
| Present value of the defined benefit obligation | **₱6,071,817** | ₱3,141,154 | ₱2,828,807 | ₱1,827,591 | ₱2,218,999 |
| Fair value of plan assets | **2,284,378** | 1,317,810 | 797,883 | 973,864 | 750,100 |
| Deficit on plan assets | **3,787,439** | 1,823,344 | 2,030,924 | 853,727 | 1,468,899 |
| Experience adjustments arising on plan liabilities | **303,433** | (216,253) | (66,200) | (273,035) | (24,385) |
| Experience adjustments arising on plan assets | – | – | – | 212,432 | 70,857 |

As of March 31, 2013, December 31, 2012 and January 1, 2011, the retirement liability (asset) included in ‘Other liabilities’ (see Note 22) and ‘Other assets’ (see Note 15), respectively, of certain subsidiaries of the Group follows:

| | PNB Europe | PNB Capital | PNB Securities | PNB Italy | Japan-PNB | PNB Gen | ASB | ALFC | PNB LII |
|---|---|---|---|---|---|---|---|---|---|
| **2013** | **₱21,795** | **(₱1,071)** | **₱155** | **₱7,497** | **₱291** | **₱19,424** | **(₱3,729)** | **(₱3,706)** | **₱6,953** |
| 2012 | 2,124 | (1,184) | 1,398 | 7,377 | 648 | 19,567 | – | – | – |
| 2011 | 39,970 | – | 992 | 7,741 | 1,575 | 14,003 | – | – | – |

*Defined contribution plan*
The Parent Company has no shortfall in the computed return from the date of the business combination up to March 31, 2013.

## 28. 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 10.00%.

Rent expense charged against current operations (included in ‘Occupancy and equipment-related costs’ in the statements of income) amounted to ₱102.2 million and ₱95.1 million for the three-month periods ended March 31, 2013 and 2012.

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

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Within one year | **₱476,667** | ₱457,904 |
| Beyond one year but not more than five years | **765,819** | 819,177 |
| More than five years | **24,601** | 28,698 |
| | **₱1,267,087** | ₱1,305,779 |

The Parent Company has entered into commercial property leases on its investment properties. These non-cancelable leases have lease terms of one to five years. Some leases include escalation clauses (such as 5% per year). For the three-month periods ended March 31, 2013 and 2012, total rent income (included under ‘Miscellaneous income’) amounted to ₱37.9 million and ₱36.6 million, respectively, for the Group (see Note 26).

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

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Within one year | **₱102,746** | ₱103,870 |
| Beyond one year but not more than five years | **147,833** | 155,447 |
| More than five years | **14,944** | – |
| | **₱265,523** | ₱259,317 |

Leases where the Group substantially transfers to the lessee all risks and benefits incidental to ownership of the leased asset are classified as finance leases and are presented as receivable at an amount equal to the Group's net investment in the lease. Finance income is recognized based on the pattern reflecting a constant periodic rate of return on the net investment outstanding in respect of the finance lease (EIR method). Lease payments relating to the period are applied against the gross investment in the lease to reduce both the principal and the unearned finance income.

Future minimum lease receivables under finance leases are as follows:

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Within one year | **₱1,225,220** | ₱889,311 |
| Beyond one year but not more than five years | **1,553,310** | 1,068,345 |
| More than five years | **85,200** | 85,800 |
| Total (Note 9) | **2,863,730** | 2,043,456 |
| Less amounts representing finance charges | **309,264** | 292,797 |
| Present value of minimum lease payments | **₱2,554,466** | ₱1,750,659 |

## 29. 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.

Effective November 1, 2005, Republic Act (RA) No. 9337, an act amending the National Internal Revenue Code (NIRC of 1997), provides that the RCIT rate shall be 30.00% and interest allowed as a deductible expenses shall be reduced by 33.00% of interest income subjected to final tax.

A minimum corporate income tax (MCIT) of 2.00% 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, the Parent Company and certain subsidiaries are allowed to deduct NOLCO from their taxable income for the next three years from the period of incurrence.

