COVER SHEET

PW-686

SEC Registration Number

PHILIPPINE BANK OF COMMUNICATIONS

(Company's Full Name)

PBCom Tower, 6795 Ayala Avenue corner V. A. Rufino Street, Makati City

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

Daniel L. Ang Tan Chai

(Contact Person)

830-7000

(Company Telephone Number)

1 2	3 1
Month	*Day*

(Fiscal Year)

AAFS

(Form Type)

Month *Day*

(Annual Meeting)

(Secondary License Type, If Applicable)

Dept. Requiring this Doc.

Amended Articles Number/Section

Total Amount of Borrowings

415

Total No. of Stockholders

Domestic

Foreign

To be accomplished by SEC Personnel concerned

File Number

LCU

Document ID

Cashier

STAMPS

Remarks: Please use BLACK ink for scanning purposes.

PBCOM
Philippine Bank of Communications

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The Management of Philippine Bank of Communications (the Company) is responsible for the preparation and fair presentation of the financial statements for the years ended December 31, 2013, 2012 and 2011, including the additional components attached therein, in accordance with the prescribed Philippine Financial Reporting Standards. This responsibility includes designing and implementing internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error, selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances.

The Board of Directors reviews and approves the financial statements and submits the same to the Stockholders.

Sycip, Gorres, Velayo and Co., the independent auditors, appointed by the stockholders has examined the financial statements of the company in accordance with Philippine Standards on Auditing, and in its report to the stockholders, has expressed its opinion on the fairness of presentation upon completion of such examination.

ERIC O. RECTO
Chairman of the Board

NINA D. AGUAS
President and Chief Executive Officer

DANIEL L. ANG TAN CHAI
Chief Finance Officer

Signed this **26th** day of **February 2014**

REPUBLIC OF THE PHILIPPINES)
CITY OF MAKATI CITY) SS.

SUBSCRIBED AND SWORN TO before me this MAR 1 1 2014 at MAKATI CITY, affiants, Eric O. Recto, Nina D. Aguas, and Daniel L. Ang Tan Chai, exhibiting to me their TIN 108-730-891, 106-903-400 and 107-169-972, respectively.

Doc. No. 523
Page No. 106
Book No. 71
Series of 2014

ATTY. H[illegible] N. LLUZ
NOTARY PUBLIC
Until December 31, 2015
Appt. No. M-44, Makati City
IBP #942830, Nov. 12, 2013-RSM
PTR #4225542, Jan. 02, 2014-Makati
S.C. Roll No. 59597
MCLE Compliance No. IV-0011330
Unit 6E Cityland Herrera Tower
#98 Rufino St. cor. Valero St.
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SyCip Gorres Velayo & Co.
6760 Ayala Avenue
1226 Makati City
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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 Bank of Communications

Report on the Financial Statements

We have audited the accompanying financial statements of Philippine Bank of Communications (the Bank) which comprise the statements of financial position as at December 31, 2013 and 2012 and the statements of income, statements of comprehensive income, statements of changes in equity and statements of cash flows for each of the three years in the period ended December 31, 2013, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2013 and 2012 and its financial performance and its cash flows for each of the three years in the period ended December 31, 2013, in accordance with Philippine Financial Reporting Standards.

Report on the Supplementary Information Required Under Revenue Regulations 19-2011 and 15-2010

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information required under Revenue Regulations 19-2011 and 15-2010 in Notes 32 and 33 to the financial statements, respectively, is presented for purposes of filing with the Bureau of Internal Revenue and is not a required part of the basic financial statements. Such information is the responsibility of the management of Philippine Bank of Communications. The information has been subjected to the auditing procedures applied in our audit of the basic financial statements. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

SYCIP GORRES VELAYO & CO

Vicky Lee Salas

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. 4225181, January 2, 2014, Makati City

February 26, 2014

PHILIPPINE BANK OF COMMUNICATIONS
STATEMENTS OF FINANCIAL POSITION

	December 31		January 1
		2012 (As restated - Note 2)	2012 (As restated - Note 2)
	2013		
ASSETS			
Cash and Other Cash Items	**₱740,012,114**	₱551,097,752	₱369,163,701
Due from Bangko Sentral ng Pilipinas (Notes 14 and 15)	**9,573,407,804**	5,511,066,971	6,040,783,141
Due from Other Banks	**661,307,665**	887,142,721	514,811,974
Interbank Loans Receivable and Securities Purchased Under Resale Agreements (Notes 7 and 30)	**202,550,011**	993,804,210	2,830,082,240
Held-for-Trading Financial Assets (Note 8)	**104,908,937**	–	–
Available-for-Sale Investments (Note 8)	**20,090,081,921**	16,778,802,551	16,143,744,549
Loans and Receivables (Notes 9 and 27)	**24,997,423,832**	15,957,494,540	10,521,538,433
Property and Equipment (Note 10)			
At cost	**1,329,539,925**	960,161,779	582,767,709
At appraised value	**417,029,000**	377,667,700	369,300,000
Investment Properties (Note 11)			
Condominium units for lease	**3,341,665,026**	3,220,308,474	3,466,407,778
Foreclosed properties	**482,553,959**	375,813,301	432,234,394
Other Assets (Note 12)	**658,175,288**	217,807,399	150,200,481
	₱62,598,655,482	₱45,831,167,398	₱41,421,034,400
LIABILITIES AND EQUITY			
Liabilities			
Deposit Liabilities (Notes 14 and 27)			
Demand	**₱7,183,260,534**	₱5,788,176,888	₱4,883,897,485
Savings	**3,089,980,661**	2,751,041,326	2,424,174,911
Time	**37,007,255,546**	22,817,096,856	20,509,819,319
	47,280,496,741	31,356,315,070	27,817,891,715
Bills Payable (Notes 15 and 30)	**9,458,240,938**	7,823,512,656	7,355,846,372
Outstanding Acceptances	**43,188,569**	32,322,191	57,006,115
Manager's Check	**173,501,481**	67,050,176	33,800,311
Accrued Interest, Taxes and Other Expenses (Note 16)	**507,545,390**	445,409,382	412,054,734
Deferred Tax Liabilities (Note 26)	**524,116,091**	432,716,410	428,223,235
Other Liabilities (Note 17)	**537,951,727**	1,282,171,307	2,019,950,490
	58,525,040,937	41,439,497,192	38,124,772,972
Equity			
Common stock (Note 19)	**7,489,113,875**	5,259,896,500	5,259,896,500
Preferred stock (Note 19)	**–**	3,000,000,000	3,000,000,000
Deposit for future stock subscription (Note 19)	**–**	3,552,598,165	2,373,032,602
Additional paid-in capital	**813,600,843**	476,011,662	476,011,662
Surplus reserves (Note 19)	**105,772,314**	105,772,314	105,772,314
Deficit	**(3,076,034,075)**	(8,653,841,019)	(9,638,622,596)
Net unrealized gains (losses) on available-for-sale investments (Note 8)	**(1,219,412,641)**	672,789,188	1,723,163,315
Revaluation increment on land (Note 10)	**209,545,919**	186,888,809	173,260,544
Cumulative translation adjustment	**(11,611,782)**	(4,885,729)	(22,652,759)
Remeasurement losses on defined benefit liability (Note 23)	**(237,359,908)**	(203,559,684)	(153,600,154)
	4,073,614,545	4,391,670,206	3,296,261,428
	₱62,598,655,482	₱45,831,167,398	₱41,421,034,400

See accompanying Notes to Financial Statements.

PHILIPPINE BANK OF COMMUNICATIONS
STATEMENTS OF INCOME

	Years Ended December 31		
	2013	2012 (As restated - Note 2)	2011 (As restated - Note 2)
INTEREST INCOME			
Loans and receivables (Notes 9 and 27)	**₱1,275,529,047**	₱1,100,749,030	₱962,579,022
Trading and investment securities (Note 22)	**1,256,063,337**	1,295,873,452	1,258,635,032
Deposits with other banks and others	**27,702,591**	15,222,937	34,495,207
Interbank loans receivable and securities purchased under resale agreements (Note 7)	**10,075,880**	44,024,361	41,694,258
Others (Note 17)	**774,557,435**	684,016,154	608,226,075
	3,343,928,290	3,139,885,934	2,905,629,594
INTEREST AND FINANCE CHARGES			
Bills payable, borrowings and others (Notes 15 and 23)	**936,698,684**	850,316,182	783,338,940
Deposit liabilities (Notes 14 and 27)	**689,479,098**	784,563,874	805,901,776
	1,626,177,782	1,634,880,056	1,589,240,716
NET INTEREST INCOME	**1,717,750,508**	1,505,005,878	1,316,388,878
Trading and securities gain - net (Notes 8 and 22)	**1,540,599,577**	754,081,491	235,993,409
Rent income (Notes 11, 24 and 27)	**256,294,205**	295,759,044	289,688,114
Fair value gain (loss) from investment properties (Note 11)	**248,913,322**	(4,491,698)	313,265,824
Service charges, fees and commissions	**215,476,713**	153,588,462	127,672,852
Gains on assets exchanged (Note 11)	**23,384,984**	–	1,673,422
Income from trust operations (Notes 21 and 27)	**22,481,120**	15,386,124	19,707,792
Profit from assets sold (Note 11)	**10,702,897**	123,280,774	8,307,707
Foreign exchange gain (loss) - net	**(17,766,725)**	24,297,249	45,892,901
Miscellaneous	**3,795,968**	10,870,732	28,053,164
TOTAL OPERATING INCOME	**4,021,632,569**	2,877,778,056	2,386,644,063
Compensation and fringe benefits (Notes 23 and 27)	**1,080,179,977**	707,756,119	593,441,729
Taxes and licenses	**456,925,887**	323,632,540	294,569,756
Depreciation and amortization (Note 10)	**133,238,857**	77,892,134	58,806,651
Occupancy and other equipment-related costs (Notes 24 and 27)	**130,530,679**	97,034,374	90,520,051
Provision for (reversal of) credit and impairment losses - net (Note 13)	**(402,674,955)**	(1,265,107)	10,649,067
Miscellaneous (Note 25)	**593,501,544**	397,787,376	160,126,031
TOTAL OPERATING EXPENSES	**1,991,701,989**	1,602,837,436	1,208,113,285
INCOME BEFORE TAX	**2,029,930,580**	1,274,940,620	1,178,530,778
PROVISION FOR INCOME TAX (Note 26)	**397,046,011**	290,159,043	365,536,330
NET INCOME (Note 28)	**₱1,632,884,569**	₱984,781,577	₱812,994,448
Basic/Diluted Earnings Per Share (Note 28)	**₱5.87**	₱3.54	₱2.92

See accompanying Notes to Financial Statements.

PHILIPPINE BANK OF COMMUNICATIONS
STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31		
	2013	2012 (As restated - Note 2)	2011 (As restated - Note 2)
NET INCOME	**₱1,632,884,569**	₱984,781,577	₱812,994,448
OTHER COMPREHENSIVE INCOME (LOSS)			
Items that recycle to profit or loss in subsequent periods:			
Securities gains from sale of AFS investments taken to profit or loss (Notes 8 and 22)	**(1,520,582,609)**	(738,069,044)	(220,166,698)
Changes in fair value of AFS investments (Note 8)	**(371,619,220)**	(312,305,083)	177,509,632
Net movement in cumulative translation adjustment	**(6,726,053)**	17,767,030	(47,450,153)
Items that do not recycle to profit or loss in subsequent periods:			
Remeasurements of defined benefit liability (Note 23)	**(33,800,224)**	(49,959,530)	(16,632,144)
Net movement in revaluation increment (Note 10)	**32,367,300**	19,468,950	(27,502,000)
Income tax effect of remeasurement of land (Note 26)	**(9,710,190)**	(5,840,685)	8,250,600
OTHER COMPREHENSIVE LOSS, NET OF TAX	**(1,910,070,996)**	(1,068,938,362)	(125,990,763)
TOTAL COMPREHENSIVE INCOME (LOSS)	**(₱277,186,427)**	(₱84,156,785)	₱687,003,685

See accompanying Notes to Financial Statements.

PHILIPPINE BANK OF COMMUNICATIONS
STATEMENTS OF CHANGES IN EQUITY

	Preferred Stock (Note 19)	Common Stock (Note 19)	Deposit for Future Stock Subscription (Note 19)	Additional Paid-in Capital	Surplus Reserves (Note 19)	Deficit	Net Unrealized Gains (Losses) on Available-for-Sale Investments (Note 8)	Remeasurement Losses on Defined Benefit Liability (Note 23)	Revaluation Increment on Land (Note 10)	Cumulative Translation Adjustment	Total Equity
Balance at January 1, 2013	**₱3,000,000,000**	**₱5,259,896,500**	**₱3,552,598,165**	**₱476,011,662**	**₱105,772,314**	**(₱8,687,171,774)**	**₱672,789,188**	**₱–**	**₱186,888,809**	**(₱4,885,729)**	**₱4,561,899,135**
Effect of retroactive application of PAS 19 (Revised) (Note 2)	–	–	–	–	–	**33,330,755**	–	**(203,559,684)**	–	–	**(170,228,929)**
Balance at January 1, 2013, as restated	**3,000,000,000**	**5,259,896,500**	**3,552,598,165**	**476,011,662**	**105,772,314**	**(8,653,841,019)**	**672,789,188**	**(203,559,684)**	**186,888,809**	**(4,885,729)**	**4,391,670,206**
Conversion of preferred stock to common stock	**(3,000,000,000)**	**3,000,000,000**	–	–	–	–	–	–	–	–	–
Reduction of par value of common stock	–	**(3,944,922,375)**	–	**3,944,922,375**	–	–	–	–	–	–	–
Issuance of additional common stock	–	**3,174,139,750**	**(3,552,598,165)**	**337,589,181**	–	–	–	–	–	–	**(40,869,234)**
Application of APIC against deficit	–	–	–	**(3,944,922,375)**	–	**3,944,922,375**	–	–	–	–	–
Total comprehensive income (loss) for the year	–	–	–	–	–	**1,632,884,569**	**(1,892,201,829)**	**(33,800,224)**	**22,657,110**	**(6,726,053)**	**(277,186,427)**
Balance at December 31, 2013	**₱–**	**₱7,489,113,875**	**₱–**	**₱813,600,843**	**₱105,772,314**	**(₱3,076,034,075)**	**(₱1,219,412,641)**	**(₱237,359,908)**	**₱209,545,919**	**(₱11,611,782)**	**₱4,073,614,545**
Balance at January 1, 2012	₱3,000,000,000	₱5,259,896,500	₱2,373,032,602	₱476,011,662	₱105,772,314	(₱9,655,254,740)	₱1,723,163,315	₱–	₱173,260,544	(₱22,652,759)	₱3,433,229,438
Effect of retroactive application of PAS 19 (Revised) (Note 2)	–	–	–	–	–	16,632,144	–	(153,600,154)	–	–	(136,968,010)
Balance at January 1, 2012, as restated	3,000,000,000	5,259,896,500	2,373,032,602	476,011,662	105,772,314	(9,638,622,596)	1,723,163,315	(153,600,154)	173,260,544	(22,652,759)	3,296,261,428
Proceeds from deposit for future stock subscription	–	–	1,179,565,563	–	–	–	–	–	–	–`	1,179,565,563
Total comprehensive income (loss) for the year	–	–	–	–	–	984,781,577	(1,050,374,127)	(49,959,530)	13,628,265	17,767,030	(84,156,785)
Balance at December 31, 2012	₱3,000,000,000	₱5,259,896,500	₱3,552,598,165	₱476,011,662	₱105,772,314	(₱8,653,841,019)	₱672,789,188	(₱203,559,684)	₱186,888,809	(₱4,885,729)	₱4,391,670,206
Balance at January 1, 2011	₱3,000,000,000	₱5,259,896,500	₱–	₱476,011,662	₱105,772,314	(₱10,451,617,044)	₱1,765,820,381	₱–	₱192,511,944	₱24,797,394	₱373,193,151
Effect of retroactive application of PAS 19 (Revised) (Note 2)	–	–	–	–	–	–	–	(136,968,010)	–	–	(136,968,010)
Balance at January 1, 2011, as restated	3,000,000,000	5,259,896,500	–	476,011,662	105,772,314	(10,451,617,044)	1,765,820,381	(136,968,010)	192,511,944	24,797,394	236,225,141
Proceeds from deposit for future stock subscription	–	–	2,373,032,602	–	–	–	–	–	–	–	2,373,032,602
Total comprehensive income (loss) for the year	–	–	–	–	–	812,994,448	(42,657,066)	(16,632,144)	(19,251,400)	(47,450,153)	687,003,685
Balance at December 31, 2011	₱3,000,000,000	₱5,259,896,500	₱2,373,032,602	₱476,011,662	₱105,772,314	(₱9,638,622,596)	₱1,723,163,315	(₱153,600,154)	₱173,260,544	(₱22,652,759)	₱3,296,261,428