FCDU offshore income (income from non-residents) is tax-exempt while gross onshore income (income from residents) is generally subject to 10.00% 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:

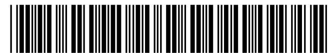
| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| Current | | |
| Regular | **₱576,420** | ₱51,155 |
| Final | **573,010** | 195,308 |
| | **1,149,430** | 246,463 |
| Deferred | **(487,538)** | (8,379) |
| | **₱661,892** | ₱238,084 |

Net deferred tax asset/liability of the Group is included in the following accounts in the statements of financial position:

| | **March 31, 2013** | December 31, 2012 (As restated - Note 2) | January 1, 2012 (As restated - Note 2) |
|---|---|---|---|
| Deferred tax assets | **₱1,089,464** | ₱1,780,682 | ₱1,775,789 |
| Deferred tax liabilities (Note 22) | **(140,915)** | (3,873) | (20,873) |
| | **₱948,549** | ₱1,776,809 | ₱1,754,916 |

The components of net deferred tax assets follow:

| | **March 31, 2013** | December 31, 2012 (As restated-Note 2) | January 1, 2012 (As restated-Note 2) |
|---|---|---|---|
| Deferred tax asset on: | | | |
| Allowance for impairment, credit and other losses | **₱4,751,289** | ₱4,323,439 | ₱4,446,842 |
| Accumulated depreciation on investment properties | **674,209** | 624,305 | 784,797 |
| Others | **660,338** | 168,436 | 67,500 |
| | **6,085,836** | 5,116,180 | 5,299,139 |
| Deferred tax liability on: | | | |
| Revaluation increment on land and buildings | **2,079,821** | 878,483 | 909,138 |
| Fair value adjustment on investment properties | **2,017,629** | 1,988,219 | 2,184,845 |
| Unrealized trading gains on derivatives | **123,276** | 141,835 | 106,777 |
| Fair value adjustments due to business combination | **711,328** | – | – |
| Unrealized gain on AFS investments | **11,146** | 8,856 | 34,637 |
| Others | **194,087** | 321,978 | 308,826 |
| | **5,137,287** | 3,339,371 | 3,544,223 |
| | **₱948,549** | ₱1,776,809 | ₱1,754,916 |



Provision for deferred tax charged directly to OCI during the period follows:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 (As restated) |
| Remeasurement losses on retirement plan | **₱4,865** | ₱– |
| Net unrealized gain (loss) on AFS investments | **304** | (25,781) |

Based on the financial forecast prepared by management and duly approved by the Executive Committee of the BOD, the Parent Company's net deferred tax assets of ₱0.9 billion and ₱1.7 billion as of March 31, 2013 and December 31, 2012 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 credit and losses and temporary differences since they believe that the related tax benefits will not be realized in the future:

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Allowance for impairment and credit losses | **₱1,824,758** | ₱745,941 |
| Retirement liability | **855,517** | 421,186 |
| Provisions | **591,373** | 472,630 |
| NOLCO | **279,125** | 1,172 |
| MCIT | **50,737** | 361,071 |
| Derivative liabilities | **11,999** | 85,125 |
| Others | **429,880** | 164,574 |
| | **₱4,043,389** | ₱2,251,699 |

Details of the Group's NOLCO follow:

| Year Incurred | Amount | Used/Expired | Balance | Expiry Year |
|---|---|---|---|---|
| 2010 | ₱118,430 | ₱– | ₱118,430 | 2013 |
| 2011 | 85,165 | – | 85,165 | 2014 |
| 2012 | 75,530 | – | 75,530 | 2015 |
| | ₱279,125* | ₱– | ₱279,125 | |

**Balance includes NOLCO amounting to ₱277,953 acquired from business combination*

Details of the Group's MCIT follow:

| Year Incurred | Amount | Used/Expired | Balance | Expiry Year |
|---|---|---|---|---|
| 2010 | ₱133,809 | (₱113,068) | ₱20,741 | 2013 |
| 2011 | 169,924 | (164,385) | 5,539 | 2014 |
| 2012 | 195,475 | (171,018) | 24,457 | 2015 |
| | ₱499,208 | (₱448,471) | ₱50,737 | |

**Balance includes MCIT amounting to ₱138,137 acquired from business combination*

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

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31,2012 (As restated - Note 2) |
| Statutory income tax rate | **30.00%** | 30.00% |
| Tax effects of: | | |
| Tax-paid income | **(13.77)** | (13.18) |
| Net non-deductible expenses | **12.03** | 16.88 |
| Tax-exempt income | **(7.23)** | (7.45) |
| FCDU income before tax | **(3.34)** | (11.30) |
| Net unrecognized deferred tax assets | **1.21** | 0.64 |
| Effective income tax rate | **18.90%** | 15.59% |

Current tax regulations define 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' in the statements of income) of the Group amounted to ₱36.4 million and ₱31.2 million for the three-month periods ended March 31, 2013 and 2012, respectively.