See accompanying Notes to Financial Statements

PHILIPPINE BANK OF COMMUNICATIONS
STATEMENTS OF CASH FLOWS

	Years Ended December 31		
	2013	2012 (As restated - Note 2)	2011 (As restated - Note 2)
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax	**₱2,029,930,580**	₱1,274,940,620	₱1,178,530,778
Adjustments to reconcile income before income tax to net cash generated from (used in) operations:			
Securities gains from sale of available-for investment (Notes 8 and 22)	**(1,520,582,609)**	(738,069,044)	(220,166,698)
Accretion of interest on bills payable (Note 15)	**802,372,613**	706,659,555	624,051,417
Depreciation and amortization (Note 10)	**133,238,857**	77,892,134	58,806,651
Profits from assets sold (Note 11)	**(10,702,897)**	(123,280,774)	(8,307,707)
Gains on assets exchanged (Note 11)	**(23,384,984)**	–	(1,673,422)
Fair value loss (gain) on investment properties (Note 11)	**(248,913,322)**	4,491,698	(313,265,824)
Accretion of interest on unquoted debt securities (Note 9)	**(262,919,547)**	(362,449,029)	(435,980,820)
Provision for (reversal of) credit and impairment losses (Note 13)	**(402,674,955)**	(1,265,107)	10,649,067
Amortization of unearned income credited to interest income - others (Note 17)	**(774,557,435)**	(684,016,154)	(608,226,075)
Reversal of provision for tax assessments (Note 20)	**–**	–	(197,871,861)
Decrease (increase) in the amounts of:			
Financial assets at FVPL	**(104,908,937)**	–	–
Loans and receivables	**(8,461,923,173)**	(5,021,968,744)	3,156,049,792
Other assets	**(170,367,764)**	(59,337,267)	18,864,357
Increase (decrease) in the amounts of:			
Deposit liabilities	**15,924,181,671**	3,538,423,355	210,243,286
Accrued interest, taxes and other expenses	**63,356,449**	(16,613,355)	123,654,733
Manager's checks	**106,451,305**	33,249,865	(219,511)
Other liabilities	**(2,217,304)**	(55,008,094)	(37,514,219)
Net cash generated from (used in) operations	**7,076,378,548**	(1,426,350,341)	3,557,623,944
Income taxes paid (Notes 16 and 26)	**(302,412,118)**	(291,498,080)	(249,004,094)
Net cash provided by (used in) operating activities	**6,773,966,430**	(1,717,848,421)	3,308,619,850
CASH FLOWS FROM INVESTING ACTIVITIES			
Decrease (increase) in interbank loans receivable (Notes 7 and 30)	**(3,421,721)**	2,590,590	–
Acquisitions of:			
Investment properties (Note 11)	**(20,478,820)**	(6,420,586)	(3,291,223)
Property and equipment (Note 10)	**(409,339,532)**	(205,371,194)	(37,375,416)
Software cost (Note 12)	**(301,659,160)**	(56,561,834)	(4,587,247)
Available-for-sale investments	**(63,878,978,767)**	(31,507,478,853)	(26,697,370,076)
Proceeds from:			
Sale of available-for-sale investments	**60,196,080,177**	30,559,174,488	26,748,012,437
Disposals of investment properties (Note 11)	**62,379,395**	176,999,772	141,604,008
Disposals of property and equipment (Note 10)	**17,814,522**	5,876,764	3,368,048
Disposal of chattel mortgage	**–**	4,999,999	–
Net cash provided by (used in) investing activities	**(4,337,603,906)**	(1,026,190,854)	150,360,531

(Forward)

	2013	2012 (As restated - Note 2)	2011 (As restated - Note 2)
	Years Ended December 31		
CASH FLOWS FROM FINANCING ACTIVITIES			
Transaction cost on shares issuance (Note 19)	**(₱40,869,234)**	₱–	₱–
Proceeds from deposit for future stock subscription (Note 19)	–	1,179,565,563	2,373,032,602
Availments of:			
Bills payable	**14,045,317,156**	11,392,737,224	15,076,554,633
Outstanding acceptances	**2,825,687,195**	1,461,405,538	1,049,319,401
Marginal deposits	**269,006,828**	6,134,966	14,504,421
Settlements of:			
Marginal deposits	**(270,251,893)**	(4,889,901)	(18,721,871)
Outstanding acceptances	**(2,814,820,817)**	(1,486,089,462)	(1,045,495,256)
Bills payable	**(13,212,961,487)**	(11,631,730,495)	(15,630,909,727)
Net cash provided by financing activities	**801,107,748**	917,133,433	1,818,284,203
EFFECT OF FOREIGN CURRENCY TRANSLATION ADJUSTMENT	**(6,726,053)**	17,767,030	(47,450,153)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**3,230,744,219**	(1,809,138,812)	5,229,814,431
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR			
Cash and other cash items	**551,097,752**	369,163,701	379,603,692
Due from Bangko Sentral ng Pilipinas	**5,511,066,971**	6,040,783,141	2,439,553,972
Due from other banks	**887,142,721**	514,811,974	556,586,784
Interbank loans receivable and securities purchased under resale agreements (Notes 7 and 29)	**952,554,800**	2,786,242,240	1,105,442,177
	7,901,862,244	9,711,001,056	4,481,186,625
CASH AND CASH EQUIVALENTS AT END OF YEAR			
Cash and other cash items	**740,012,114**	551,097,752	369,163,701
Due from Bangko Sentral ng Pilipinas	**9,573,407,804**	5,511,066,971	6,040,783,141
Due from other banks	**661,307,665**	887,142,721	514,811,974
Interbank loans receivable and securities purchased under resale agreements (Notes 7 and 29)	**157,878,880**	952,554,800	2,786,242,240
	₱11,132,606,463	₱7,901,862,244	₱9,711,001,056

OPERATIONAL CASH FLOWS FROM INTEREST

	Years Ended December 31		
	2013	2012	2011
Interest received	**₱2,184,973,121**	₱2,086,124,517	₱1,851,233,687
Interest paid	**809,982,373**	927,302,708	957,034,060

See accompanying Notes to Financial Statements.

1. Corporate Information

Philippine Bank of Communications (the Bank) is a publicly listed domestic commercial bank organized in the Philippines primarily to engage in commercial banking services such as deposit products, loans and trade finance, domestic and foreign fund transfers, treasury, foreign exchange and trust services through a network of 66 local branches.

The Bank's original Certificate of Incorporation was issued by the Securities and Exchange Commission (SEC) on August 23, 1939. On June 21, 1988, the board of directors (BOD) of the Bank approved the amendment of Article IV of its Amended Articles of Incorporation to extend the corporate life of the Bank, which expired on August 23, 1989, for another 50 years or up to August 23, 2039. The Amended Articles of Incorporation were approved by the SEC on November 23, 1988.

The Bank acquired a license to operate as an expanded commercial bank from the Bangko Sentral ng Pilipinas (BSP) on December 24, 1993. On March 31, 2000, the BSP's Monetary Board approved the amendment of the Bank's license to a regular commercial banking.

On May 28, 2013, the BSP approved the Bank's application to establish 10 new branches in key cities in the country.

The Bank's principal place of business is at the PBCom Tower, 6795 Ayala Avenue corner V. A. Rufino Street, Makati City.

<u>Rehabilitation Plan</u>
On March 15, 2004, the Bank and its majority stockholders entered into a Financial Assistance Agreement (FAA) with the Philippine Deposit Insurance Corporation (PDIC) under the following salient provisions:
1. Fresh capital infusion from the existing major stockholders amounting to ₱3.00 billion;
2. Compliance at all times with a risk-based capital adequacy ratio (RBCAR) of at least 12.50%, with any shortfall thereof to be covered by additional capital infusion from the major stockholders (Note 19);
3. Prohibition against the sale of, or lien or encumbrances on the controlling interest;
4. Sale of certain non-performing assets (NPAs) to a Special Purpose Vehicle (SPV) and amortization of losses from such sale based on SPV guidelines, with the necessary modifications or amendments thereto;
5. Maximum direct loan from PDIC amounting to ₱7.64 billion payable at the end of ten (10) years with interest rate of 1.00% per annum;
6. Unless the loan is prepaid in accordance with the FAA, the major stockholders agree to absolutely divest, sell or transfer their controlling interest to a strategic third party investor; and
7. Prior approval from PDIC on the declaration, distribution, or payment of cash or stock dividends; effecting any profit sharing or distribution of bonuses to directors and officers of the Bank; transactions or activities not in accordance with the rehabilitation plan; and any single major capital expenditure.

On March 25, 2004, the BSP through its Monetary Board approved the revised Financial Recovery and Rehabilitation Program of the Bank subject to the following conditions, among others:

(a) infusion of the ₱3.00 billion fresh capital (as required under the FAA discussed above) within 30 days from the approval date of the rehabilitation plan; and
(b) existing appraisal increment reserve shall be allowed as part of unimpaired capital for purposes of computing the regulatory ratios.

On March 26, 2004, the major stockholders infused the ₱3.00 billion fresh capital to the Bank as advances for future stock subscriptions, awaiting the approval of the SEC on the amendment of the Bank's Articles of Incorporation covering the increase in the authorized capital stock of the Bank by the creation of new preferred shares. On April 1, 2006, the SEC approved the capital increase of the Bank from ₱14.50 billion to ₱17.50 billion.

Financial Assistance
Proceeds from the PDIC loan amounting to ₱7.64 billion were used by the Bank to purchase government securities (GS collateral), which were pledged to PDIC to secure such obligation (Notes 8 and 15). The 12.375% interest income on these securities, net of all taxes and the corresponding 1.00% interest expense on the PDIC loan, represents PDIC's income support to the Bank. Any interest income in excess of 85.00% of the actual losses from the sale of NPAs to an SPV shall inure to PDIC's benefit. The actual loss on the sale of the NPAs amounting to ₱10.77 billion, which was charged on the year it was incurred, is the difference between the net book value of the NPAs and the proceeds from such sale.

For regulatory purposes, the loss was allowed under the regulations issued by the BSP for banks and financial institutions availing the provisions of Republic Act No. 9182, The Special Purpose Vehicle Act of 2002, to be deferred and amortized to profit or loss over ten years.

On September 29, 2011, the Bank requested for the substitution of the government securities currently being used as collateral for the ₱7.64 billion PDIC loan with other obligations of the Republic of the Philippines (ROP) and/or other acceptable risk-free instruments. With the prevailing favorable market conditions, the existing GS Collateral provided a key opportunity for the Bank to improve its equity amidst the full recognition of the SPV losses.

On January 5, 2012, the PDIC approved the Bank's request for the substitution of the government securities pledged as collateral for its ₱7.64 billion loan from PDIC, subject to the following conditions:

1. The existing government securities shall be replaced only with a similar type of government securities maturing not earlier than the March 2014 loan maturity but no later than 2020, with interest enough to (i) cover the 20.00% final tax and 1.00% interest due to PDIC and (ii) provide continuing income support to the Bank up to March 2014 as originally intended under the 2004 FAA;
2. The substitution of the existing government securities shall be allowed in tranches with a minimum of ₱500.00 million per tranche and must be completed within a 4-month period reckoned from the 1st tranche of government securities substitution. Once the substitution of the entire ₱7.64 billion government securities have been completed, no further substitution shall be allowed by PDIC until the loan matures in March 2014;
3. The existing government securities or a portion thereof, shall be released only after the substitute government securities has been pledged to PDIC;
4. During the substitution period and until the settlement in full of the ₱7.64 billion loan from PDIC, the Bank commits to maintain a total market value of the government securities at ₱7.80 billion (Notes 8 and 15);

5. A periodic determination of the market value of the collateral aspect shall be made on a monthly basis and every time a substitution is made and in cases of significant interest rate movement in the market;
6. In the event of shortfall or decrease in the market value of the substitute government securities, the Bank is bound to deliver additional collateral as may be acceptable to PDIC to restore and maintain the market value of government securities collateral to at least ₱7.80 billion (Note 8). PDIC may allow release of excess collateral upon written request of the Bank;
7. Any yield (including the gain as a result of the substitution) on the substitute government securities in excess of the 85.00% cap of the actual SPV losses, shall inure to the benefit of PDIC, pursuant to the FAA;
8. In no case shall any portion of the PDIC income support including the gain as a result of the substitution be used to declare, distribute or pay cash or stock dividends, or effect any profit sharing or distribution of bonuses to directors and officers of the Bank.

On November 14, 2012, the BOD of PDIC approved the request of the Bank for the extension of the substitution to December 31, 2013 to complete the GS Collateral substitution process.

As at December 31, 2013 and 2012, total income received by the Bank which includes the gain arising from the sale of GS Collateral, net of all taxes and the corresponding 1.00% interest expense on the PDIC loan, amounted to ₱7.08 billion and ₱6.14 billion, respectively. The total income received by the Bank from the income support is below 85.00% of the actual losses incurred from the sale of NPAs.

On March 15, 2014, the FAA with PDIC will mature.

Strategic Third Party Investor
On July 26, 2011, pursuant to the FAA, the major shareholders of the Bank, namely the Chung, Luy, and Nubla Groups, signed a Memorandum of Agreement (MOA) with ISM Communications Corporation (the “ISM Group”), involving the sale of their entire stake in the Bank to the ISM Group and the commitment of the Chung and Nubla Groups to reinvest the proceeds of the sale of their respective shares amounting to ₱2.80 billion in the Bank (Note 19).

On October 31, 2011, the Monetary Board approved ISM Group's acquisition of the controlling interest in the Bank.

On December 23, 2011, the ISM Group’s acquisition of the Bank was successfully transacted through the Philippine Stock Exchange via a special block sale.

<u>BSP Approvals</u>
The BSP, in its Resolution No. 2088 dated December 14, 2012, approved the request of the Bank to book ₱1.92 billion revaluation increment resulting from the revaluation of PBCom Tower and allowed the Bank to include the revaluation increment as part of unimpaired and qualifying capital in computing for net worth and capital adequacy ratio (Note 19). ₱1.57 billion out of the ₱1.92 billion revaluation increment is included in the carrying value of condominium units for lease included under ‘Investment properties’ (Note 11). Deferred tax liability recognized and charged to profit or loss from the revaluation increment amounted to ₱470.95 million (Note 26). The remaining revaluation increment of ₱359.29 million on condominium units included under Property and equipment is not recognized in the Bank’s financial statements because the accounting policy of the Bank for property and equipment, except land, is to carry these assets at cost.

2. **Accounting Policies**

Basis of Preparation
The accompanying financial statements of the Bank have been prepared on a historical cost basis except for derivative instruments, financial assets at fair value through profit or loss (FVPL), available-for-sale (AFS) investments and investment properties that are measured at fair value and land, classified as 'Property and equipment', that is measured at appraised value. All values are rounded to the nearest peso unless otherwise stated.

The financial statements provide comparative information in respect of the previous period. In addition, the Bank presents an additional statement of financial position at the beginning of the earliest period presented when there is a retrospective application of an accounting policy, a retrospective restatement, or a reclassification of items in the financial statements. An additional statement of financial position as at January 1, 2012 is presented in these consolidated financial statements due to retrospective application of certain accounting policies disclosed under Changes in Accounting Policies and Disclosures of this note.

The functional currency of the Bank is the Philippine peso.

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

Presentation of Financial Statements
The Bank presents its statement of financial position in order of liquidity. An analysis regarding recovery of assets or settlement of liabilities within 12 months after the statement of financial position date (current) and more than 12 months after the statement of financial position date (non-current) is presented in Note 18.

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liability simultaneously. Income and expenses are not offset in the statement of income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Bank.

Changes in Accounting Policies and Disclosures
The Bank applied, for the first time, certain standards and amendments that require restatement of previous financial statements. These include Philippine Accounting Standard (PAS) 19, *Employee Benefits* (Revised 2011), PFRS 13, *Fair Value Measurement* and amendments to PAS 1, *Presentation of Financial Statements*.

The nature and the impact of each new standard and amendment are described below:

PFRS 7*, Financial instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities* (Amendments)
These amendments require an entity to disclose 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. The amendments require entities to disclose, in a tabular format, unless another format is more appropriate, the following minimum quantitative information. This is presented separately for financial assets and financial liabilities recognized at the end of the reporting period:

a) The gross amounts of those recognized financial assets and recognized financial liabilities;
b) The amounts that are set off in accordance with the criteria in PAS 32 when determining the net amounts presented in the statement of financial position;
c) The net amounts presented in the statement of financial position;
d) The amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in (b) above, including:
   i. Amounts related to recognized financial instruments that do not meet some or all of the offsetting criteria in PAS 32; and
   ii. Amounts related to financial collateral (including cash collateral); and
e) The net amount after deducting the amounts in (d) from the amounts in (c) above.

The additional disclosures required by the amendments are presented in Note 30 to the financial statements.

PFRS 10, *Consolidated Financial Statements*
The Bank adopted PFRS 10 in the current year. PFRS 10 replaced the portion of PAS 27, *Consolidated and Separate Financial Statements,* that addressed the accounting for consolidated financial statements. It also included the issues raised in SIC 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 require 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 that were in PAS 27.

The application of PFRS 10 affected the Bank's accounting for its equity interest in PBCom Finance. For all financial years up to December 31, 2012, PBCom Finance Corporation was considered to be an associate under the previously existing PAS 28, *Investments in Associates*, and was accounted for using the equity method. At the date of initial application of PFRS 10, the Bank assessed that it has de facto control over PBCom Finance. However, considering the relative size of PBCom Finance vis-à-vis the Bank, management chose not to consolidate the balances of PBcom Finance on a line-by-line basis for practical expediency in order to maintain understandability of the financial statements. Instead, the Bank carried such investment at cost. Additional information on PBCom Finance was no longer disclosed because it is not a significant investee company.

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. PFRS 13 defines fair value as an exit price. PFRS 13 also requires additional disclosures.

As a result of the guidance in PFRS 13, the Bank re-assessed its policies for measuring fair values. The Bank has assessed that the application of PFRS 13 has not materially impacted the fair value measurements of the Bank. Additional disclosures, where required, are provided in the individual notes relating to the assets and liabilities whose fair values were determined. Fair value hierarchy is provided in Note 4.

Philippine Accounting Standard (PAS) 1, *Presentation of Financial Statements - Presentation of Items of Other Comprehensive Income or OCI* (Amendments)
The Bank applied the amendments to PAS 1 which introduced groupings of items in OCI as follows:
a) 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 'Cumulative Translation Adjustment' or 'Net Unrealized Gains (Losses) on AFS Investments'; or
b) items that will never be recycled to profit or loss. These include 'Revaluation increment on Land' and 'Remeasurement Losses on Defined Benefit Liability'.

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

PAS 19, *Employee Benefits* (Revised)
Amendments to PAS 19 range from fundamental changes such as removing the corridor mechanism and 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.

PAS 19 (Revised) replaced the interest cost and expected return on plan assets with the concept of net interest on defined benefit liability or asset which is calculated by multiplying the net balance sheet defined benefit liability or asset by the discount rate used to measure the employee benefit obligation, each as at the beginning of the annual period.

PAS 19 (Revised) also amended the definition of short-term employee benefits and requires employee benefits to be classified as short-term based on expected timing of settlement rather than the employee's entitlement to the benefits. In addition, PAS 19 (Revised) modifies the timing of recognition for termination benefits. The modification requires termination benefits to be recognized at the earlier of when the offer cannot be withdrawn or when the related restructuring costs are recognized.

Changes to definition of short-term employee benefits and timing of recognition for termination benefits did not have any impact on the Bank's financial position and financial performance.

The adoption of the revised standard, which required retrospective application, resulted in the restatement of previously reported retirement obligation of the Bank. The adjustment amounts were determined by the Bank with the assistance of an external actuary. The Bank closed to 'Deficit' the net effect of all transition adjustments as at January 1, 2011 (the transition date) upon retrospective application of PAS 19 (Revised), as applicable. The Bank will retain the remeasurements recognized in OCI and will not transfer these to other items in equity.