## 30. Earnings Per Share

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

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 (As restated) |
| a) Net income attributable to equity holders of the Parent Company | **₱2,827,420** | ₱1,287,197 |
| b) Weighted average number of common shares for basic earnings per share (Note 25) | **944,687** | 662,046 |
| c) Basic and diluted earnings per share (a/b) | **₱2.99** | ₱1.94 |

There are no potential common shares that would dilute the earnings per share.

## 31. 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 consolidated statements of financial position since these are not assets of the Parent Company. Such assets held in trust were carried at a value of ₱100.4 billion and ₱56.0 billion as of March 31, 2013 and December 31, 2012, respectively (see Note 33). In connection with the trust functions of the Parent Company, government securities amounting to ₱1.1 billion and ₱0.6 billion (included under 'AFS investments') as of March 31, 2013 and December 31, 2012, respectively, are deposited with the BSP in compliance with trust regulations.

In compliance with existing banking regulations, the Parent Company transferred from surplus to surplus reserves ₱145.7 million of which ₱136.2 million pertains to the required reserve of the trust business arising from business combination as of March 31, 2013 and ₱9.7 million as of December 31, 2012, 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.

## 32. 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 Directors, Officers, Stockholders and Related Interests (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.

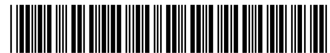
In the aggregate, DOSRI loans generally should not exceed the Parent Company's equity or 15.00% of the Parent Company's total loan portfolio, whichever is lower. As of March 31, 2013 and December 31, 2012, the Parent Company was in compliance with such regulations.

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

| | **March 31, 2013** | December 31, 2012 |
|---|---:|---:|
| Total Outstanding DOSRI Accounts | **₱5,803,352** | ₱2,650,526 |
| Percent of DOSRI accounts granted prior to effectivity of BSP Circular No. 423 to total loans | **1.82%** | 2.03% |
| Percent of DOSRI accounts granted after effectivity of BSP Circular No. 423 to total loans | **1.82%** | 2.03% |
| Percent of DOSRI accounts to tota loans | **1.82%** | 2.03% |
| Percent of unsecured DOSRI accounts to total DOSRI accounts | **0.99%** | 3.29% |
| Percent of past due DOSRI accounts to total DOSRI accounts | **0.00%** | 0.00% |
| Percent of nonaccruing DOSRI accounts to total DOSRI accounts | **0.00%** | 0.00% |

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 10.00% of a bank's net worth, the unsecured portion of which shall not exceed 5.00% of such net worth. Further, the total outstanding exposures to subsidiaries and affiliates shall not exceed 20.00% of the net worth of the lending bank. BSP Circular No. 560 is effective on February 15, 2007.



Details on significant related party transactions of the Group follow (transactions with subsidiaries have been eliminated in the consolidated financial statements). Transactions reported under subsidiaries represent companies where the Parent Company has control. Transactions reported under other related parties represent companies which are under common control.

| | As of March 31, 2013 | | |
|---|---|---|---|
| **Category** | **Amount/ Volume** | **Outstanding Balance** | **Nature, Terms and Conditions** |
| **Subsidiaries** | | | |
| Receivables from customers | | **₱564,000** | Revolving credit lines with fixed annual interest rate of 4.25% and maturity terms of less than 90 days<br>Unsecured - ₱564.0 million with no impairment |
| Accounts receivable | | **200,192** | Advances to finance deficit in pension liability, remittance cover and additional working capital<br>Non-interest bearing; unsecured; payable on demand |
| Accrued interest receivable | | **1,008** | Interest in receivables from customers |
| Deposit liabilities | | **1,559,757** | With annual rates ranging from 0.10% to 3.00% and maturity terms ranging from 30 days to one (1) year |
| Bills payable | | **1,076,050** | Foreign currency-denominated bills payable with fixed annual interest rate of 0.85% and maturity term of 180 days; unsecured |
| Accrued interest payable | | **363** | Interest on deposit liabilities and bills payable |
| Due to other banks | | **253,983** | Clearing accounts for funding and settlement of remittances |
| Due from other banks | | **229,226** | With annual fixed interest rates ranging from 0.01% to 4.50% including time with maturities of up to 90 days |
| Operating lease | | **203** | Advance rental deposit received for 2 years and 3 months |
| | **Three Months Ended March 31, 2013** | | |
| Interest income | **₱5,993** | | Interest income on receivable from customers |
| Interest expense | **3,173** | | Interest expense on deposit liabilities and bills payable |
| Rental income | **5,960** | | Rental income with lease terms ranging from 2 to 5 years and annual escalation rates ranging from 5.00% to 10.00% |
| Fees and commissions | **32** | | Professional fees on service agreement |
| Other expense | **501** | | Share in utilities expense |
| Securities transactions: | | | |
| Purchases | **688,645** | | Outright purchase of securities |
| Sales | **361,458** | | Outright sale of securities |
| Trading gains | **4,235** | | Gain from sale of investment securities |