The effects of adoption of PAS 19 (Revised) are detailed below:

	December 31, 2012		
	As previously Reported	Restatements	Restated
Statement of Financial Position			
Liabilities			
Accrued other expenses payable	₱68,876,735	₱170,228,929	₱239,105,664
Equity			
Deficit	–	33,330,755	33,330,755
Remeasurement losses on defined benefit liability	–	(203,559,684)	(203,559,684)

	January 1, 2012		
	As previously Reported	Restatements	Restated
Statement of Financial Position			
Liabilities			
Accrued other expenses payable	₱66,336,863	₱136,968,010	₱203,304,873
Equity			
Deficit	–	16,632,144	₱16,632,144
Remeasurement losses on defined benefit liability	–	(153,600,154)	(153,600,154)

Change in presentation
The presentation in the statement of income was updated to reflect changes resulting from the adoption of PAS 19 (Revised). Previously, net interest expense on the retirement liability is presented under 'Compensation and fringe benefits expense' in the statement of income. Under PAS 19 (Revised) this amount is now presented under 'Interest expense' in the statement of income. This presentation better reflects the nature of net interest since it corresponds to the compounding effect of the long-term net retirement liability.

As an effect of retrospective application of PAS 19 (Revised), 2012 and 2011 compensation and fringe benefit expense decreased by ₱29.71 million and ₱28.82 million, respectively, while interest expense increased by ₱13.01 million and ₱12.19 million, respectively.

As of December 31, 2013, impact of PAS 19 (Revised) to defined benefit obligations is an increase in accrued other expenses payable of ₱193.67 million, increase in remeasurement losses on defined benefit liability of ₱237.36 million, increase in interest expense of ₱13.87 million and decrease in compensation and fringe benefit expenses of ₱30.55 million.

The following new and amendments to the standards apply for the first time in 2013. However, they do not impact the annual financial statements of the Bank.

New and Revised Standards and Interpretations
- PFRS 1, *First-time Adoption of International Financial Reporting Standards - Government Loans* (Amendments)
- PFRS 11, *Joint Arrangements*
- PFRS 12, *Disclosure of Interests in Other Entities*
- PAS 27, *Separate Financial Statements* (as revised in 2011)
- PAS 28, *Investments in Associates and Joint Ventures* (as revised in 2011)
- Philippine Interpretation 20, *Stripping Costs in the Production Phase of a Surface Mine*

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*

Reclassifications
In 2013, nonfinancial receivables were reclassified from loans and receivables to other assets in the statement of financial position. Further, gains on foreclosures are presented as a separate line in the statements of income under 'Gain on assets exchanged'. The reclassifications were made to better present the nature of these transactions. Comparative balances were restated to be consistent with the 2013 presentation. Impacts on prior-period financial statements follow:

	December 31, 2012			January 1, 2012		
(Amounts in thousands)	As previously reported	Restatements	As restated	As previously reported	Restatements	As restated
Statement of Financial Position						
Assets						
Loans and receivables	₱15,957,495	(₱304,516)	₱15,652,979	₱10,521,538	(₱270,586)	₱10,250,952
Allowance for credit losses						
- Loans and receivables	2,636,997	(304,516)	(294,827)	2,688,857	(270,586)	2,418,271
Miscellaneous assets	205,639	304,516	510,155	138,490	270,586	409,076
Allowance for credit losses						
- Other assets	353,259	304,516	657,775	311,934	270,587	582,521
Statement of Income						
Income						
Fair value gain from						
investment properties	–	–	–	314,939	(1,673)	313,266
Gains on assets exchanged*	–	–	–	–	1,673	1,673

*There were no foreclosures in 2012.

Significant Accounting Policies

Foreign Currency Translation
The accompanying separate financial statements of the Bank include the accounts maintained in the Regular Banking Unit (RBU) and Foreign Currency Deposit Unit (FCDU). The functional currency of the RBU and the FCDU is the Philippine peso 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. The financial statements of these units are combined after eliminating inter-unit accounts and transactions.

RBU
As at statement of financial position date, foreign currency-denominated monetary assets and liabilities of the RBU are translated in Philippine peso based on the Philippine Dealing System (PDS) closing rate prevailing at end of the year and foreign currency-denominated income and expenses, based on the PDS weighted average rate (WAR) for the year. Foreign exchange differences arising from the restatement of foreign currency-denominated assets and liabilities in the RBU are credited to or charged against profit or loss in the year in which the rates change. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

FCDU
As at statement of financial position date, the assets and liabilities of the FCDU are translated into the Bank's presentation currency (the Philippine peso) at the PDS closing rate prevailing at the statement of financial position date, and their income and expenses are translated at PDSWAR for the year. Exchange differences arising on translation are taken directly to the statement of comprehensive income as 'Cumulative translation adjustment'.

Fair Value Measurement
The Bank measures financial instruments, such as, derivatives and AFS investments, and non-financial assets such as investment properties, at fair value at each statement of financial position date. Also, fair values of financial instruments measured at amortized cost are disclosed in Note 4.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:
- in the principal market for the asset or liability, or
- in the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible to the Bank. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a 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 Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:
- Level 1 - Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognized in the financial statements on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and fair value hierarchy as explained above.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and other cash items, amounts due from BSP and other banks, and interbank loans receivable and securities purchased under resale agreements (SPURA) with original maturities of three months or less from dates of placements and that are subject to insignificant risks of changes in value. Due from BSP includes the statutory reserves required by the BSP which the Bank considers as cash equivalents wherein drawlist can be made to meet the Bank's cash requirements as allowed by the BSP. The components of cash and cash equivalents are shown in the statement of cash flows. Cash and cash equivalents are carried at amortized cost in the statement of financial position.

SPURA

The Bank enters into short-term purchases of securities under resale agreements of identical securities with the BSP. Resale agreements are contracts under which a party purchases securities and resells such securities to the same selling party at a specified future date at a fixed price. The amounts advanced under resale agreements are carried as SPURA in the statement of financial position. SPURA are carried at cost. Interest earned on resale agreements is reported as 'Interest income' in the statement of income.

Financial Instruments - Initial Recognition and Subsequent Measurement

Date of recognition

Regular way purchases and sales of financial assets, except for derivatives, are recognized on settlement date. Settlement date accounting refers to (a) the recognition of an asset on the day it is received by the Bank, and (b) the derecognition of an asset and recognition of any gain or loss on disposal on the day that such asset is delivered by the Bank. Any change in fair value of unrecognized financial asset is recognized in the statement of income for assets classified as financial assets at FVPL; and is recognized in equity for assets classified as AFS investments. Loans and receivables are recognized when cash is advanced to the borrowers while financial liabilities are recognized when cash is received by the Bank.

Initial recognition of financial instruments

All financial instruments are recognized initially at fair value. Transaction costs are included in the initial measurement of all financial instruments, except for financial assets and financial liabilities at FVPL.

The Bank classifies its financial assets in the following categories: financial assets at FVPL, held-to-maturity (HTM) investments, loans and receivables and AFS investments. Financial liabilities are classified into financial liabilities at FVPL and other financial liabilities at amortized cost. The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments are acquired and their characteristics. Management determines the classification of its financial instruments at initial recognition and where appropriate, re-evaluates such designation at every statement of financial position date.

Financial instruments held for trading

Financial instruments held for trading include government debt securities and quoted equity securities purchased and held principally with the intention of selling them in the near term. These securities are carried at fair value; realized and unrealized gains and losses on these instruments are recognized as 'Trading and securities gain - net' in the statement of income. Interest earned or incurred on financial instruments held for trading is reported under 'Interest income' (for financial assets) and 'Interest expense' (for financial liabilities).

Financial instruments designated at FVPL
Financial instruments classified in this category are designated by management on initial recognition when any of the following criteria is 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;
- 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.

Financial instruments designated at FVPL are initially recognized in the statement of financial position at fair value. Changes in fair value of financial instruments designated at FVPL are recorded in 'Trading and securities gain - net' in the statement of income. Interest earned or incurred is recognized as 'Interest income' or 'Interest expense', respectively, in the statement of income.

As of December 31, 2013 and 2012, the Bank has no financial instruments designated at FVPL.

Derivative instruments
The Bank uses derivative instruments such as currency forward and swap contracts. These derivatives are entered into as a means of managing the Bank's liquidity. Such derivative 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. Derivative instruments are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Any gains or losses arising from changes in fair value of derivative instruments that do not qualify for hedge accounting are taken directly to the statement of income.

The fair value of currency forward contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

Embedded derivatives
The Bank assesses the existence of an embedded derivative when it first becomes a party to the contract and performs reassessment if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

An embedded derivative is separated from the host financial or nonfinancial contract and accounted for as a derivative if all of the following conditions are met:

- the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristic of the host contract;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- the hybrid or combined instrument is not recognized at FVPL.

The Bank determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed and whether the change is significantly relative to the previously expected cash flows on the contract.

Embedded derivatives that are bifurcated from the host contracts are accounted for as financial assets or liabilities at FVPL. Changes in fair values of embedded derivatives are included in the statement of income. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

As of December 31, 2012, the Bank has no derivatives that are embedded in its financial and nonfinancial contracts.

HTM investments
HTM investments are quoted non-derivative financial assets with fixed or determinable payments and with fixed maturities for which the Bank has the positive intention and ability to hold to maturity. If the Bank were to sell more than an insignificant amount of HTM investments before maturity (other than in certain specific circumstances), the entire category would be tainted and would have to be reclassified as AFS investments. Furthermore, the Bank would be prohibited from classifying any financial assets as HTM investments for the following two years.

After initial recognition, these investments are subsequently measured at amortized cost using the effective interest method, less any impairment in value.

Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate (EIR). The amortization is included in 'Interest income' in the statement of income. Gains and losses are recognized in profit or loss when HTM investments are derecognized and impaired, as well as through the amortization process. The losses arising from impairment of such investments are recognized in the statement of income under 'Provision for (reversal of) credit and impairment losses'. The effects of restatement on foreign currency-denominated HTM investments are recognized in the statement of income.

Loans and receivables
This accounting policy relates to the statement of financial position captions 'Due from BSP', 'Due from other banks', 'Interbank loans receivable and SPURA' and 'Loans and receivable'. These are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market, other than:
- those that the Bank intends to sell immediately or in the near term and those that the Bank, upon initial recognition, designates as at FVPL
- those that the Bank, upon initial recognition, designates as AFS; and
- those for which the Bank may not cover substantially all of its initial investment, other than because of credit deterioration.

After initial measurement, loans and receivables 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 and costs that are an integral part of the EIR. The amortization is included in 'Interest income' in the statement of income. The losses arising from impairment are recognized in 'Provision for (reversal of) credit and impairment losses' in the statement of income.

AFS investments
AFS investments are those which are designated as such or do not qualify to be classified as designated 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 government securities, treasury notes and shares of stock.

After initial measurement, AFS investments are subsequently measured at fair value. The effective yield component of AFS debt securities, as well as the impact of restatement on foreign currency-denominated AFS debt securities, is reported in the statement of income. The unrealized gains and losses arising from the fair valuation of AFS investments are excluded from reported earnings and are reported as 'Net unrealized gains (losses) on AFS investments' under OCI in the statement of comprehensive income.

When the security is disposed of, the cumulative gain or loss previously recognized in OCI is recognized as 'Trading and securities gain - net' in the statement of income. Where the Bank holds more than one investment in the same security, these are deemed to be disposed of on a specific identification basis. Interest earned on holding AFS investments are reported as 'Interest income' using the EIR. Dividends earned on holding AFS investments are recognized in the 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 'Provisions for (reversal of) credit and impairment losses' in the statement of income.

Financial liabilities at amortized cost
This accounting policy relates to the statement of financial position caption 'deposit liabilities', 'bills payable' and 'other borrowed funds', which are not designated at FVPL.

They are classified as such when the substance of the contractual arrangement results in the Bank 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, deposit liabilities, bills payable and similar financial liabilities not qualified as and not designated as 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.

Reclassification of financial assets
A financial asset is reclassified out of the FVPL category when the following conditions are met:
- the financial asset is no longer held for the purpose of selling or repurchasing it in the near term; and
- there is a rare circumstance.

A financial asset that is reclassified out of the FVPL category is reclassified at its fair value on the date of reclassification. Any gain or loss already recognized in the statement of income is not reversed. The fair value of the financial asset on the date of reclassification becomes its new amortized cost, as applicable.

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 Bank 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 Bank 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 risks and rewards of the asset but has transferred the control over the asset.

Where the Bank 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 Bank'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 Bank could be required to repay.

The transfer of risks and rewards is evaluated by comparing the Bank's exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. The Bank has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer (e.g., because the entity has sold a financial asset subject to an agreement to buy it back at a fixed price or the sale price plus a lender's return). The Bank has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset (e.g., because the entity has sold a financial asset subject only to an option to buy it back at its fair value at the time of repurchase or has transferred a fully proportionate share of the cash flows from a larger financial asset in an arrangement).

Whether the Bank has retained control of the transferred asset depends on the transferee's ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control.

Financial liability
A financial liability is derecognized when the obligation under the liability is discharged, cancelled or has expired. When 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 derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the statement of income.

Impairment of Financial Assets
The Bank assesses at each statement of financial position date whether there is any objective evidence that a financial asset or a 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 a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Financial assets carried at amortized cost
For financial assets carried at amortized cost, which includes HTM investments and loans and receivables, the Bank 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 estimated future cash flows are discounted at the financial asset's original EIR.

If a financial asset carried at amortized cost 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. 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, 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, in a subsequent year, 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 (reversal of) credit and impairment losses' in the statement of income.

If the Bank determines that no objective evidence of impairment exists for an 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, 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 in 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 unemployment rates, property prices, commodity 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 Bank to reduce any differences between loss estimates and actual loss experience.

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

In the 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 OCI 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 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 statement of income. If, in subsequent year, the fair value of a debt instrument increased and the increase can be objectively related to an event occurring after the impairment loss was recognized in the statement of income, the impairment loss is reversed through the statement of income.

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

Collateral valuation
The Bank seeks to use collateral, where possible, to mitigate its risks on financial assets. The collateral comes in various forms such as cash, securities, letter of credits/guarantees, real estate, receivables and other non-financial assets and credit enhancements. The fair value of collateral is generally assessed, at a minimum, at inception. To the extent possible, the Bank uses active market data for valuing financial assets held as collateral. Other financial assets which do not have a readily determinable market value are valued using models. Non-financial collateral, such as real estate and chattel, is valued based on data provided by third parties such as independent appraisers.

Foreclosed collateral
The Bank's policy is to determine whether a foreclosed asset is best used for its internal operations or should be sold. Assets determined to be useful for the internal operations are transferred to their relevant asset category at the lower of the foreclosed value or the carrying value of the original secured asset. Assets that are determined better to be sold are immediately transferred to assets held for sale at their fair value at the foreclosure date in line with the Bank's policy.

Property and Equipment

Property and equipment, except land, are stated at cost less accumulated depreciation and amortization and impairment in value. Land is stated at appraised value less any impairment in value. The appraisal values were determined by professionally qualified and independent appraisers. The revaluation increment resulting from revaluation is credited to 'Revaluation increment on land' under OCI, net of deferred tax liability.

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 the property and equipment have been put into operation, such as repairs and maintenance are charged against operations in the year in which the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of property and equipment.

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Upon derecognition, the cost and the related accumulated depreciation and amortization and any impairment in value of the asset are removed from the accounts, and any resulting gain or loss (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is reflected as income or loss in the statement of income.

Depreciation and impairment

Depreciation on property and equipment is computed using the straight-line method based on the estimated useful life (EUL) of the depreciable assets. Leasehold improvements are amortized over the EUL of the improvements or the terms of the related leases, whichever is shorter.

EUL of components of property and equipment are as follows:

	Years
Condominium property	50
Buildings and improvements	25
Leasehold improvements	1-5
Furniture, fixtures and equipment	5

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. Likewise, the asset's residual values are reviewed, and adjusted if appropriate, at each financial year end.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash-generating units (CGUs) to which the assets are related to are written down to their recoverable amounts (see accounting policy on Impairment of Nonfinancial Assets).

Investment Properties
Investment properties include real properties acquired in settlement of loans and receivables and investments in condominium units which are measured initially at cost including certain transaction costs.

Real properties acquired through a nonmonetary asset exchange is measured initially at fair value unless (a) the exchange lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable.

Subsequent to initial recognition, investment properties are stated at fair value, which reflects the prevailing market conditions at the statement of financial position date. Gains or losses resulting from changes in the fair values of investment properties are recognized in the statement of income under 'Fair value gain (loss) from investment properties' in the period in which they arise. Fair values are evaluated on a periodic basis using valuation models recommended by the International Valuation Standards Committee (Note 4).

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

Transfers are made to investment property 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 property when, and only when, there is a change in use, evidenced by commencement of owner-occupation or commencement of development with a view to sell.

For a transfer from investment property carried at fair value to owner-occupied property, the asset's deemed cost for subsequent accounting is its fair value at the date of change in use. For transfers from owner-occupied property to investment property under the fair value model, the related properties are accounted for under property and equipment up to the time of change in use. At that date, any difference between the carrying amount of the property and the fair value is to be treated in the same way as a revaluation.

Intangible Assets
Intangible assets consist of software costs and branch licenses.

Software cost
Costs related to software purchased by the Bank for use in operations are recognized as 'Intangible assets' in the statement of financial position. Capitalized computer software cost is amortized on a straight-line basis over two to five years.

Branch licenses
These intangible assets were determined to have indefinite useful lives and are therefore not amortized. The useful life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis. Branch licenses are tested for impairment annually either individually or at the CGU level.

Impairment of Nonfinancial Assets

Property and equipment

At each statement of financial position date, the Bank assesses whether there is any indication that its nonfinancial assets may be impaired. When an indicator of impairment exists or when an annual impairment testing for an asset is required, the Bank makes a formal estimate of the recoverable amount.

Recoverable amount is the higher of an asset's (or CGU'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 from those other assets or groups of assets, in which case the recoverable amount is assessed as part of the CGU to which it belongs.

Where the carrying amount of an asset (or CGU) exceeds its recoverable amount, the asset (or CGU) 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 (or CGU).

An impairment loss is recognized only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged against the statement of income in the period in which it arises, unless the asset is carried at a revalued amount in which case the impairment loss is charged against the revaluation increment of the said asset.

A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, but not to an amount higher than the carrying amount that would have been determined (net of any depreciation) had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is credited to current operations, unless the asset is carried at a revalued amount in which case the reversal of the impairment loss is credited to the revaluation increment of the said asset.

Intangible assets

Branch licenses are tested for impairment annually at the statement of financial position date either individually or at the CGU level, as appropriate.