| | As of March 31, 2013 | | |
|---|---|---|---|
| **Category** | **Amount/ Volume** | **Outstanding Balance** | **Nature, Terms and Conditions** |
| **Other Related Parties** | | | |
| Receivable from customers | | **₱5,757,756** | Loans with interest rates ranging from 0.50% to 16.50% and maturity terms ranging from 11 months to 25 years<br>Secured - ₱2.8 billion and unsecured - ₱0.1 billion; without impairment<br>Collaterals include bank deposits hold-out, real estates and chattel mortgages |
| Sales contract receivables | | **105,750** | Arising from sale of investment property; title will be transferred upon full payment; non-interest bearing loan payable within one year<br>Secured - ₱105.8 million; with no impairment<br>Collateral pertains to investment property sold |
| Accrued interest receivables | | **15,764** | Accrued interest of receivables from customers |

(Forward)

| Category | Amount/ Volume | Outstanding Balance | Nature, Terms and Conditions |
|---|---|---|---|
| | | **As of March 31, 2013** | |
| Bills payable | | **610,800** | With annual interest rates ranging from 5.00% to 5.50%; maturity terms ranging from 90 to 180 days; unsecured |
| Deposit liabilities | | **4,120,300** | With annual interest rates ranging from 0.38% to 1.93% and maturity terms ranging from 30 days to one (1) year |
| Accrued interest payable | | **4,951** | Interest on deposit liabilities and bills payable |
| Operating lease | | **203** | Advance rental deposit received for 2 years and 3 months |
| Due from other banks | | **2,343,552** | With annual fixed interest rates ranging from 0.01% to 4.50% including time with maturities of up to 90 days and savings with interest rate of 13.00% |
| Investment securities | | **249,719** | 49,943,860 shares of stock classified as AFS investments with allowance for impairment loss of ₱249.0 million |
| | | **Three Months Ended March 31, 2013** | |
| Interest income | **₱59,286** | | Interest income on receivable from customers and due from other banks |
| Interest expense | **6,175** | | Interest expense on deposit liabilities and bills payable |
| Rental income | **20,402** | | Rental income with lease terms ranging from 2 to 10 years and annual escalation rates ranging from 5.0% to 10.0% |
| Rental expense | **3,251** | | Monthly rent payments to related parties with terms ranging from 24 to 240 months |
| Fees and commissions expense | **2,164** | | Expense on professional fees on service agreement |
| Securities transactions: | | | |
| Purchases | **11,539,297** | | Outright purchase of securities |
| Sales | **1,425,198** | | Outright sale of securities |
| Trading gains | **73,539** | | Gain from sale of investment securities |
| Deposits | **76,539,438** | | Deposits for the period |
| Withdrawals | **796,517** | | Withdrawals for the period |
| Loan releases | **25,316** | | Loan drawdowns |
| Loan collections | **2,524,276** | | Settlement of loans and interest |

| Category | Amount/ Volume | Outstanding Balance | Nature, Terms and Conditions |
|---|---|---|---|
| | | As of December 31, 2012 | |
| **Subsidiaries** | | | |
| Receivables from customers | | ₱564,000 | Revolving credit lines with fixed annual interest rate of 4.25% and maturity terms of less than 31 days Unsecured - ₱564.0 million with no impairment |
| Accounts receivable | | 106,458 | Advances to finance deficit in pension liability, remittance cover and additional working capital Non-interest bearing, unsecured, payable on demand |
| Accrued interest receivable | | 1,026 | Interest on receivables from customers |
| Deposit liabilities | | 552,297 | With annual rates ranging from 0.10% to 3.00% and maturity terms ranging from 30 days to one (1) year |
| Bills payable | | 863,579 | Foreign currency-denominated bills payable with fixed annual interest rate of 1.03% and maturity term of 180 days; unsecured |
| Accrued interest payable | | 3,473 | Interest on deposit liabilities and bills payable |
| Due to banks | | 205,480 | Clearing accounts for funding and settlement of remittances |

| Category | Amount/ Volume | Outstanding Balance | Nature, Terms and Conditions |
|---|---|---|---|
| | Year Ended December 31, 2012 | | |
| Interest income | ₱28,271 | | Interest income on receivable from customers |
| Interest expense | 12,772 | | Interest expense on deposit liabilities and bills payable |
| Other income | 7,615 | | Rental income with lease term of three (3) years and annual escalation rate of 10.00% |
| Other expense | 2,004 | | Share in utilities expense |