Software cost is assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Government Loans with Low Interest Rates

Government loans with low interest rates are recognized initially at fair value and the difference between the fair value of the loan and the proceeds of the loan is considered a form of government grant (recorded under 'Unearned income') and is recognized as income over the period of the loan using the effective interest method.

Common Stock

Common stocks are recorded at par. Proceeds in excess of par value are recognized under equity as 'Additional-paid-in capital' in the statement of financial position. Incremental costs incurred which are directly attributable to the issuance of new shares are shown in equity as a deduction from proceeds, net of tax.

Deficit
Deficit represents the net accumulated losses of the Bank.

Deposit for Future Stock Subscription
Deposit for future stock subscriptions refer to the payments made by stockholders of the Bank on subscription to the increase in the authorized capital which cannot be directly credited to capital stock issued pending approval by the BSP and registration with the SEC of the amendment to the Articles of Incorporation for the proposed increase in capital stock. Under SEC Financial Reporting Bulletin 006 issued in 2012, an entity should not consider a deposit for future subscription as an equity instrument unless all of the following elements are present:
a. There is a lack or insufficiency of authorized unissued shares of stock to cover the deposit;
b. The entity's BOD and shareholders have approved an increase in capital stock to cover the shares corresponding to the amount of the deposit; and
c. An application for the approval of the increase in capital stock has been presented for filing or filed with the SEC and BSP.

If any or all of the foregoing elements are not present, the deposit for future stock subscription should be recognized as a liability.

Revenue Recognition
Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured, regardless of when the payment is being made. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duty. The Bank assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent. The following specific recognition criteria must also be met before revenue is recognized:

Interest income
Interest on financial instruments is recognized based on the effective interest method of accounting.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and allocating the interest income or interest expense over the relevant period.

The EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

When calculating the EIR, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) including 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. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognized thereafter using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Service charges and penalties
Service charges and penalties are recognized only upon collection or accrued when there is reasonable degree of certainty as to its collectability.

Fees and commissions
Loan fees that are directly related to acquisition and origination of loans are included in the cost of the loan and are amortized using the effective interest method over the term of the loan. Loan commitment fees are recognized as earned over the term of the credit lines granted to each borrower. Loan syndication fees are recognized upon completion of all syndication activities and where the Bank does not have further obligation to perform under the syndication agreement.

Trading and securities gain - net
Trading and securities gain - net represents results arising from trading activities including gains and losses from changes in fair value of financial assets at FVPL and disposal of AFS investments.

Dividends
Dividends are recognized when the Bank's right to receive the payments is established.

Rental
Rental income arising from leased premises is accounted for on a straight-line basis over the lease terms of ongoing leases.

<u>Expense Recognition</u>
An expense is recognized when it is probable that a decrease in future economic benefit related to a decrease in an asset or an increase in liability has occurred and the decrease in economic benefits can be measured reliably. Revenues and expenses that relate to the same transaction or other event are recognized simultaneously.

<u>Interest Expense</u>
Interest expense for all interest-bearing financial liabilities are recognized in 'Interest expense' in the statement of income using the EIR of the financial liabilities to which they relate to.

<u>Retirement Benefits</u>
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 defined benefit obligation is calculated annually by an independent actuary. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates on government bonds that have terms to maturity approximating the terms of the related retirement liability. 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 government 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. Plan assets are not available to the creditors of the Bank, nor can they be paid directly to the Bank. The 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 risks 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 Bank'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.

Defined contribution
The Bank also contributes to its contributory, defined-contribution type staff provident plan based on a fixed percentage of the employees' salaries as defined in the plan.

<u>Leases</u>
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 the 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.

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

Bank as lessor
Leases where the Bank does not transfer substantially all the risks and benefits of ownership of the assets are classified as operating leases.

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.

Income Taxes

Current tax

Current tax assets and liabilities for the current period 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 statement of financial position date.

Deferred tax

Deferred tax is provided using the balance sheet liability method on all temporary differences at the statement of financial position 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, with certain exceptions. Deferred tax assets are recognized for all deductible temporary differences, carryforward of unused tax credits from excess minimum corporate income tax (MCIT) over regular corporate income tax (RCIT) and unused net operating loss carryover (NOLCO), to the extent that it is probable that taxable income will be available against which the deductible temporary differences and carryforward of unused MCIT and unused NOLCO can be utilized. Deferred tax, however, is not recognized when it arises 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.

The carrying amount of deferred tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred tax assets to be utilized.

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 statement of financial position date.

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

Provisions

Provisions are recognized when an obligation (legal or constructive) is incurred as a result of a past event and where it is probable that an outflow of assets embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Where the Bank expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of income, net of any reimbursement.

If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an ‘Interest expense’ in the statement of income.

Contingent Assets and Liabilities
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.

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

Diluted EPS is calculated by dividing the net income attributable to common shareholders by the weighted average number of common shares outstanding during the year adjusted for the effects of any dilutive potential common shares. As of December 31, 2013 and 2012, the Bank does not have dilutive potential common shares.

Dividends on Common Shares
Dividends on common shares are recognized as a liability and deducted from equity when approved by the respective shareholders' of the Bank. Dividends for the year that are approved after the statement of financial position date are dealt with as an event after the statement of financial position date.

Segment Reporting
The Bank'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. Financial information on business segments is presented in Note 6. The Bank's assets producing revenues are located in the Philippines (i.e., one geographical location). Therefore, geographical segment information is no longer presented.

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 Bank acts in a fiduciary capacity such as nominee, trustee or agent.

Events after the Reporting Period
Post-year-end events that provide additional information about the Bank's position at the statement of financial position date (adjusting event) are reflected in the financial statements. Post-year-end events that are not adjusting events, if any, are disclosed when material to the financial statements.

Future Changes in Accounting Policies

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

Effective 2014
Investment Entities (Amendments to PFRS 10, PFRS 12 and PAS 27)
These amendments provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under PFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. It is not expected that this amendment would be relevant to the Bank since none of the entities in the Bank would qualify as an investment entity under PFRS 10.

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 Bank's financial position or performance. The amendments to PAS 32 are to be applied retrospectively.

PAS 36, *Impairment of Assets - Recoverable Amount Disclosures for Non-Financial Assets* (Amendments)
These amendments remove the unintended consequences of PFRS 13 on the disclosures required under PAS 36. In addition, these amendments require disclosure of the recoverable amounts for the assets or CGUs for which impairment loss has been recognized or reversed during the period. These amendments are effective retrospectively. The amendments affect disclosures only and have no impact on the Bank's financial position or performance.

PAS 39, *Financial Instruments: Recognition and Measurement - Novation of Derivatives and Continuation of Hedge Accounting* (Amendments)
These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. The Bank has not novated its derivatives during the current period. However, these amendments would be considered for future novations.

Philippine Interpretation 21, *Levies* (Philippine Interpretation 21)
Philippine Interpretation 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. The Bank does not expect that Philippine Interpretation 21 will have material financial impact in future financial statements.

Effective 2015 onwards
PAS 19, *Employee Benefits - Defined Benefit Plans: Employee Contributions* (Amendments)
The amendments apply to contributions from employees or third parties to defined benefit plans. Contributions that are set out in the formal terms of the plan shall be accounted for as reductions to current service costs if they are linked to service or as part of the remeasurements of the net defined benefit asset or liability if they are not linked to service. Contributions that are discretionary shall be accounted for as reductions of current service cost upon payment of these contributions to the plans. The amendments to PAS 19 are to be applied retrospectively. The Bank does not expect that the Amendments to PAS 19 will have material financial impact on the financial statements.

PFRS 9, *Financial Instruments*
PFRS 9, as issued, reflects the first and third phases of the project to replace PAS 39 and applies to the classification and measurement of financial assets and liabilities and hedge accounting, respectively. Work on the second phase, which relate to impairment of financial instruments, and the limited amendments to the classification and measurement model is still ongoing, with a view to replace 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 liabilities designated as at FVPL using the fair value option, 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 relating to the entity's own 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 to PFRS 9, including the embedded derivative bifurcation 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 Bank's financial assets, but will potentially have no impact on the classification and measurement of financial liabilities.

On hedge accounting, PFRS 9 replaces the rules-based hedge accounting model of PAS 39 with a more principles-based approach. Changes include replacing the rules-based hedge effectiveness test with an objectives-based test that focuses on the economic relationship between the hedged item and the hedging instrument, and the effect of credit risk on that economic relationship; allowing risk components to be designated as the hedged item, not only for financial items, but also for non-financial items, provided that the risk component is separately identifiable and reliably measurable; and allowing the time value of an option, the forward element of a forward contract and any foreign currency basis spread to be excluded from the designation of a financial instrument as the hedging instrument and accounted for as costs of hedging. PFRS 9 also requires more extensive disclosures for hedge accounting.

PFRS 9 currently has no mandatory effective date. PFRS 9 may be applied before the completion of the limited amendments to the classification and measurement model and impairment methodology.

The Bank conducted an evaluation to determine the impact of early adoption of PFRS 9 and the accounts affected are 'Available-for-sale investments', 'Receivable from customers' and 'Unquoted debt securities' under Loans and receivables. As of December 31, 2013, the Bank opted not to early adopt PFRS 9.

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 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 (IASB) and an evaluation of the requirements of the final Revenue standard against the practices of the Philippine real estate industry is completed. Adoption of the interpretation when it becomes effective will not have any impact on the financial statements of the Bank.

Annual Improvements to PFRSs (2010-2012 cycle)
The Annual Improvements to PFRSs (2010-2012 cycle) contain non-urgent but necessary amendments to the following standards:

PFRS 2, *Share-based Payment - Definition of Vesting Condition*
The amendment revised the definitions of vesting condition and market condition and added the definitions of performance condition and service condition to clarify various issues. This amendment shall be prospectively applied to share-based payment transactions for which the grant date is on or after July 1, 2014. This amendment does not apply to the Bank as it has no share-based payments.

PFRS 3, *Business Combinations - Accounting for Contingent Consideration in a Business Combination*
The amendment clarifies that a contingent consideration that meets the definition of a financial instrument should be classified as a financial liability or as equity in accordance with PAS 32. Contingent consideration that is not classified as equity is subsequently measured at fair value through profit or loss whether or not it falls within the scope of PFRS 9 (or PAS 39, if PFRS 9 is not yet adopted). The amendment shall be prospectively applied to business combinations for which the acquisition date is on or after July 1, 2014. The Bank shall consider this amendment for future business combinations.

PFRS 8, *Operating Segments - Aggregation of Operating Segments and Reconciliation of the Total of the Reportable Segments' Assets to the Entity's Assets*
The amendments require entities to disclose the judgment made by management in aggregating two or more operating segments. This disclosure should include a brief description of the operating segments that have been aggregated in this way and the economic indicators that have been assessed in determining that the aggregated operating segments share similar economic characteristics. The amendments also clarify that an entity shall provide reconciliations of the total of the reportable segments' assets to the entity's assets if such amounts are regularly provided to the chief operating decision maker. These amendments are applied retrospectively. The amendments affect disclosures only and have no impact on the Bank's financial position or performance.

PFRS 13, *Fair Value Measurement - Short-term Receivables and Payables*
The amendment clarifies that short-term receivables and payables with no stated interest rates can be held at invoice amounts when the effect of discounting is immaterial.

PAS 16, *Property, Plant and Equipment - Revaluation Method - Proportionate Restatement of Accumulated Depreciation*
The amendment clarifies that, upon revaluation of an item of property, plant and equipment, the carrying amount of the asset shall be adjusted to the revalued amount, and the asset shall be treated in one of the following ways:

a. The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. The accumulated depreciation at the date of revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account any accumulated impairment losses.
b. The accumulated depreciation is eliminated against the gross carrying amount of the asset.

The amendment shall apply to all revaluations recognized in annual periods beginning on or after the date of initial application of this amendment and in the immediately preceding annual period. The Bank does not expect that the Improvements to PAS 16 will have material financial impact on the financial statements.

PAS 24, *Related Party Disclosures - Key Management Personnel*
The amendments clarify that an entity is a related party of the reporting entity if the said entity, or any member of a group for which it is a part of, provides key management personnel services to the reporting entity or to the parent company of the reporting entity. The amendments also clarify that a reporting entity that obtains management personnel services from another entity (also referred to as management entity) is not required to disclose the compensation paid or payable by the management entity to its employees or directors. The reporting entity is required to disclose the amounts incurred for the key management personnel services provided by a separate management entity. The amendments are applied retrospectively. The amendments affect disclosures only and have no impact on the Bank's financial position or performance.

PAS 38, *Intangible Assets - Revaluation Method - Proportionate Restatement of Accumulated Amortization*
The amendments clarify that, upon revaluation of an intangible asset, the carrying amount of the asset shall be adjusted to the revalued amount, and the asset shall be treated in one of the following ways:
a. The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. The accumulated amortization at the date of revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account any accumulated impairment losses.
b. The accumulated amortization is eliminated against the gross carrying amount of the asset.

The amendments also clarify that the amount of the adjustment of the accumulated amortization should form part of the increase or decrease in the carrying amount accounted for in accordance with the Standard.

The amendments shall apply to all revaluations recognized in annual periods beginning on or after the date of initial application of this amendment and in the immediately preceding annual period. The amendments have no impact on the Bank's financial position or performance.

<u>Annual Improvements to PFRSs (2011-2013 cycle)</u>
The Annual Improvements to PFRSs (2011-2013 cycle) contain non-urgent but necessary amendments to the following standards:

PFRS 1, *First-time Adoption of Philippine Financial Reporting Standards - Meaning of 'Effective PFRSs'*
The amendment clarifies that an entity may choose to apply either a current standard or a new standard that is not yet mandatory, but that permits early application, provided either standard is applied consistently throughout the periods presented in the entity's first PFRS financial statements. This amendment is not applicable to the Bank as it is not a first-time adopter of PFRS.

PFRS 3, *Business Combinations - Scope Exceptions for Joint Arrangements*
The amendment clarifies that PFRS 3 does not apply to the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself. The amendment is applied prospectively.

PFRS 13, *Fair Value Measurement - Portfolio Exception*
The amendment clarifies that the portfolio exception in PFRS 13 can be applied to financial assets, financial liabilities and other contracts. The amendment is applied prospectively. The amendment has no significant impact on the Bank's financial position or performance.

PAS 40, *Investment Property*
The amendment clarifies the interrelationship between PFRS 3 and PAS 40 when classifying property as investment property or owner-occupied property. The amendment stated that judgment is needed when determining whether the acquisition of investment property is the acquisition of an asset or a group of assets or a business combination within the scope of PFRS 3. This judgment is based on the guidance of PFRS 3. This amendment is applied prospectively. The amendment has no significant impact on the Bank's financial position or performance.

3. Significant Accounting Judgments and Estimates

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

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

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

a) *Operating leases*
In determining whether or not there is indication of operating lease treatment, the Bank considers retention of ownership title to the leased property, period of lease contract relative to the estimated useful economic life of the leased property and bearer of executory costs, among others.

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

Bank as lessee
The Bank has entered into lease on premises it uses for its operations. The Bank has determined that all significant risks and rewards of ownerships of the properties it leases on operating lease are not transferrable to the Bank.

b) *Fair value of financial instruments*
The Bank 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.

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values.

The carrying values and corresponding fair values of financial assets and financial liabilities as well as the manner in which fair values were determined are discussed in more detail in Note 4.

c) *Embedded derivatives*
Where a hybrid instrument is not classified as financial assets at FVPL, the Bank evaluates whether the embedded derivatives should be bifurcated and accounted for separately. This includes assessing whether the embedded derivative has a close economic relationship to the host contract.

d) *Contingencies*
The Bank is currently involved in various legal proceedings. The estimate of the probable costs for the resolution of these claims has been developed in consultation with outside counsel handling the Bank's defense in these matters and is based upon an analysis of potential results. The Bank currently does not believe that these proceedings will have a material adverse effect on the financial statements. It is possible, however, that future results of operations could be materially affected by changes in the estimates or in the effectiveness of the strategies relating to these proceedings (Note 20).

e) *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 Bank considers the following:
1) the currency that mainly influences sales prices for financial instruments and services (this will often be the currency in which sales prices for its financial instruments and services are denominated and settled);
2) the currency in which funds from financing activities are generated; and
3) the currency in which receipts from operating activities are usually retained.

f) *Fair value of investment properties*
Fair values of investment properties are determined using valuation methodologies acceptable under PFRS and valuation standards. Management determines the applicable valuation model based on the related income generated from the asset.

g) *Change in use of assets*
PAS 40 requires management to use its judgment to determine whether a property qualifies as an investment property. The Bank has developed criteria so it can exercise its judgment consistently. A property that is held to earn rentals or for capital appreciation or both and which generates cash flows largely independently of the other assets held by the Bank is accounted for as investment properties. On the other hand, a property that is used for operations or in the process of providing services or for administrative purposes and which do not directly generate cashflows as a stand-alone asset are accounted for as property and equipment. The Bank assesses on an annual basis the accounting classification of its properties taking into consideration the current use of such properties.

Estimates

a) *Going concern*
The Bank's management has made an assessment of its ability to continue as a going concern and is satisfied that it has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

b) *Credit losses on loans and receivables*
The Bank reviews its loans and receivables at each statement of financial position date to assess whether an allowance 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 allowance required. 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 Bank 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 is based on any deterioration in the internal rating of the loan or investment since it was granted or acquired. These internal ratings take into consideration factors such as any deterioration in country risk, industry, and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

The carrying value of loans and receivables and allowance for credit losses on loans and receivables are disclosed in Notes 9 and 13, respectively.

c) *Impairment of AFS equity investments*
The Bank determines that AFS equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost.

The determination of what is 'significant' or 'prolonged' requires judgment. The Bank treats 'significant' generally as 20.00% or more and 'prolonged' as greater than 12 months. In addition, the Bank evaluates among other factors, the normal volatility in share price and evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

The carrying value of AFS equity investments and related allowance for impairment losses are disclosed in Notes 8 and 13, respectively.

d) *Impairment of AFS debt investments*
The Bank determines that AFS debt investments are impaired based on the same criteria as loans and receivables.

As of December 31, 2013 and 2012, no impairment losses were recognized on AFS debt investments, which comprise bonds issued by the Philippine Government. The carrying value of AFS debt investments is disclosed in Note 8.

e) *Amortized cost of financial instruments*
The determination of amortized cost on financial instruments includes estimating future payments or receipts from such financial instruments. The Bank assesses annually whether new information warrants revisions to such estimates which will require adjusting the carrying amounts of financial instruments, except for reclassified financial assets, to reflect actual or revised estimates of cash flows. The Bank recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate. The adjustment is recognized in the statement of income as income or expense.