| Category | Amount/ Volume | Outstanding Balance | Nature, Terms and Conditions |
|---|---|---|---|
| | As of December 31, 2012 | | |
| **Other Related Parties** | | | |
| Receivable from customers | | ₱2,873,011 | Loans with interest rates ranging from 0.50% to 16.50% and maturity terms ranging from one (1) month to 25 years.<br>Secured - ₱2.8 billion and unsecured - ₱0.1 billion; with no impairment<br>Collateral includes bank deposit hold-out, real estate and chattel mortgages |
| Sales Contract Receivables | | 105,750 | Arising from sale of investment property<br>Title will be transferred upon full payment<br>Non-interest bearing loan payable within one year<br>Secured - ₱105.8 million; with no impairment<br>Collateral pertains to investment property sold |
| Accrued interest receivables | | 1,647 | Interest on receivables from customers |
| Bills payable | | 554,175 | Foreign currency-denominated bills payable with fixed annual interest rate of 1.77% and maturity term of 181 days, no collateral |
| Deposit liabilities | | 1,272,976 | With annual rates ranging from 0.38% to 1.73% and maturity terms ranging from 30 days to one (1) year |
| Due from other banks | | 196,977 | Includes savings deposits with interest rate of 0.13% |
| Investment securities | | 270,212 | 52,443,860 shares of stock classified as AFS investments with allowance for impairment loss of ₱270.0 million. |

| Category | Amount/ Volume | Outstanding Balance | Nature, Terms and Conditions |
|---|---|---|---|
| | Year Ended December 31, 2012 | | |
| Interest income | ₱154,464 | | Interest income on receivable from customers |
| Profit from asset sold | 39,095 | | Gain from sale of investment property |
| Interest expense | 10,626 | | Interest expense on deposit liabilities |
| Other income | 16,830 | | Rental income with lease term of 10 years from November 1, 2007 to October 31, 2017 and annual escalation rate of 5.00% starting sixth year of the lease term |
| Securities transactions: | | | |
| Purchases | 16,431,445 | | Outright purchase of securities |
| Sales | 11,884,060 | | Outright sale of securities |
| Trading gains | 19,017 | | Gain from sale of investment securities |
| Loan releases | 512,941 | | Loan drawdowns |
| Loan collections | 2,326,902 | | Settlement of loans and interest |

The related party transactions shall be settled in cash. There are no provisions for credit losses for the three-month periods ended March 31, 2013 and 2012 in relation to amounts from related parties.

The compensation of the key management personnel follows:

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | March 31, 2012 |
| Short-term employee benefits | **₱69,755** | ₱33,837 |
| Post-employment benefits | **12,211** | 4,911 |
| | **₱81,966** | ₱38,748 |

The Parent Company and EPPI signed two JVA for the development of two properties under 'Real estate under joint venture (JV) agreement' by the Parent Company with book values of ₱1.2 billion. These two projects are among the Parent Company's strategies in reducing its non-performing assets.

The Parent Company contributed the aforementioned properties into the JV as approved by BSP. EPPI, on the other hand, contributed its resources and technical expertise for the completion of the said JV. The Parent Company is prohibited to contribute funds for the development of the JV. Hence, there are no receivables from each party with respect to the JV. Income from the sale of the properties under the JV will be shared by the Parent Company and EPPI in accordance with the terms of the JVA. This JVA does not fall as joint venture arrangement under PFRS 11.

Transactions with Retirement Plans

Management of the retirement funds of the Group is handled by the Parent Company's Trust Banking Group (TBG). The fair values and carrying values of the funds amounted to ₱2.3 billion and ₱1.3 billion, respectively, as of March 31, 2013 and December 31, 2012.

Relevant information on Funds' assets/liabilities as of March 31, 2013 and December 31, 2012 and income/expense for the three-month period ended March 31, 2013 and for the year ended December 31, 2012 are as follows:

| | **March 31, 2013** | December 31, 2012 |
|---|---|---|
| Investment securities: | | |
| Held for trading | **₱791,213** | ₱712,875 |
| Available-for-sale | **789,769** | 212,437 |
| Held-to-maturity | **66,397** | 68,000 |
| Deposits with other banks | **453,225** | 263,830 |
| Deposits with PNB | **334** | 50,792 |
| Loans and other receivables | **183,323** | 37,807 |
| **Total Fund Assets** | **₱2,284,261** | ₱1,345,741 |
| Trust Fees Payable | **₱–** | ₱754 |
| Accrued Expense | **891** | – |
| Due to BIR | **320** | – |
| **Total Fund Liabilities** | **₱1,211** | ₱754 |

| Fund Income | March 31, 2013 (Three Months) | December 31, 2012 (One Year) |
|---|---|---|
| Interest income | **₱16,591** | ₱20,738 |
| Trading gain | **1,142** | – |
| Dividend income | **546** | – |
| Unrealized gains on HFT (PNB) | – | 271,049 |
| Gains on sale of investment securities | – | 72 |
| | **₱18,279** | ₱291,859 |
| **Fund Expense** | | |
| Trust fees | **₱899** | ₱2,442 |
| Other expenses | **2,381** | 270 |
| | **₱3,280** | ₱2,712 |

As of March 31, 2013 and December 31, 2012, the retirement fund of the Group include 7,833,795 shares of PNB classified under HFT. No limitations and restrictions are provided and voting rights over these shares are exercised by a trust officer or any of its designated alternate officer of TBG.

As of March 31, 2013 and December 31, 2012, AFS and HTM investments include government and private debt securities and various funds. Deposits with other banks pertain to Special Deposit Accounts (SDA) placement with BSP. Loans and other receivables include accrued interest amounting to ₱0.04 million as of March 31, 2013 and December 31, 2012 and income include interest on deposit with PNB amounting to ₱0.3 million and ₱1.0 million for the three-month periods ended March 31, 2013 and 2012, respectively, for the Group. Investments are approved by an authorized fund manager or officer of TBG.

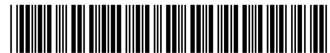
Other fund managed by TBG

The TBG manages the sinking fund established by PSC to secure its borrowings with the Parent Company. As of March 31, 2013 and December 31, 2012, the sinking fund amounted to ₱5.3 billion and ₱5.2 billion, respectively (see Note 9).

## 33. Provisions, Contingent Liabilities and Other Commitments

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 60.00% 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 50.00% of any profit that may be realized by the Parent Company on account of the sale; and
c) If the amount in the escrow account has not reached the total of ₱3.0 billion by June 30, 2013, the difference shall be paid by the Parent Company by way of a debit to its regular account with the BSP.

On November 28, 1997, the Parent Company remitted ₱150.0 million in compliance with item (a).

The Parent Company'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 revalued amount 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.

As of December 31, 2012, the total trust assets of the escrow account maintained with the BSP amounted to ₱2.9 billion. Average yield during the year was 5.49%. 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 liabilities due the BSP.

On February 7, 2013, the BSP accepted the Parent Company's proposal to make an early payment to settle the ₱3.0 billion obligation to the BSP in exchange of the assets under the escrow fund. The real estate collaterals pledged to BSP were also released as a result of settlement of the obligation to BSP.

As discussed in Note 9, in 2004, the Parent Company sold the outstanding loans receivable of ₱5.3 billion from National Steel Corporation (NSC) to SPV companies under the provisions of RA No. 9182. On October 10, 2008, simultaneous to the denial of their 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 settle pre-closing real estate taxes (taxes due as of October 14, 2004) due on the

NSC Plant Assets and to deliver to them titles to NSC's Plant Assets free from all liens and encumbrances. However, the banks and the Liquidator dispute the assertions that pre-closing taxes were in arrears, invoking under an installment agreement executed between the Liquidator and the City of Iligan. As part of the agreement to sell the plant assets to the SPV companies, the

Liquidator assumed responsibility of settling and paying the Plant Assets' pre-closing real estate taxs, while the SPV companies assumed the responsibility of updating the post-closing taxes (taxes due after October 14, 2004). Consequently, all pre-closing real estate taxes due on the plant assets have been paid in accelerated basis on December 18, 2008.

On October 13, 2008, after the commencement of the arbitration but before the arbitral panel was constituted, 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 in default and declaring all installments due until the arbitration proceeding at the SIAC is settled.

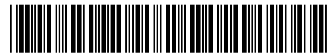
Thereafter, upon application by the Parent Company for a variation of the injunction and an order of the Singapore High court, the SPV companies remitted ₱750.0 million cash in place of the Standby Letter of Credit which they undertook to provide under the Asset Purchase Agreement, subject to the condition 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 by the Singapore High Court. The denial of the second variation (the ₱1.0 billion Standby Letter of Credit) was elevated to the Court of Appeals of Singapore but the same was also denied on September 11, 2009, without prejudice, however, to resort to the same reliefs before the Arbitration Panel.