In 2012, the Bank reassessed its estimates of the timing of settlement for its investments in MRT Bonds as a result of the rating upgrade for MRT III notes and payment of MRT notes tranches 2E and 2D based on expected maturity dates instead of the legal maturity dates, where actual payments made are two years earlier than the original estimates.

The change in estimates reflecting the revised timing of payment based on the actual payment pattern of earlier tranches of MRT notes had the effect of increasing the carrying value of the Bank's investment in MRT amounting to $4.99 (₱204.84) million as of December 31, 2012 (Note 9).

f) *Impairment of nonfinancial assets - Property and equipment*
The Bank assesses impairment on nonfinancial assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The factors that the Bank 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 Bank recognizes an impairment loss whenever the carrying amount of an asset exceeds its recoverable amount. The recoverable amount is computed using the fair value less cost to sell approach for property and equipment at cost. Recoverable amounts are estimated for individual assets or, if it is not possible, for the CGU to which the asset belongs.

The carrying value of property and equipment is disclosed in Note 10.

g) *Intangible assets*
The Bank's management conducts an annual review for any impairment in value of its intangible assets. Intangible assets are written down for impairment where the recoverable amount is insufficient to support its carrying value. The carrying value of intangible assets is disclosed in Note 12.

h) *Estimated useful lives of property and equipment and software cost*
The Bank reviews on an annual basis the estimated useful lives of property and equipment and software cost based on expected asset utilization as anchored on business plans and strategies that also consider expected future technological developments and market behavior.

It is possible that future results of operations could be materially affected by changes in these estimates brought about by changes in the factors mentioned. A reduction in the estimated useful lives of property and equipment and software costs would increase the recorded depreciation and amortization expense and decrease noncurrent assets. The estimated useful lives of property and equipment and software cost are disclosed in Note 2.

i) *Fair value determination of investment properties and revaluation of land*
The Bank carries its investment properties at fair value, with changes in fair value being recognized in the statement of income. In addition, it measures land at revalued amounts with changes in appraised value being recognized in OCI. The Bank engages independent valuation specialists to determine fair and appraised values on a periodic basis.

For condominium units under investment properties, the valuer used a valuation technique based on the income capitalization approach since these properties generate cash flows through rental income.

The fair value of condominium units is most sensitive to the capitalization rate. The key assumptions used to determine the fair value of condominium units are further discussed in Note 4.

j) *Present value of defined benefit obligation*
The cost of defined benefit plans as well as the present value of the defined benefit obligation are determined using actuarial valuations. The actuarial valuation involves making various assumptions. These include the determination of the discount rates, future salary increases and mortality rates. Due to the complexity of the valuation, the underlying assumptions and its long-term nature, defined benefit obligations are highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date. The net benefit liability as at December 31, 2013 is disclosed in Note 23.

In determining the appropriate discount rate, management considers the present value of cash flows (expected benefit payments) as of valuation date determined using the rates from the derived zero yield curve. The discount rate used is the single-weighted uniform discount rate, which when applied to the same cash flows, results in the same present value as of the valuation date.

The mortality rate is based on publicly available mortality tables for the specific country and is modified accordingly with estimates of mortality improvements. Future salary increases and pension increases are based on expected future inflation rates for the specific country.

k) *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 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 profits together with future tax planning strategies. The recognized and unrecognized deferred tax assets are disclosed in Note 26.

4. Fair Value Measurement

As of December 31, 2013 and 2012, except for the following financial instruments, the carrying values of the Bank's financial assets and liabilities as reflected in the statements of financial position and related notes approximate their respective fair values (amounts in thousands):

	2013		2012	
	Carrying Value	**Fair Value**	Carrying Value	Fair Value
Financial Assets				
Loans and receivables:				
Receivables from customers:				
Corporate loans	**₱16,246,830**	**₱16,541,077**	₱11,701,254	₱12,282,831
Consumer loans	**2,106,037**	**2,941,204**	45,006	112,418
Unquoted debt securities	**5,696,615**	**6,775,255**	3,376,221	2,292,925
Financial Liabilities				
Financial liabilities at amortized cost:				
Deposit liabilities:				
Time	**37,007,256**	**37,226,453**	22,817,097	22,780,493
Bills payable:				
Banks and other financial institutions	**7,852,560**	**8,033,404**	6,636,778	7,301,950

The methods and assumptions used by the Bank in estimating the fair value of its financial instruments are as follows:

<u>Derivative Assets/Liabilities</u>
Fair values are calculated by reference to the prevailing interest differential and spot exchange rate as of the statement of financial position date, taking into account the remaining term to maturity of the derivative assets/liabilities.

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

Quoted equity securities
Fair values of club shares are based on quoted prices published in GG&A Club Shares. GG&A Club Shares is involved in trading and leasing proprietary and non-proprietary club shares.

Unquoted equity securities
Fair values could not be reliably determined due to the unpredictable nature of future cash flows and the lack of suitable methods of carrying at a reliable fair value. These are carried at cost less any allowance for impairment losses. Unquoted equity securities are not significant in relation to the Bank's portfolio of financial instruments.

<u>Loans and Receivables</u>
Cash and other cash items, amounts due from BSP and other banks and interbank loans receivable and SPURA
The carrying amounts approximate fair values considering that these accounts consist mostly of overnight deposits.

Receivables from customers
Fair values of loans and receivables are estimated using the discounted cash flow methodology, using the Bank's current incremental lending rates for similar types of loans and receivables.

Unquoted debt securities classified as loans
For unquoted debt securities with nil coupon interest rates, fair values are estimated based on the discounted cash flow methodology using the interpolated risk-free rate.

For unquoted debt securities with floating interest rates, fair values are estimated using discounted cash flow methodology using the prevailing rate of return.

Accrued interest receivable and payable and Returned checks and other cash items (RCOCI)
Carrying amounts approximate fair values due to either the demand nature or relatively short-term maturities.

Accounts receivable, sales contracts receivable and refundable security deposits
Quoted market prices are not readily available for these assets. They are not reported at fair value and are not significant in relation to the Bank's total portfolio of financial instruments.

Financial Liabilities at Amortized Cost
Deposit liabilities
Fair values of time deposits are estimated based on the discounted cash flow methodology using the current incremental borrowing rates for similar types of borrowings. The carrying amount of demand and savings deposit liabilities approximate fair value considering that these are due and demandable.

Where no active market price or rate is available, fair values are estimated using present value or other valuation techniques, using inputs based on market data and conditions, and reflect appropriate adjustments that market participants would make for credit and liquidity risks existing at the statement of financial position dates.

Bills payable
Fair value is estimated using the discounted cash flow methodology using the Bank's current incremental borrowing rates for similar borrowings with maturities consistent with those remaining for the liability being valued. Where the instrument has a relatively short maturity, the carrying amounts approximate fair values.

Outstanding acceptances, manager's checks, accrued other expenses, accounts payable and marginal deposits
Carrying amounts approximate fair values due to either the demand nature or relatively short-term maturities.

Due to Treasurer of the Philippines
Quoted market prices are not readily available for such liabilities. They are not reported at fair value and are not significant in relation to the Bank's total portfolio of financial instruments.

Fair Value Hierarchy

The following tables provide the fair value measurement of the assets and liabilities of the Bank as of December 31, 2013 (amounts in thousands), analyzed among those whose fair value is based on:

- Level 1 - quoted market prices in active markets for identical assets or liabilities; when fair values of listed equity and debt securities, as well as publicly traded derivatives at the reporting date are based on quoted market prices or binding dealer price quotations, without any deduction for transaction costs, the instruments are included within Level 1 of the hierarchy;

- Level 2 - those involving inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); for all other financial instruments, fair value is determined using valuation techniques. Valuation techniques include discounted cashflows, comparison to similar instruments for which market observable prices exists (i.e., PDSI-R2); and

- Level 3 - those with inputs for the asset or liability that are not based on observable market data (unobservable inputs); instruments included in Level 3 are those for which there are currently no active market.

	Fair value measurements at the end of the reporting period using			
Description (Amounts in thousands)	Fair value at December 31, 2013	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Recurring fair value measurements				
Financial Assets[(a)]				
Held-for-trading (HFT) (Note 8)				
Debt securities	₱104,909	₱104,909	₱–	₱–
AFS investments (Note 8)				
Government securities	20,047,034	8,879,880	11,167,154	–
Quoted equity securities	31,740	–	31,740	–
	20,183,683	8,984,789	11,198,894	–
Nonfinancial Assets				
Investment properties (Note 11)				
Foreclosed properties[(b)]				
Land	366,226	–	–	366,226
Building and improvements	116,328	–	–	116,328
Condominium units for lease[(a)]	3,341,665	–	–	3,341,665
Land at appraised value[(a)] (Note 10)	417,029	–	–	417,029
	4,241,248	–	–	4,241,248
Assets and Liabilities for which fair values are Disclosed				
Financial Assets[(a)]				
Loans and Receivables (Note 9)				
Receivable from customers				
Corporate loans	16,541,077	–	–	16,541,077
Consumer loans	2,941,204	–	–	2,941,204
Unquoted debt securities	6,775,255	–	–	6,775,255
	26,257,536	–	–	26,257,536
Nonfinancial Assets				
Property and equipment (Note 10)				
Condominium units[(b)]	922,635	–	–	922,635
Buildings and improvements[(a)]	223,839	–	–	223,839
	1,146,474	–	–	1,146,474

(Forward)

Description (Amounts in thousands)	Fair value at December 31, 2013	Fair value measurements at the end of the reporting period using: Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial Liabilities[a]				
Deposit liabilities				
Time	₱37,226,453	₱–	₱–	₱37,226,453
Bills Payable				
Banks and other financial institutions	8,033,404	–	–	8,033,404
	45,259,857	–	–	45,230,757

(a) valued as of December 31, 2013
(b) valued at various dates in 2013.

As of December 31, 2013 and 2012, there were no financial instruments carried at fair value that were measured based on Level 3 inputs. Fair values of AFS investments under Level 2 were based on interpolation of market rates of benchmark securities as of reporting date.

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 in 2013 and 2012, except for recurring non-financial assets transferred out of Level 3 (Note 11).

Movements in the fair value measurement of nonfinancial assets categorized within Level 3 are discussed in Note 10 for Land and Note 11 for Investment properties.

Significant unobservable inputs

Quantitative information about the Bank's fair value measurements using significant unobservable inputs (Level 3) follows (amounts in thousand):

Description	**Fair value at December 31, 2013**	**Valuation technique(s)**	**Unobservable input (s)**	**Range (weighted average)**
Investment properties (Note 11)				
Foreclosed properties				
Land	**₱366,226**	Market sales comparison approach	Price per square meter	₱30 - ₱57,773
Building and improvements	**116,328**	Market sales comparison approach	Price per square meter	₱1,240 - ₱50,000
Condominium units for lease	**3,341,665**	Income capitalization approach	Capitalization rate[a]	8.30%
			Vacancy rate[b]	5.00%
			Rental rates[c]	₱632 - ₱1,123
Land classified under Property and equipment (Note 10)	**₱417,029**	Market sales comparison approach	Price per square meter	₱13,500 - ₱172,566

[a] 8.80% in 2012
[b] 5.00% in 2012
[c] ₱632-₱1,161 in 2012

Investment properties are stated at fair value, which has been determined based on valuations made by professionally qualified appraisers accredited by BSP and SEC. The fair values of foreclosed assets were derived based on market sales comparison approach. Under this approach, the recent transaction for similar properties in the same areas as the investment properties and taking into account the economic conditions prevailing at the time the valuation were made. Prices of recent transactions are adjusted to account for differences in a property's size, shape, location, marketability and bargaining allowances. For depreciable properties, other inputs considered in the valuations will include the age and remaining useful life of the building.

On the other hand, the fair value of the condominium units for lease was determined using the income capitalization approach model, a valuation model in accordance with that recommended by the Philippine Valuation Standards. The income capitalization approach model is used since the properties generate revenue from rental income. Income capitalization approach is a method used to convert an estimate of a single year's income expectancy into an indication of value in one direct step – either by dividing the income estimate by an appropriate income rate or by multiplying the income estimate by an appropriate income factor. The rate of interest calculated represents the relationship between income and value observed in the market and is derived through comparable sales analysis. The income from a property, usually annual net operating income or pre-tax cash flow, is divided by its sale or equity price to obtain the income rate.

The valuation, therefore, is based on the following critical assumptions:
1. Rental rates are based on prevailing market rates as of December 31, 2013. All other income and expenses are based on actual amounts recognized in 2013.
2. Capitalization rate (income rate) was based on market rent where selling prices and rental rates of similar properties were gathered where a range of 7.74% to 10.09% per annum was established.
3. The floor areas are used in this valuation are the areas indicated in total leasable area comprising the usable area plus the limited common areas.

There has been no change in the valuation techniques used during the year.

5. Financial Risk Management Objectives and Policies

Introduction

Risk is inherent in the Bank's activities but is managed through a continuing and pro-active process of identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities.

The Bank is exposed to the following risks from its financial instruments:

a. Credit risk
b. Liquidity risk
c. Market risk
    i. Interest rate risk
    ii. Foreign currency risk
    iii. Equity price risk

Risk management structure

The Bank's risk management environment is characterized by a well-defined risk organizational structure, flow of risk information, risk-based audit coverage, and an established compliance system.

BOD
The BOD is responsible for establishing and maintaining a sound risk management system and is ultimately accountable for identifying and controlling risks; there are, however, separate independent bodies responsible for managing and monitoring risks.

Risk Oversight Committee (ROC)
The ROC has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits.

Enterprise Risk Management Group (ERMG)
The ERMG is an independent unit within the Bank that directly reports to the ROC. It is the responsibility of the ERMG to identify, analyze and measure risks from the Bank's trading, lending, borrowing and other transactional activities. It also recommends control policies and procedures to mitigate risk in identified risk areas in Treasury, Credit, Trust and other areas of operations.

Risk Control
The Risk Control function performs the important day-to-day monitoring of risk exposures against approved limits and reporting of such exposures, and implementation of policies and control procedures.

Treasury Segment
The Treasury Segment is responsible for managing the Bank's assets and liabilities. It is also primarily responsible for the management of the funding and liquidity risks of the Bank.

Internal Audit Group (IAG)
Risk management processes throughout the Bank are audited by the IAG which examines both the adequacy of the procedures and the Bank's compliance thereto. IAG discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Risk measurement and reporting systems
The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment.

The Bank also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks are primarily performed based on limits established by the Bank. These limits reflect both the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept. In addition, the Bank monitors and measures the overall risk-bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Information gathered from all the businesses is evaluated and processed in order to analyze, control and identify risks early. All significant information is presented to the BOD, the ROC, and the head of each business division. The report includes credit exposure to groups and industries, Value-at-Risk (VaR), liquidity ratios and risk profile changes. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis for prudential reporting and an annual basis for financial reporting.

Credit Risk and Concentration of Assets and Liabilities and Off-Balance Sheet Items

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Bank's credit risk arises from its lending and trading of securities and foreign exchange activities. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual borrowers and groups of borrowers as well as limits on large lines and industry concentrations. ERMG monitors exposures in relation to these limits.

Through the Bank's Credit Management Group (CMG), the Bank is able to continually manage credit-related risks in its risk asset portfolio through objective assessments/evaluations of credit proposals prior to presentation to the Credit Committee, ensuring the highest standards of credit due diligence and independence.

The Bank obtains security where appropriate, enters into collateral arrangements with counterparties, and limits the duration of exposures. The Bank's credit risk management process is guided by policies and procedures established by the CPRG and approved by the BOD.

The Bank has an internal credit risk rating system (ICRRS) for the purpose of measuring credit risk for every exposure in a consistent manner that is as accurate as possible and uses the risk information for business and financial decision making. The system covers companies with asset size of more than ₱15.00 million and with financial statements audited by SEC accredited auditors starting reporting year 2005. The Bank adopted the Bankers Association of the Philippines model which has been approved by the BSP under BSP Circular No. 439 as a minimum standard for an ICRRS. The system has two components, namely: a) Borrower Risk Rating System which provides an assessment of credit risk without considering the security arrangements and b) Facility Risk Factor which is an account rating taking into account the collateral and other credit risk mitigants. The rating scale consists of 14 grades, 10 of which fall under unclassified accounts and while the remaining four are classified accounts according to regulatory provisioning guidelines. The use of the 14 grade rating scale started in June 2013. Previously, the rating scale comprise of 10 grades only (six unclassified and four classified accounts).

The Bank has in place a loan portfolio quality and credit process review that allows the Bank to continuously identify and assess the risks on credit exposures and take corrective actions. This function is carried out by the Bank's Credit Review Unit under the CMG.

Maximum exposure to credit risk
The table below provides the analysis of the maximum exposure of the Bank's financial instruments to credit risk, excluding those where the carrying values as reflected in the statements of financial position and related notes already represent the financial instrument's maximum exposure to credit risk, before and after taking into account collateral held or other credit enhancements (amounts in thousands):

	2013			2012		
	Gross maximum exposure	**Net exposure**	**Financial effect of collateral or credit enhancement**	Gross maximum exposure	Net exposure	Financial effect of collateral or credit enhancement
Credit risk exposure relating to on-balance sheet items are as follows:						
Interbank loans receivable and SPURA	**₱202,550**	**₱202,550**	**₱–**	₱993,804	₱494,229	₱499,575
Loans and receivables:						
Receivables from customers:						
Corporate loans	**16,246,830**	**16,015,564**	**231,266**	11,701,254	10,643,459	1,057,795
Consumer loans	**2,106,037**	**998,220**	**1,107,817**	45,006	22,695	22,311
Total Credit Exposure	**₱18,555,417**	**₱17,216,334**	**₱1,339,083**	₱12,740,064	₱11,160,383	₱1,579,681

For sales contract receivables, the fair value of collaterals and their corresponding financial effect on credit exposure are no longer disclosed since the system does not regularly monitor such information. The carrying value of those sales contract receivables are disclosed in Note 9.

Risk concentrations by industry
Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry.

Group exposures and risk concentrations to industries are monitored and reported in accordance with the Bank's policies on group lending/inter-corporate earmarking and managing large exposure and credit risk concentrations.

Credit-related commitment risks
The Bank makes available to its customers guarantees that may require the Bank to make payments on their behalf and enters into commitments to extend credit lines to secure their liquidity needs. Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods. Such commitments expose the Bank to similar risks to loans and are mitigated by the same control processes and policies.

The industry sector analysis of the maximum exposure of the Bank to credit risk concentration follows (amounts in thousands):

	December 31, 2013				
	Loans and receivables	**Loans and advances to banks***	**Investment securities**	**Others****	**Total**
Government	**₱2,757,104**	**₱9,573,408**	**₱20,151,944**	**₱–**	**₱32,482,456**
Wholesale and retail trade	**6,357,374**	–	–	**1,462,669**	**7,820,043**
Manufacturing	**4,686,273**	–	–	**767,762**	**5,454,035**
Construction and real estate	**3,223,258**	–	–	**135,271**	**3,358,529**
Banks and financial institutions	**2,796,639**	**863,857**	**18,477**	**15,538**	**3,694,511**
Transportation, storage, communication	**1,340,392**	–	–	**67,162**	**1,407,554**
Electricity, gas and water supply	**1,508,662**	–	–	–	**1,508,662**
Agriculture, hunting and forestry	**482,461**	–	–	–	**482,461**
Mining and quarrying	**448,350**	–	–	**40,742**	**489,092**
Others	**3,319,078**	–	**31,740**	**59,479**	**3,410,297**
	26,919,591	**10,437,265**	**20,202,161**	**2,548,623**	**60,107,640**
Less allowance for credit and impairment losses	**1,922,167**	–	**7,170**	–	**1,929,337**
	₱24,997,424	**₱10,437,265**	**₱20,194,991**	**₱2,548,623**	**₱58,178,303**

* Consist of due from BSP, due from other banks, and interbank loans receivable and SPURA

** Consist of RCOCI, refundable deposits and commitments and contingencies

	December 31, 2012				
	Loans and receivables	Loans and advances to banks*	Investment securities	Others**	Total
Government	₱3,345,842	₱6,011,067	₱16,744,365	₱–	₱26,101,274
Wholesale and retail trade	4,970,270	–	–	441,367	5,411,637
Manufacturing	3,898,038	–	–	189,818	4,087,856
Construction and real estate	3,064,628	–	–	10,758	3,075,386
Banks and financial institutions	707,702	1,380,947	18,330	7,691	2,114,670
Transportation, storage, communication	1,199,822	–	–	53,365	1,253,187
Electricity, gas and water supply	1,621	–	–	–	1,621
Agriculture, hunting and forestry	156,220	–	–	–	156,220
Mining and quarrying	129,183	–	–	–	129,183
Others	816,650	–	23,130	134,612	974,392
	18,289,976	7,392,014	16,785,825	837,611	43,305,426
Less allowance for credit and impairment losses	2,332,481	–	7,022	–	2,339,503
	₱15,957,495	₱7,392,014	₱16,778,803	₱837,611	₱40,965,923

* Consist of due from BSP, due from other banks, and interbank loans receivable and SPURA

** Consist of RCOCI, refundable deposits and commitments and contingencies

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For securities lending and reverse repurchase transactions; cash or securities
- For commercial lending; deposit hold-out, mortgages over real estate properties, machineries, inventory and trade receivables
- For retail lending; mortgages over residential properties.

It is the Bank's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Bank does not occupy repossessed properties for business use.

Collaterals obtained by the Bank from settlement of loan and receivables in 2013 and 2012 and which remain outstanding as of December 31, 2013 and 2012 amounted to ₱98.23 million and nil, respectively (Note 11).

The Bank does not hold collateral on financial assets which it may sell or repledge in absence of default by the owner of the collateral.

Credit quality per class of financial assets

Loans and Receivables
Description of the loan grades or Internal Credit Risk Rating used by the Bank for corporate commercial loans follows:

Borrower's Risk Rating (BRR) Grade	Description
1	Excellent
2	Strong
3	Good
4	Fairly Good
5	Satisfactory
6	Fairly Satisfactory
7	Acceptable
8	Acceptable with care
9	Acceptable with caution
10	Watch List
11	Loans Especially Mentioned
12	Substandard
13	Doubtful
14	Loss

The grades are defined as follows:

Excellent - An obligor rated 1 has an excellent capacity to meet its financial commitments with minimal credit risk.

Strong - An obligor rated 2 has a strong capacity to meet its financial commitments with very low credit risk.

Good - An obligor rated 3 has a good capacity to meet its financial commitments with low credit risk.

Fairly Good - An obligor rated 4 differs from rated 3 obligor only to a small degree and has a fairly good capacity to meet its financial commitments with low credit risk.

Satisfactory - An obligor rated 5 has a satisfactory capacity to meet its financial commitments with moderate credit risk.

Fairly Satisfactory - An obligor rated 6 has a fairly satisfactory capacity to meet its financial commitments with moderate credit risk.

Acceptable - An obligor rated 7 has an acceptable capacity to meet its financial commitments with substantial credit risk.

Acceptable with care - A credit, though acceptable, needs care in granting facilities. However, the borrower is still creditworthy.

Acceptable with caution - A credit, though acceptable, needs significant caution to be exercised while granting facilities to the borrower. The borrower is still creditworthy but has problems that need to be addressed.

Watch List - Below standard. An obligor rated 10 is judged to be of poor credit standing and is subject to high default risk.

Loans Especially Mentioned - These are loans that have unlocated collateral folders and documents, not supported by board resolutions authorizing the borrowings, without credit investigation report or not supported by documents required under Subsection 4312Q.1 of the Manual of Regulations for Banks.

Substandard - Loans which involve a substantial and unreasonable degree of risk to the institution because of unfavorable record or unsatisfactory characteristics.

Doubtful - Loans which have existing facts, conditions, and values that make collection or liquidation in full highly improbable and in which substantial loss is probable.

Loss - Loans which are considered uncollectible or worthless and of such little value that their continuance as bankable assets is not warranted.

The credit quality of the Bank's loans and receivables from customers, which is based on the ICRRS grade, is grouped as follows:

High Grade (BRR 1 to 7)
Under this category, the borrower has the apparent ability to satisfy its obligations in full and therefore, no loss in ultimate collection is anticipated. These loans or portions thereof are secured by hold-outs on deposits/deposit substitute, margin deposits or government-supported securities, other readily marketable collateral or are supported by sufficient credit and financial information of favorable nature to assure repayment as agreed.

Standard Grade (BRR 8 to 10)
Under this category are accounts not considered adversely classified but require close supervision/monitoring due to some warning signals such as start-up business, substantial changes in the business affecting operation or management, three continuous years of substantial decline in income (exclusive of extraordinary income/losses).

Substandard Grade or Past-Due (BRR 11 to 14)
Under this category are loans which exhibit unfavorable record or unsatisfactory characteristics, or where existing facts, conditions and values, make collection or liquidation in full improbable. Positive and vigorous management action is required to avert or minimize loss.

Due from Bank, Other Banks, Interbank Receivables and Government Securities
The Bank follows an internally developed risk rating system for local banks and external risk ratings [i.e. Standard and Poor's (S&P)] for foreign banks and government securities. A description of the rating systems for local banks follows:

High Grade (Tier 1)
Tier 1 - Banks categorized under this tier are capable of withstanding very difficult market conditions for 2-3 years without deteriorating to a substandard credit classification by virtue of their size, reputation and ranking in the industry.

Standard Grade (Tier 2 to Tier 3)
These are accounts that have potential weaknesses that deserve management's close attention. These potential weaknesses, if left uncorrected, may affect the repayment of the financial instrument thus increase credit risk to the Bank.

Tier 2 - Banks categorized under this tier may deteriorate to substandard within 1-2 years under very difficult market conditions.

Tier 3 - Banks categorized under this tier may deteriorate to substandard within one year under very difficult market conditions. These are banks, which fall short relative to size, in view of perceived concern of uncertainty about their portfolio, earnings, or market condition. Banks with total net worth of ₱3.00 billion to less than ₱4.50 billion and net income of ₱200.00 million to less than ₱400.00 million are included in this category.

Substandard Grade (Tier 4)
Tier 4 - These are banks, which fall short relative to size, in view of perceived concern of uncertainty about their portfolio, earnings, or market condition. Banks with total net worth of ₱1.50 billion to less than ₱3.00 billion and net income of ₱70.00 million to less than ₱200.00 million are included in this category.

Foreign Banks and Other Government Securities
The following is the credit rating scale applicable for foreign banks, government securities, and corporate investment outlets (aligned with S&P ratings):

AAA - Obligor's capacity to meet its financial commitment is extremely strong.

AA - Obligor's capacity to meet its financial commitment is very strong. It differs from the highest-rated obligors at a minimal degree.

A - Obligor has strong capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors rated in higher-rated categories.

BBB and below:

BBB - Obligation rated 'BBB' has adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

BB - Obligation is less vulnerable to nonpayment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

B - Obligation rated ‘B’ is more vulnerable to nonpayment than obligations rated ‘BB’, but the obligor currently has the capacity to meet its financial commitment on the obligation.

Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitment on the obligation.

CCC - Obligation is currently vulnerable to nonpayment, and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitment on the obligation. In the event of adverse business, financial, or economic conditions, the obligor is not likely to have the capacity to meet its financial commitment on the obligation.

CC - Obligation is currently highly vulnerable to nonpayment.

C - Obligations are currently highly vulnerable to nonpayment, payment arrearages allowed by the terms of the documents, and subject of a bankruptcy petition or similar action which have not experienced a payment default.

Among others, the ‘C’ rating may be assigned to subordinated debt, preferred stock or other obligations on which cash payments have been suspended in accordance with the instrument’s terms or when preferred stock is the subject of a distressed exchange offer, whereby some or all of the issue is either repurchased for an amount of cash or replaced by other instruments having a total value that is less than par.

D - Obligation is in payment default. Payments on an obligation are not made on the date due even if the applicable grace period has not expired. The ‘D’ rating also will be used upon the filing of a bankruptcy petition or the taking of similar action if payments on an obligation are jeopardized. An obligation's rating is lowered to ‘D’ upon completion of a distressed exchange offer, whereby some or all of the issue is either repurchased for an amount of cash or replaced by other instruments having a total value that is less than par.

The table below shows the credit quality by class of financial assets based on the Bank’s credit rating system (amounts in thousands).

	2013						
	Neither Past Due nor Impaired						
	High Grade	Standard Grade	Substandard Grade	Unrated*	Past Due But Not Impaired	Past Due or Impaired	Total
Due from BSP	₱–	₱–	₱–	₱9,573,408	₱–	₱–	₱9,573,408
Due from other banks	60,178	28,544	13,698	–	–	–	102,420
	60,178	28,544	13,698	9,573,408	–	–	9,675,828
AFS investments:							
Equity securities							
Quoted	–	–	–	31,740	–	–	31,740
Unquoted	–	–	–	11,307	–	7,170	18,477
	–	–	–	43,047	–	7,170	50,217
Loans and receivables:							
Receivables from customers**:							
Corporate	9,190,432	6,874,391	71,328	–	154,831	1,162,900	17,453,882
Consumer	–	2,027,970	–	–	101,498	14,383	2,143,851
Unquoted debt securities	3,297,000	–	–	2,399,615	–	–	5,696,615
Accounts receivable	–	42,914	1,564	425,675	–	93,438	563,591
Accrued interest receivable	–	167,248	–	293,544	–	491,831	952,623
Sales contracts receivable	–	79,067	–	–	18,074	11,888	109,029
RCOCI	–	–	–	6,159	–	–	6,159
Refundable security deposits	–	–	–	25,200	–	–	25,200
	12,487,432	9,191,590	72,892	3,150,193	274,403	1,774,440	26,950,950
Total	₱12,547,610	₱9,220,134	₱86,590	₱12,766,648	₱274,403	₱1,781,610	₱36,676,995

*Financial instruments that are not rated (includes due from BSP, SPURA and equity securities)
**At gross amount but net of unearned discounts

	AA	**A**	**BBB and below**	**Total**
Due from other banks	**₱92,034**	**₱466,597**	**₱257**	**₱558,888**
Interbank loans receivable	**44,671**	**157,879**	**–**	**202,550**
HFT financial assets				
Debt securities	**–**	**–**	**104,909**	**104,909**
AFS investments				
Government securities	**–**	**–**	**20,047,034**	**20,047,034**
	₱136,705	**₱624,476**	**₱20,152,200**	**₱20,913,381**

	2012						
	Neither Past Due nor Impaired						
	High Grade	Standard Grade	Substandard Grade	Unrated*	Past Due But Not Impaired	Past Due or Impaired	Total
Due from BSP	₱–	₱–	₱–	₱5,511,067	₱–	₱–	₱5,511,067
SPURA	–	–	–	500,000	–	–	500,000
Due from other banks	68,982	39,745	5,894	–	–	–	114,621
	68,982	39,745	5,894	6,011,067	–	–	6,125,688
AFS investments:							
Equity securities							
Quoted	–	–	–	23,130	–	–	23,130
Unquoted	–	–	–	11,307	–	7,023	18,330
	–	–	–	34,437	–	7,023	41,460
Loans and receivables:							
Receivables from customers**:							
Corporate	8,642,390	2,901,776	61,444	429,304	176,470	1,152,314	13,363,698
Consumer	–	51,075	–	–	–	–	51,075
Unquoted debt securities	122,250	–	–	3,253,971	–	–	3,376,221
Accounts receivable	–	30,278	2,184	425,675	–	83,942	542,079
Accrued interest receivable	–	31,711	–	310,403	–	489,030	831,144
Sales contracts receivable	–	104,086	–	–	21,672		125,758
RCOCI	–	–	–	5,691	–	–	5,691
Refundable security deposits	–	–	–	18,084	–	–	18,084
	8,764,640	3,118,926	63,628	4,443,128	198,142	1,725,286	18,313,750
Total	₱8,833,622	₱3,158,671	₱69,522	₱10,488,632	₱198,142	₱1,732,309	₱24,480,898

*Financial instruments that are not rated (includes due from BSP, SPURA and equity securities)
**At gross amount but net of unearned discounts

	AA	A	BBB and below	Total
Due from other banks	₱1,945	₱766,167	₱4,410	₱772,522
Interbank loans receivable	41,249	452,555	–	493,804
Derivative asset	–	2,147	–	2,147
AFS investments				
Government securities	–	–	16,744,365	16,744,365
	₱43,194	₱1,220,869	₱16,748,775	₱18,012,838

As of December 31, 2013 and 2012, restructured loans by the Bank which are neither past due nor impaired are as follows:

	2013	2012
Receivable from customers:		
Corporate	**₱68,450,466**	₱219,004,635
Consumer	**378,457**	–

Impaired loans and receivables and investment securities

Impaired loans and receivables and investment securities are those for which the Bank determines that it is probable that it will be unable to collect all principal and interest due based on the contractual terms of the promissory note and securities agreements.

Aging analysis of past due but not impaired loans per class of financial assets

Aging analysis of past due but not impaired financial assets are shown below (amounts in thousands):

	December 31, 2013					
	Up to 1 month	**1 to 3 months**	**3 to 6 months**	**6 to 12 months**	**Greater than 1 year**	**Total**
Receivable from customer:						
Corporate loans	**₱124,203**	**₱26,878**	**₱–**	**₱–**	**₱3,750**	**₱154,831**
Consumer loans	**67,938**	**27,968**	**5,592**	**–**	**–**	**101,498**
Sales contract receivable	**5,897**	**–**	**2,686**	**–**	**9,491**	**18,074**
	₱198,038	**₱54,846**	**₱8,278**	**₱–**	**₱13,241**	**₱274,403**

	December 31, 2012					
	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	Greater than 1 year	Total
Receivable from customer:						
Corporate loans	₱137,927	₱140	₱56	₱61	₱38,286	₱176,470
Sales contract receivable	5,194	4,373	1,050	217	10,838	21,672
	₱143,121	₱4,513	₱1,106	₱278	₱49,124	₱198,142

Liquidity Risk and Funding Management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis.

This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required. In addition, the Bank makes use of a monthly system generated Liquidity Gap Report in analyzing its liquidity position where the difference between the Bank's maturing assets and liabilities is captured. A Maximum Cumulative Outflow limit is likewise established to control the liquidity gap for each currency. The Asset and Liability Committee (ALCO) meets weekly to discuss among others the liquidity state of the Bank.

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed lines of credit that it can access to meet liquidity needs. In addition, the Bank maintains a statutory deposit with the BSP equal to 18.00% of customer deposits. The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank.

The most important of these is to maintain limits on the ratio of liquid assets to deposit liabilities, set to reflect market conditions. Liquid assets consists of cash and cash equivalents, due from other banks, due from BSP, interbank call loans receivables and AFS investments.