In April 2010, the Arbitral Panel was constituted. The Parent Company filed therein an application to discharge or vary the injunction. On July 7, 2010, the Arbitration Panel issued a ruling denying the Parent Company's application for a discharge of the injunction issued by the Singapore High Court. On the application to vary the injunction order, no ruling was made by the Arbitration Panel.

Consequently, the main issues for alleged breach of the Asset Purchase Agreement, damages and suspension of payments were heard before the Arbitration Panel. On May 9, 2012, the Arbitration Panel issued a Partial Award in favor of the SPV companies, including such reliefs as payment of a certain sum of money and transfer of clean titles on the plant assets under the name of NSC by the bank consortium and the NSC Liquidator in favor of the SPV companies. The Parent Company, one of the members of the consortium, holds a forty-one percent (41%) interest in the claim, and has already set aside the appropriate reserve provision for the same.

Meanwhile, on July 9, 2012, the bank consortium filed with the Singapore High Court a Petition to Set Aside the Partial Award rendered by the Arbitration Panel, which Petition is pending to date.



Movements of provisions for legal claims for the Group are as follows:

| | **March 31, 2013 (Three Months)** | December 31, 2012 (One Year) |
|---|---:|---:|
| Balance at beginning of period | **₱1,575,433** | ₱874,950 |
| Provisions | **200,000** | 834,259 |
| Provisions acquired through business combination | **195,971** | – |
| Reclassification and settlements | **(162)** | (133,776) |
| Balance at end of period | **₱1,971,242** | ₱1,575,433 |

BSP Reporting

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

| | **March 31, 2013** | December 31, 2012 |
|---|---:|---:|
| Trust department accounts (Note 31) | **₱100,418,539** | ₱55,976,479 |
| Deficiency claims receivable | **11,850,751** | 6,309,340 |
| Credit card lines | **11,043,390** | – |
| Outstanding guarantees issued | **1,257,880** | 628,422 |
| Other contingent accounts | **520,056** | 41,317 |
| Outward bills for collection | **360,346** | 105,029 |
| Inward bills for collection | **312,517** | 140,548 |
| Unused commercial letters of credit | **139,258** | 36,096 |
| Confirmed export letters of credit | **78,901** | 78,126 |
| Items held as collateral | **52** | 244 |

## 34. **Notes to Consolidated Statements of Cash Flows**

The amounts of due from BSP and due from other banks which have original maturities of more than three months are as follows:

| | Three Months Ended | |
|---|---:|---:|
| | **March 31, 2013** | March 31, 2012 |
| Due from other banks | **₱3,484,186** | ₱– |
| Due from BSP | **–** | 19,300,000 |
| | **₱3,484,186** | ₱19,300,000 |

## 35. **Offsetting of Financial Assets and Liabilities**

The amendments to PFRS 7, which is effective January 1, 2013, require the Group to disclose information about rights of offset and related arrangements (such as collateral posting requirements) for financial instruments under an enforceable master netting agreements or similar arrangements. The effects of these arrangements are disclosed in the succeeding tables.

*Financial assets*

| March 31, 2013 | | | | | | |
|---|---|---|---|---|---|---|
| **Financial assets recognized at end of reporting period by type** | **Gross carrying amounts (before offsetting)** | **Gross amounts offset in accordance with the offsetting criteria** | **Net amount presented in statements of financial position [a-b]** | **Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria** | | **Net exposure [c-d]** |
| | | | | **Financial instruments** | **Fair value of financial collateral** | |
| | **[a]** | **[b]** | **[c]** | **[d]** | | **[e]** |
| Derivative assets (Note 7) | **₱24,118,063** | **₱23,753,313** | **₱364,750** | **₱–** | **₱–** | **₱364,750** |
| Securities held under agreements to resell (Note 4) | **20,000,000** | **–** | **20,000,000** | **–** | **19,970,313** | **29,687** |
| Total | **₱44,118,063** | **₱23,753,313** | **₱20,364,750** | **₱–** | **₱19,970,313** | **₱394,437** |

| December 31, 2012 | | | | | | |
|---|---|---|---|---|---|---|
| Financial assets recognized at end of reporting period by type | Gross carrying amounts (before offsetting) | Gross amounts offset in accordance with the offsetting criteria | Net amount presented in statements of financial position [a-b] | Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria | | Net exposure [c-d] |
| | | | | Financial instruments | Fair value of financial collateral | |
| | [a] | [b] | [c] | [d] | | [e] |
| Derivative assets (Note 7) | ₱13,918,337 | ₱13,526,872 | ₱391,465 | ₱295,260 | ₱– | ₱96,205 |
| Securities held under agreements to resell (Note 4) | 18,300,000 | – | 18,300,000 | – | 18,874,894 | – |
| Total | ₱32,218,337 | ₱13,526,872 | ₱18,691,465 | ₱295,260 | ₱18,874,894 | ₱96,205 |