Analysis of financial instruments by remaining contractual maturities

The tables below summarize the maturity profile of the Bank's financial instruments as of December 31, 2013 and 2012 based on undiscounted contractual payments. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history (amounts in millions):

	December 31, 2013					
	On demand	**Less than 3 months**	**3-12 months**	**1-2 years**	**Beyond 2 years***	**Total**
Financial Assets						
HFT debt instruments	**₱105**	**₱–**	**₱–**	**₱–**	**₱–**	**₱105**
AFS investments:						
Government securities	**–**	**7,320**	**538**	**1,387**	**29,773**	**39,018**
Loans and receivables:						
Due from BSP	**9,573**	**–**	**–**	**–**	**–**	**9,573**
Due from other banks	**661**	**–**	**–**	**–**	**–**	**661**
Interbank loans receivable and SPURA	**158**	**45**	**–**	**–**	**–**	**203**
Receivables from customers:						
Corporate	**–**	**9,606**	**3,724**	**1,060**	**4,283**	**18,673**
Consumer	**–**	**4**	**88**	**562**	**2,926**	**3,580**
Other assets:						
Derivatives						
Gross contractual receivable	**–**	**683**	**–**	**–**	**–**	**683**
Gross contractual payable	**–**	**(683)**	**–**	**–**	**–**	**(683)**
Total financial assets	**10,497**	**16,975**	**4,350**	**3,009**	**36,982**	**71,813**
Financial Liabilities						
Deposit liabilities						
Demand	**7,183**	**–**	**–**	**–**	**–**	**7,183**
Savings	**3,090**	**–**	**–**	**–**	**–**	**3,090**
Time	**2,152**	**31,816**	**303**	**1**	**2,941**	**37,213**
Bills payable						
PDIC	**–**	**7,658**	**–**	**–**	**–**	**7,658**
Banks and other financial institutions	**–**	**459**	**–**	**–**	**–**	**459**
Private firms and individuals	**–**	**1,581**	**26**	**–**	**–**	**1,607**
Outstanding acceptances	**43**	**–**	**–**	**–**	**–**	**43**
Manager's checks	**174**	**–**	**–**	**–**	**–**	**174**
Accrued interest payable	**59**	**35**	**–**	**–**	**–**	**94**
Accrued other expense	**169**	**–**	**–**	**–**	**–**	**169**
Other liabilities:						
Accounts payable	**103**	**–**	**–**	**–**	**–**	**103**
Refundable security deposits	**–**	**6**	**20**	**56**	**–**	**82**
Due to the Treasurer of the Philippines	**–**	**19**	**–**	**–**	**–**	**19**
Total financial liabilities	**₱12,973**	**₱41,574**	**₱349**	**₱57**	**₱2,941**	**₱57,894**

*Including non-performing loans and receivables

	December 31, 2012					
	On demand	Less than 3 months	3-12 months	1-2 years	Beyond 2 years*	Total
Financial Assets						
AFS investments:						
Government securities	₱–	₱314	₱815	₱8,749	₱15,564	₱25,442
Loans and receivables:						
Due from BSP	5,511	–	–	–	–	5,511
Due from other banks	887	–	–	–	–	887
Interbank loans receivable and SPURA	329	665	–	–	–	994
Receivables from customers:						
Corporate	–	7,038	3,438	140	3,254	13,870
Consumer	–	36	3	7	218	264
Other assets:						
Derivatives						
Gross contractual receivable	–	698	–	–	–	698
Gross contractual payable	–	(698)	–	–	–	(698)
Total financial assets	6,727	8,053	4,256	8,896	19,036	46,968
Financial Liabilities						
Deposit liabilities						
Demand	5,788	–	–	–	–	5,788
Savings	2,751	–	–	–	–	2,751
Time	772	16,265	5,255	588	80	22,960
Bills payable						
PDIC	–	19	57	7,659	–	7,735
Private firms and individuals	–	1,190	–	–	–	1,190
Outstanding acceptances	32	–	–	–	–	32
Manager's checks	67	–	–	–	–	67
Accrued interest payable	37	16	27	–	–	80
Accrued other expense	109	–	–	–	–	109
Other liabilities:						
Accounts payable	64	–	–	–	–	64
Refundable security deposits	1	8	28	59	–	96
Due to the Treasurer of the Philippines	–	11	–	–	–	11
Total financial liabilities	₱9,621	₱17,509	₱5,367	₱8,306	₱80	₱40,883

*Including non-performing loans and receivables

The table below shows the contractual expiry by maturity of the Bank's commitments and contingent liabilities as of December 31, 2013 and 2012 (amounts in millions):

	December 31, 2013				
	On demand	**Less than 3 months**	**3 to 12 months**	**Beyond 1 year**	**Total**
Unused Commercial LC:					
Standby LC	**₱71**	**₱137**	**₱948**	**₱–**	**₱1,156**
Sight LC outstanding	**18**	**189**	**117**	**–**	**324**
Usance LC outstanding	**4**	**522**	**11**	**–**	**537**
Outstanding shipping guarantees	**–**	**–**	**500**	**–**	**500**
	₱93	**₱848**	**₱1,576**	**₱–**	**₱2,517**

	December 31, 2012				
	On demand	Less than 3 months	3 to 12 months	Beyond 1 year	Total
Unused Commercial LC:					
Standby LC	₱1	₱64	₱360	₱54	₱479
Sight LC outstanding	14	129	74	–	217
Usance LC outstanding	12	87	1	–	100
Outstanding shipping guarantees	–	–	16	–	16
	₱27	₱280	₱451	₱54	₱812

The table below shows the different credit risk exposures of the Bank by risk weight applied in accordance with BSP Circular No. 538 (amounts in thousands):

	December 31, 2013						
	Net	**Risk Weights**[b]					
	Exposures[a]	**0%**	**20%**	**50%**	**75%**	**100%**	**150%**
On-balance sheet assets[c]	**₱65,630**	**₱29,896**	**₱137**	**₱3,603**	**₱–**	**₱31,602**	**₱392**
Credit risk weighted on-balance sheet assets[d = b x c]	**34,018**	**–**	**27**	**1,802**	**–**	**31,602**	**588**
Off-balance sheet assets[e]	**8,559**	**5,953**	**1,450**	**–**	**–**	**1,156**	**–**
Credit risk weighted off-balance sheet assets[f = b x e]	**1,446**	**–**	**290**	**–**	**–**	**1,156**	**–**
Total Credit Risk Weighted Assets[d + f]	**₱35,465**	**₱–**	**₱317**	**₱1,802**	**₱–**	**₱32,758**	**₱588**

(a) Net of specific provisions

	December 31, 2012						
	Net	Risk Weights[b]					
	Exposures[a]	0%	20%	50%	75%	100%	150%
On-balance sheet assets[c]	₱46,635	₱23,035	₱322	₱884	₱–	₱22,108	₱286
Credit risk weighted on-balance sheet assets[d = b x c]	23,042	–	64	442	–	22,108	429
Off-balance sheet assets[e]	6,817	5,998	340	–	–	479	–
Credit risk weighted off-balance sheet assets[f = b x e]	547	–	68	–	–	479	–
Total Credit Risk Weighted Assets[d + f]	₱23,590	₱–	₱132	₱442	₱–	₱22,587	₱429

(a) Net of specific provisions

Market Risk Management

Market risk is the risk of loss to future earnings, fair values or future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes. The Bank's market risk originates from its holdings of foreign exchange instruments, debt securities, equity securities and derivatives.

VaR

Value-at-Risk (VaR) is a statistical estimate of potential loss given prevailing market price trends, correlations and volatilities.

VaR estimates the potential decline in the value of a portfolio, under normal market conditions, a given "confidence level" over a specified time horizon.

VaR is used to alert senior management whenever the potential for losses in the Bank's portfolios exceeds the VaR limit. This allows management to react quickly and adjust its portfolio strategies in different market conditions in accordance with the Bank's risk philosophy and appetite.

In 2002, the Bank commenced using Bloomberg's Parametric VaR (PVaR) module in its VaR computation. Bloomberg's PVaR is run on a Parametric VaR model whose data set contains 1 year of historical prices and a daily update of its variance/covariance matrix. In accordance with BSP standards, the Bank uses a 99.00% confidence level and a 10-day defeasance period. This means, that statistically, the Bank's losses on trading operations will exceed VaR on at least 1 out of 100 trading business days.

The Market & Liquidity Risk Officer runs VaR on a daily basis, monitors the VaR against the Board approved VaR limit and submits Daily VaR Reports to concerned division/group/segment heads.

To verify the validity of the VaR model used, the Market & Liquidity Risk Manager through its quarterly back testing procedure examines how frequently actual daily losses exceeds the daily VaR. Backtesting results are reviewed by the Chief Risk Officer. Exceptions, if any, are reported to the ROC and the BOD.

There were 33 recorded exemptions in the USD ROP VaR limit and 19 in peso government securities primarily attributed to the unusual volatility in domestic market prices in 2013. The Market & Liquidity Risk Unit together with Treasury Segment, regularizes the exemptions in the VaR limit through re-evaluation and re-alignment of prevailing volatility in market prices to the business strategy and bankwide risk appetite. Results of re-evaluation and re-alignment arising from VaR limit exemptions was likewise reviewed and approved by the ROC and BOD. There was no recorded breach on VaR limit in 2012.

Since VaR is designed to describe risk in normal market conditions (i.e. 99.00% of the time), it may not capture potential losses in the extreme that occur following movements outside the prevailing market trend. Stress testing is done to address extreme market conditions.

A summary of the VaR position of the exposures of the Bank to changes in market conditions is as follows:

	Interest Rate	
	USD ROP (In USD MM)	**Peso GS (In Peso MM)**
2013-31 December	**2.42**	**550.78**
2013-Average Daily	**1.90**	**435.95**
2013-Highest	**2.83**	**636.36**
2013-Lowest	**1.22**	**187.59**

	Interest Rate	
	USD ROP (In USD MM)	Peso GS (In Peso MM)
2012-31 December	1.226	189.688
2012-Average Daily	1.728	214.282
2012-Highest	3.695	352.902
2012-Lowest	0.237	147.743

Stress testing

The Bank likewise performs stress testing on its FX trading position and on its outstanding investment portfolios. Stress testing is a technique used to determine the impact on earnings of above position/portfolios from conditions or scenarios deemed “extreme” but plausible. Stress testing is used to inform senior management as to where vulnerabilities in the Bank’s portfolio actually lie.

This helps them evaluate the Bank’s tolerance for risks and understand the combinations of risks that can produce large losses.

Unlike VaR, which reflects price behavior in everyday markets, stress tests simulate portfolio performance during abnormal market periods. Accordingly, they provide information about risks falling outside those typically captured by the VaR framework. Hence, losses resulting from stress tests are larger than the losses predicted by the VaR model.

The Bank's Market & Liquidity Risk Manager performs the stress testing of traded securities using uniform set of market stress shocks as prescribed by the BSP under their Uniform Stress Testing Program for Banks. The stress testing is conducted quarterly and its results are reported to the ROC and BOD.

To identify possible episodes of stress in the domestic financial market, Market & Liquidity Risk Management Unit employs the Citi Early Warning Signal Risk Index – Philippines that measure stress in economic and financial variables with a view of predicting weakness in local currencies. A reading above 0.5 means that stress is above average and a reading below 0.5 means that stress is below average. The risk index level is reported monthly to ALCO and quarterly to ROC.

Interest Rate Risk Management

Interest rate risk arises from the possibility that changes in the interest rates will affect future cash flows or the fair value of financial instruments. The Bank follows a prudent policy on managing its assets and liabilities so as to ensure that the exposure to fluctuations in interest rates is kept within acceptable limits.

A substantial proportion of the total loan portfolio is for a term of less than one year, and the majority of the balance of its medium-term portfolio is on a floating-rate basis. As of December 31, 2013 and 2012, 79.07% and 85.68%, respectively, of the Bank's total loan portfolio comprised floating rate loans which are repriced periodically by reference to the transfer pool rate which reflects the Bank's internal cost of funds. As a result of these factors, the Bank's exposure to interest rate fluctuations, and other market risks, is significantly reduced.

The Bank, in keeping with banking industry practice, aims to achieve stability and lengthen the term structure of its deposit base, while providing adequate liquidity to cover transactional banking requirements of customers. Interest is paid on substantial portion of demand accounts which constituted 15.19% and 18.46% respectively of total deposits of the Bank as of December 31, 2013 and 2012, respectively, and pays a variable interest rate of 0.13% to 1.00% and fixed rate of 0.13%. Rates on savings accounts and time deposit accounts, which constituted 6.54% and 78.27%, respectively, of total deposits as of December 31, 2013 and 8.77% and 72.77%, respectively, of total deposits as of December 31, 2012 are set by different criteria. Savings account rates are set by reference to prevailing market rates, while rates on time deposits and special savings accounts are usually priced by reference to rates applicable to prevailing rates on Philippine Treasury Bills and other money market instruments or, in the case of foreign currency deposits, Singapore Interbank Offer Rate and other benchmark dollar deposit rates in the Asian and international money markets with similar maturities.

The following table provides for the average EIR by period of maturity or repricing of the Bank as of December 31, 2013 and 2012:

	2013			2012		
	Less than 3 months	**3 months to 1 year**	**Greater than 1 year**	Less than 3 months	3 months to 1 year	Greater than 1 year
Peso-Denominated						
Assets						
Due from banks	**0.29%**	–	–	0.44%	–	–
Interbank loans	–	–	–	3.50%	–	–
Loans and receivables	**5.96%**	**6.34%**	**10.34%**	7.97%	8.10%	10.97%
Liabilities						
Deposit liabilities	**1.70%**	**1.55%**	**3.11%**	2.83%	2.63%	4.04%
Bills payable	**1.22%**	–	–	3.25%	–	–
Foreign Currency-Denominated						
Assets						
Due from banks	**0.24%**	–	–	0.27%	–	–
Interbank loans	**0.83%**	–	–	0.26%	–	–
Loans and receivables	**5.14%**	**5.42%**	**6.50%**	5.79%	5.98%	6.50%
Liabilities						
Deposit liabilities	**1.61%**	**1.57%**	**1.43%**	1.62%	1.81%	1.56%
Bills payable	**0.92%**	–	–	–	–	–

The Bank also monitors its exposure to fluctuations in interest rates by measuring the impact of interest rate movements on its interest income. This is done by modeling the impact of various changes in interest rates to the Bank's interest-related income and expenses.

The method by which the Bank measures the sensitivity of its assets and liabilities to interest rate fluctuations is by way of interest rate analysis. This analysis provides the Bank with a measure of the impact of changes in interest rates on the actual portfolio i.e., the risk exposure of future accounting income. The repricing gap is calculated by distributing the financial assets and financial liabilities into tenor buckets according to the time remaining to maturity or next repricing date and then obtaining the difference between the total of the repricing (interest sensitive) assets and repricing (interest sensitive) liabilities.

A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. Accordingly, during a period of rising interest rates, a bank with a positive gap would be better positioned than one with a negative gap to invest in or hold higher yielding assets more quickly than it would need to refinance its interest-bearing liabilities. During a period of falling interest rates, a bank with a positive gap would tend to see its 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.

The following tables set forth the asset-liability gap position of the Bank as of December 31, 2013 and 2012 (amounts in millions):

	December 31, 2013					
	Up to 1 month	**More than 1 month to 3 months**	**More than 3 to 12 months**	**More than 1 year but less than two years**	**Beyond two years**	**Total**
Assets						
Due from BSP	**₱9,573**	**₱–**	**₱–**	**₱–**	**₱–**	**₱9,573**
Due from other banks	**661**	**–**	**–**	**–**	**–**	**661**
Interbank loan receivables and SPURA	**203**	**–**	**–**	**–**	**–**	**203**
HFT financial assets	**–**	**–**	**–**	**–**	**105**	**105**
AFS investments	**62**	**7,157**	**–**	**–**	**12,828**	**20,047**
Loans and receivables	**2,443**	**5,787**	**3,688**	**1,326**	**6,377**	**19,621**
Total assets	**12,942**	**12,944**	**3,688**	**1,326**	**19,310**	**50,210**
Liabilities						
Deposit liabilities	**25,793**	**9,896**	**983**	**–**	**10,608**	**47,280**
Bills payable	**1,310**	**8,122**	**26**	**–**	**–**	**9,458**
Total liabilities	**27,103**	**18,018**	**1,009**	**–**	**10,608**	**56,738**
Asset-liability gap	**(₱14,161)**	**(₱5,074)**	**₱2,679**	**₱1,326**	**₱8,702**	**(₱6,528)**

	December 31, 2012					
	Up to 1 month	More than 1 month to 3 months	More than 3 to 12 months	More than 1 year but less than two years	Beyond two years	Total
Assets						
Due from BSP	₱5,511	₱–	₱–	₱–	₱–	₱5,511
Due from other banks	887	–	–	–	–	887
Interbank loan receivables and SPURA	994	–	–	–	–	994
AFS investments	20	–	71	8,038	8,615	16,744
Loans and receivables	2,562	4,464	3,334	125	2,943	13,428
Total assets	9,974	4,464	3,405	8,163	11,558	37,564
Liabilities						
Deposit liabilities	13,779	7,150	3,310	573	6,544	31,356
Bills payable	–	1,187	–	6,637	–	7,824
Total liabilities	13,779	8,337	3,310	7,210	6,544	39,180
Asset-liability gap	(₱3,805)	(₱3,873)	₱95	₱953	₱5,014	(₱1,616)

The following table demonstrates the sensitivity of the cumulative net position of risk-sensitive assets and risk-sensitive liabilities to a reasonable change in interest rates, with all other variables held constant, on the Bank's statements of income.

	2013			
(Amounts in millions)	**Changes in interest rates (in basis points)**			
Changes in interest rates (in basis points)	**+50**	**-50**	**+100**	**-100**
Change in annualized net interest income	**(₱32.64)**	**₱32.64**	**(₱65.28)**	**₱65.28**

	2012			
(Amounts in millions)	Changes in interest rates (in basis points)			
Changes in interest rates (in basis points)	+50	-50	+100	-100
Change in annualized net interest income	(₱8.08)	₱8.08	(₱16.16)	₱16.16

The following table sets forth the estimated change in the Bank's other comprehensive income due to a reasonably possible change in the market prices of quoted bonds classified under AFS securities, brought about by movement in the interest rate curve as of December 31, 2013 and 2012:

	2013			
	Change in interest rates (in basis points)			
(Amounts in millions)	**+50**	**+10**	**-10**	**-50**
Change in equity	**(₱685.61)**	**(₱141.60)**	**₱143.92**	**₱739.46**

	2012			
	Change in interest rates (in basis points)			
(Amounts in millions)	+50	+10	-10	-50
Change in equity	(₱530.28)	(₱109.34)	₱111.05	₱573.01

The table below shows the different market risk-weighted assets using the standardized approach in accordance with BSP Circular No. 538:

Type of Market Risk Exposure	**2013**	2012
Interest Rate Exposures	**₱73,187**	₱–
Foreign Exposures	**35,807**	24,764
2012-Lowest	**₱108,994**	₱24,764

Foreign Currency Risk Management

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Foreign currency liabilities generally consist of foreign currency-deposits in the Bank's FCDU account 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 Bank and foreign currency-denominated borrowings appearing in the regular books of the Bank.

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

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

The table summarizes the Bank's exposure to foreign exchange risk as of December 31, 2013 and 2012. Included in the table are the Bank's assets and liabilities at carrying amounts, categorized by currency (amounts in thousands and in Philippine peso equivalent).

	2013			2012		
	USD	**Others***	**Total**	USD	Others*	Total
Assets						
Loans and receivables:						
Due from other banks	**₱145,212**	**₱21,754**	**₱166,966**	₱73,832	₱29,631	₱103,463
Corporate loans	**462,991**	**–**	**462,991**	288,144	–	288,144
Accrued interest receivable	**1,251**	**–**	**1,251**	564	–	564
Accounts receivable	**1**	**–**	**1**	–	–	–
Other assets	**68**	**132**	**200**	63	117	180
Total assets	**₱609,523**	**₱21,886**	**₱631,409**	₱362,603	₱29,748	₱392,351
Liabilities						
Deposit liabilities:						
Savings	**–**	**2,291**	**2,291**	–	3,502	3,502
Time	**–**	**5,607**	**5,607**	–	4,977	4,977
Outstanding acceptances	**43,189**	**–**	**43,189**	32,322	–	32,322
Other liabilities:						
Others	**33**	**–**	**33**	31	–	31
Total liabilities	**₱43,222**	**₱7,898**	**₱51,120**	₱32,353	₱8,479	₱40,832
Net exposure	**₱566,301**	**₱13,988**	**₱580,289**	₱330,250	₱21,269	₱351,519

**Includes Euro, Australian Dollar, Japanese Yen, Swiss Franc, Canadian Dollar, Singapore Dollar*

The table below indicates the exposure of the Bank in USD on its non-trading monetary assets and liabilities. The analysis calculates the effect of a reasonable possible movement of the base currency rate against the USD, with all other variables held constant on the statement of income and statement of comprehensive income. A negative amount in the table reflects a potential net reduction in income or comprehensive income, while a positive amount reflects a potential net increase. The Bank's exposure in currencies other than USD is minimal.