*Financial liabilities*

| March 31, 2013 | | | | | | |
|---|---|---|---|---|---|---|
| **Financial assets recognized at end of reporting period by type** | **Gross carrying amounts (before offsetting)** | **Gross amounts offset in accordance with the offsetting criteria** | **Net amount presented in statements of financial position [a-b]** | **Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria** | | **Net exposure [c-d]** |
| | | | | **Financial instruments** | **Fair value of financial collateral** | |
| | **[a]** | **[b]** | **[c]** | **[d]** | | **[e]** |
| Derivative liabilities (Note 18) | **₱16,822,654** | **₱16,782,658** | **₱39,996** | **₱–** | **₱–** | **₱39,996** |
| Securities sold under agreements to repurchase (Notes 8 and 19)* | **4,949,058** | **–** | **4,949,058** | **158,091** | **6,301,144** | **–** |
| Bills payable (Notes 8 and 19) | **1,222,646** | **–** | **1,222,646** | **–** | **3,515,120** | **–** |
| Total | **₱22,994,358** | **₱16,782,658** | **₱6,211,700** | **₱158,091** | **₱9,816,264** | **₱39,996** |

| December 31, 2012 | | | | | | |
|---|---|---|---|---|---|---|
| Financial assets recognized at end of reporting period by type | Gross carrying amounts (before offsetting) | Gross amounts offset in accordance with the offsetting criteria | Net amount presented in statements of financial position [a-b] | Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria | | Net exposure [c-d] |
| | | | | Financial instruments | Fair value of financial collateral | |
| | [a] | [b] | [c] | [d] | | [e] |
| Derivative liabilities (Note 18) | ₱12,162,897 | ₱11,879,146 | ₱283,751 | ₱– | ₱– | ₱283,751 |
| Securities sold under agreements to repurchase (Notes 8 and 19)* | 2,971,471 | – | 2,971,471 | 21,141 | 3,509,709 | – |
| Bills payable (Notes 8 and 19) | 2,948,934 | – | 2,948,934 | – | 4,756,800 | – |
| Total | ₱18,083,302 | ₱11,879,146 | ₱6,204,156 | ₱21,141 | ₱8,266,509 | ₱283,751 |

** Included in bills and acceptances payable in the statements of financial position*

The amounts disclosed in column (d) include those rights to set-off amounts that are only enforceable and exercisable in the event of default, insolvency or bankruptcy. This includes amounts related to financial collateral both received and pledged, whether cash or non-cash collateral, excluding the extent of over-collateralization.

## 36. Events After Reporting Date

*Redemption of ₱6.0 Billion Unsecured Subordinated Notes*
On June 20, 2013, the Parent Company exercised its Call Option on its ₱6.0 billion 8.50% Unsecured Subordinated Notes due on June 18, 2018 amounting to ₱5.8 billion (Series A) and ₱0.2 billion (Series B) in accordance with the terms and conditions of the Unsecured Subordinated Notes issued on June 19, 2008. The notes were redeemed at face value and no gain or loss was recognized on the date of settlement.

*Increase in Authorized Capital Stock*
On May 28, 2013, the Stockholders of the Parent Company approved the following at their Annual Stockholders' Meeting:

1. Increase in Authorized Capital Stock of the Parent Company from ₱50,000,000,040.00 divided into 1,250,000,001 Common Shares with a par value of Forty Pesos (₱40.00) per share to ₱70,000,000,040.00 divided into 1,750,000,001 common shares with a par value of Forty Pesos (₱40.00) per share.

2. Amendment of Article Vll of the Articles of Incorporation to reflect the aforementioned increase in the authorized capital of stock of the Parent Company.

*Approval and Confirmation of Planned Issuance of LTNCD*
On May 24, 2013, the BOD of the Parent Company approved the issuance of Peso denominated LTNCD of up to ₱5.0 billion. On July 11, 2013, the BSP granted the Parent Company the authority to issue such LTNCD.

The Parent Company plans to launch the offer during the third quarter of 2013, subject to compliance with regulatory requirements. Proceeds from the LTNCD will be used for general corporate purposes and to further strengthen banking operations.

## 37. Approval of the Release of the Consolidated Financial Statements

The accompanying consolidated financial statements of the Group were authorized for issue by the BOD on July 18, 2013.