	2013			
(Amounts in thousands)	**Changes in foreign exchange rates**			
Changes in foreign exchange rates	**+3.00%**	**-3.00%**	**+4.00%**	**-4.00%**
Change in annualized net income	**₱1,107**	**(₱1,043)**	**₱1,492**	**(₱1,377)**

	2012			
(Amounts in thousands)	Changes in foreign exchange rates			
Changes in foreign exchange rates	+3.00%	-3.00%	+4.00%	-4.00%
Change in annualized net income	₱9,908	(₱9,908)	₱13,210	(₱13,210)

As of December 31, 2013 and 2012, there is no impact on the Bank's OCI other than those already affecting profit and loss.

<u>Equity Price Risk Management</u>
Equity price risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks. The Bank holds a minimal amount of equity securities, hence any changes to equity prices are deemed to not significantly affect its financial performance.

Operational Risk
The Bank uses the Basic Indicator Approach in computing Operational Risk in accordance with BSP Circular No. 538 (amounts in millions):

	2013	2012
Average Gross Income (Previous 3 Years)	**₱2,006**	₱1,936
Capital Charge (Average Gross Income times 18.75%[(a)])	**376**	363
Risk Weighted Asset (Capital Charge times 10)	**₱3,761**	₱3,630

(a) Equivalent to adjusted capital charge of 15% of 125% to be consistent with required minimum Capital Adequacy Ratio of 10%

6. **Segment Information**

The Bank's operating businesses are organized and managed separately according to the nature of services provided and the different markets served with each segment representing a strategic business unit. In June 2013, the Bank effected in its quarterly reporting the change in its business segments which resulted from organizational changes introduced by the new management and shareholders to ensure focused delivery of products and services to potential and existing customers. The Bank's business segments are as follows:

Prosperity Banking - principally handling individual customers' deposits, and providing overdrafts and fund transfer facilities (formerly under Consumer Banking)

Convenience Banking - principally providing consumer type loans, i.e. Mortgage, Auto and Personal Loans (formerly under Consumer Banking);

Enterprise Banking - principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers (formerly under Corporate Banking);

Treasury - principally providing money market, trading and treasury services, as well as the management of the Bank's funding operations by use of treasury bills, government securities and placements and acceptances with other banks, through treasury and wholesale banking.

Trust Group - principally engaging in trust and other fiduciary business and performing investment management services and also functions as Trustee or Investment Manager.

Interest income is reported net as management primarily relies on net interest revenue as a performance measure, not the gross interest income and expense. Included under Treasury is the income support earned by the Bank from the FAA.

No revenue from transactions with a single external customer or counterparty amounted to 10.00% or more of the Bank's total revenue in 2013, 2012, and 2011.

For management purposes, business segment information provided to the Chief Operating Decision Maker (CODM) is based on the Regulatory Accounting Principles (RAP) submitted to BSP in compliance with the reportorial requirements under the Financial Reporting Package (FRP) for banks, which differ from PFRS. The CODM is the Bank's BOD.

The following table presents income and profit and certain asset and liability information regarding the Bank's operating segments as of and for the years ended December 31, 2013, 2012 and 2011 (amounts in thousands):

	2013								
	Prosperity Banking Segment	Enterprise Banking Segment	Treasury Segment	Convenience Banking Segment	Trust Group	Unallocated	RAP	RAP-PFRS Adjustments	Total
Revenue									
Total revenue	₱501,660	₱424,623	₱1,935,044	₱133,979	₱2,690	₱751,379	₱3,749,375	(₱275,548)	₱3,473,827
Other operating income	16,827	7,183	(2,312)	354	14,529	261,951	298,532	249,274	547,806
Total operating income	518,487	431,806	1,932,732	134,333	17,219	1,013,330	4,047,907	(26,274)	4,021,633
Compensation and fringe benefits	271,696	83,826	18,785	70,605	21,429	638,094	1,104,435	(24,255)	1,080,180
Taxes and licenses	124,760	54,409	201,270	217	1,595	86,564	468,815	(11,889)	456,926
Occupancy and equipment-related costs	105,148	835	229	3,232	292	20,795	130,531	–	130,531
Depreciation and amortization	55,185	5,020	2,065	4,142	1,335	163,737	231,484	(98,245)	133,239
Provision for (reversal of) credit and impairment losses	–	–	–	54	–	–	54	(402,729)	(402,675)
Other operating expenses	136,904	35,626	54,419	41,690	11,165	252,610	532,414	61,087	593,501
Net operating income (loss)	(₱175,206)	₱252,090	₱1,655,964	₱14,393	(₱18,597)	(₱148,470)	₱1,580,174	₱449,757	₱2,029,931
Segment Results									
Net interest income	₱448,221	₱277,866	₱385,336	₱125,484	₱2,690	₱748,939	₱1,988,536	(₱270,785)	₱1,717,751
Trading and securities gain – net	–	–	1,549,625	–	–	(4,262)	1,545,363	(4,763)	1,540,600
Rent income	–	–	–	–	–	256,294	256,294	–	256,294
Service charges, fees, and commissions	53,439	146,757	83	8,495	–	6,703	215,477	–	215,477
Foreign exchange gain (loss) – net	3,519	4,296	(2,341)	–	(12)	(23,229)	(17,767)	–	(17,767)
Profits from asset sold	72	–	–	–	–	32,393	32,465	(21,762)	10,703
Income from trust operations	5,502	2,438	–	–	14,541	–	22,481	–	22,481
Fair value gain from investment properties	–	–	–	–	–	–	–	248,913	248,913
Gains on foreclosures	–	–	–	–	–	–	–	23,385	23,385
Miscellaneous	7,734	449	29	354	–	(3,508)	5,058	(1,262)	3,796
Total operating income	518,487	431,806	1,932,732	134,333	17,219	1,013,330	4,047,907	(26,274)	4,021,633
Compensation and fringe benefits	271,696	83,826	18,785	70,605	21,429	638,094	1,104,435	(24,255)	1,080,180
Taxes and licenses	124,760	54,409	201,270	217	1,595	86,564	468,815	(11,889)	456,926
Occupancy and other equipment-related costs	105,148	835	229	3,232	292	20,795	130,531	–	130,531
Depreciation and amortization	55,185	5,020	2,065	4,142	1,335	163,737	231,484	(98,245)	133,239
Provision for (reversal of) credit and impairment losses	–	–	–	54	–	–	54	(402,729)	(402,675)
Other operating expenses	136,904	35,626	54,419	41,690	11,165	252,610	532,414	61,087	593,501
Total operating expense	693,693	179,716	276,768	119,940	35,816	1,161,800	2,467,733	(476,031)	1,991,702
Segment profit (loss)	(175,206)	252,090	1,655,964	14,393	(18,597)	(148,470)	1,580,174	449,757	2,029,931
Provision for income tax	–	5,969	85,322	–	–	226,743	318,034	79,012	397,046
Net income (loss)	(₱175,206)	₱246,121	₱1,570,642	₱14,393	(₱18,597)	(₱375,213)	₱1,262,140	₱370,745	₱1,632,885
Segment Assets									
Equity investment									
Property and equipment	₱288,629	₱–	₱–	₱–	₱–	₱1,788,557	₱2,077,186	(₱330,617)	₱1,746,569
Investment properties	–	–	–	–	–	3,126,568	3,126,568	697,651	3,824,219
Unallocated assets	7,796,020	19,041,379	19,309,388	2,007,431	80,126	11,563,951	59,798,295	(2,770,428)	57,027,867
Total segment assets	₱8,084,649	₱19,041,379	₱19,309,388	₱2,007,431	₱80,126	₱16,479,076	₱65,002,049	(₱2,403,394)	₱62,598,655
Total segment liabilities	₱44,485,826	₱43,189	₱5,034,349	₱–	₱–	₱10,691,159	₱60,254,523	(₱1,729,482)	₱58,525,041

	2012								
	Prosperity Banking Segment	Enterprise Banking Segment	Treasury Segment	Convenience Banking Segment	Trust Group	Unallocated	RAP	RAP-PFRS Adjustments	Total
Revenue									
Total revenue	₱363,701	₱255,329	₱704,025	₱1,039	₱4,480	₱1,057,768	₱2,386,342	₱26,334	₱2,412,676
Other operating income	15,994	10,234	12,653	–	11,289	458,389	508,559	(43,457)	465,102
Total operating income	379,695	265,563	716,678	1,039	15,769	1,516,157	2,894,901	(17,123)	2,877,778
Compensation and fringe benefits	228,831	44,111	17,644	11,746	12,480	422,654	737,466	(29,710)	707,756
Taxes and licenses	82,518	35,213	143,250	40	1,100	69,855	331,976	(8,343)	323,633
Occupancy and equipment-related costs	102,296	2,648	1,475	407	1,071	(10,178)	97,719	(685)	97,034
Depreciation and amortization	38,901	3,155	1,241	1,198	447	88,108	133,050	(55,158)	77,892
Reversal of credit and impairment losses	–	–	–	–	–	–	–	(1,265)	(1,265)
Other operating expenses	151,285	12,392	41,023	4,047	6,432	210,605	425,784	(27,997)	397,787
Net operating income (loss)	(₱224,136)	₱168,044	₱512,045	(₱16,399)	(₱5,761)	₱735,113	₱1,168,906	₱106,035	₱1,274,941
Segment Results									
Net interest income	₱322,756	₱153,628	₱232,523	₱775	₱4,480	₱770,992	₱1,485,154	₱19,852	₱1,505,006
Trading and securities gain – net	–	–	471,464	–	–	276,136	747,600	6,481	754,081
Rent income	–	–	–	–	–	303,852	303,852	(8,093)	295,759
Service charges, fees, and commissions	40,946	101,701	38	264	–	10,640	153,589	–	153,589
Foreign exchange gain (loss) – net	1,956	8,826	12,643	–	8	864	24,297	–	24,297
Profits from asset sold	–	–	–	–	–	154,186	154,186	(30,905)	123,281
Income from trust operations	3,606	499	–	–	11,281	–	15,386	–	15,386
Fair value loss from investment properties	–	–	–	–	–	–	–	(4,492)	(4,492)
Miscellaneous	10,431	909	10	–	–	(513)	10,837	34	10,871
Total Operating Income	379,695	265,563	716,678	1,039	15,769	1,516,157	2,894,901	(17,123)	2,877,778
Compensation and fringe benefits	228,831	44,111	17,644	11,746	12,480	422,654	737,466	(29,710)	707,756
Taxes and licenses	82,518	35,213	143,250	40	1,100	69,855	331,976	(8,343)	323,633
Occupancy and other equipment-related costs	102,296	2,648	1,475	407	1,071	(10,178)	97,719	(685)	97,034
Depreciation and amortization	38,901	3,155	1,241	1,198	447	88,108	133,050	(55,158)	77,892
Provision for (reversal of) credit and impairment losses	–	–	–	–	–	–	–	(1,265)	(1,265)
Other operating expenses	151,285	12,392	41,023	4,047	6,432	210,605	425,784	(27,997)	397,787
Total operating expense	603,831	97,519	204,633	17,438	21,530	781,044	1,725,995	(123,158)	1,602,837
Segment profit (loss)	(224,136)	168,044	512,045	(16,399)	(5,761)	735,113	1,168,906	106,035	1,274,941
Provision for income tax	–	2,371	84,801	–	1,065	203,179	291,416	(1,257)	290,159
Net income (loss)	(₱224,136)	₱165,673	₱427,244	(₱16,399)	(₱6,826)	₱531,934	₱877,490	₱107,292	₱984,782
Segment Assets									
Property and equipment	₱253,296	₱–	₱–	₱–	₱–	₱1,633,518	₱1,886,814	(₱548,985)	₱1,337,829
Unallocated assets	4,829,316	11,746,281	15,782,865	54,183	102,577	13,794,839	46,310,061	(1,816,723)	44,493,338
Total segment assets	₱5,082,612	₱11,746,281	₱15,782,865	₱54,183	₱102,577	₱15,428,357	₱48,196,875	(₱2,365,708)	₱45,831,167
Total segment liabilities	₱30,293,550	₱32,945	₱2,376,645	₱–	₱–	₱9,718,024	₱42,421,164	(₱981,667)	₱41,439,497

	2011							
	Prosperity Banking Segment	Enterprise Banking Segment	Treasury Segment	Trust Group	Unallocated	RAP	RAP-PFRS Adjustments	Total
Revenue								
Total revenue	₱514,284	₱186,772	₱373,750	₱1,550	₱630,004	₱1,706,360	(₱26,305)	₱1,680,055
Other operating income	12,681	18,808	(7,172)	15,504	562,707	602,528	104,061	706,589
Total operating income	526,965	205,580	366,578	17,054	1,192,711	2,308,888	77,756	2,386,644
Compensation and fringe benefits	230,478	43,846	20,309	14,983	248,823	558,439	35,003	593,442
Taxes and licenses	74,006	304	13,198	2	216,612	304,122	(9,552)	294,570
Occupancy and equipment-related costs	105,334	2,824	1,493	1,511	(15,637)	95,525	(5,005)	90,520
Depreciation and amortization	30,719	2,870	1,330	898	1,226,811	1,262,628	(1,203,822)	58,806
Reversal of credit and impairment losses	–	–	–	–	(130,108)	(130,108)	140,757	10,649
Other operating expenses	135,393	40,076	73,826	5,790	58,593	313,678	(153,552)	160,126
Net operating income (loss)	(₱48,965)	₱115,660	₱256,422	(₱6,130)	(₱412,383)	(₱95,396)	₱1,273,927	₱1,178,531

(Forward)

	2011							
	Prosperity Banking Segment	Enterprise Banking Segment	Treasury Segment	Trust Group	Unallocated	RAP	RAP-PFRS Adjustments	Total
Segment Results								
Net interest income	₱471,058	₱109,177	₱138,098	₱1,550	₱631,228	₱1,351,111	(₱34,722)	₱1,316,389
Trading and securities gain – net	–	–	235,615	–	(8,039)	227,576	8,417	235,993
Rent income	–	–	–	–	290,288	290,288	(600)	289,688
Service charges, fees, and commissions	43,226	77,595	38	–	6,814	127,673	–	127,673
Foreign exchange gain (loss) – net	1,717	8,606	(7,173)	(4)	42,747	45,893	–	45,893
Profits from asset sold	94	657	–	–	124,790	125,541	(117,233)	8,308
Income from trust operations	4,043	157	–	15,508	–	19,708	–	19,708
Fair value gain from investment properties	–	–	–	–	–	–	313,266	313,266
Gains on foreclosures	–	–	–	–	–	–	1,673	1,673
Miscellaneous	6,827	9,388	–	–	104,883	121,098	(93,045)	28,053
Total Operating Income	526,965	205,580	366,578	17,054	1,192,711	2,308,888	77,756	2,386,644
Compensation and fringe benefits	230,478	43,846	20,309	14,983	248,823	558,439	35,003	593,442
Taxes and licenses	74,006	304	13,198	2	216,612	304,122	(9,552)	294,570
Occupancy and other equipment-related costs	105,334	2,824	1,493	1,511	(15,637)	95,525	(5,005)	90,520
Depreciation and amortization	30,719	2,870	1,330	898	1,226,811	1,262,628	(1,203,822)	58,806
Provision for (reversal of) credit and impairment losses	–	–	–	–	(130,108)	(130,108)	140,757	10,649
Other operating expenses	135,393	40,076	73,826	5,790	58,593	313,678	(153,552)	160,126
Total Operating Expense	575,930	89,920	110,156	23,184	1,605,094	2,404,284	(1,196,171)	1,208,113
Segment profit (loss)	(48,965)	115,660	256,422	(6,130)	(412,383)	(95,396)	1,273,927	1,178,531
Provision for income tax	25,229	1,499	60,517	–	161,676	248,921	116,615	365,536
Net income (loss)	(₱74,194)	₱114,161	₱195,905	(₱6,130)	(₱574,059)	(₱344,317)	₱1,157,312	₱812,995
Segment Assets								
Property and equipment	₱220,085	₱–	₱–	₱–	₱757,134	₱977,219	(₱25,151)	₱952,068
Unallocated assets	4,830,426	6,706,150	15,313,258	103,596	17,505,691	44,459,121	(3,990,155)	40,468,966
Total segment assets	₱5,050,511	₱6,706,150	₱15,313,258	₱103,596	₱18,262,825	₱45,436,340	(₱4,015,306)	₱41,421,034
Total segment liabilities	₱26,629,123	₱98,654	₱2,690,311	₱–	₱9,233,559	₱38,651,647	(₱526,874)	₱38,124,773

Net operating gain (loss) after tax reported to the CODM which is based on RAP amounted to ₱1.26 billion, ₱877.49 million and (₱355.89) million in 2013, 2012 and 2011 respectively. The difference based on RAP and PFRS primarily represents the annual amortization of SPV losses (in 2011) and difference in the accounting treatment for investments properties and related transactions under RAP and PFRS.

7. Interbank Loans Receivable and Securities Purchased Under Resale Agreements

This account consists of:

	2013	2012
Interbank loans receivable	**₱202,550,011**	₱493,804,210
SPURA	**–**	500,000,000
	₱202,550,011	₱993,804,210

As of December 31, 2013 and 2012, interbank loans receivable is comprised of USD-denominated loans amounting to \$4.56 (₱202.55) million and \$12.03 (₱493.80) million, respectively.

Interest income on interbank loans receivable and SPURA follows:

	2013	2012	2011
SPURA	**₱9,377,792**	₱43,449,679	₱41,086,111
Interbank loans receivable	**698,088**	574,682	608,147
	₱10,075,880	₱44,024,361	₱41,694,258

Interbank loans receivable bears nominal annual interest rate ranging from 0.50% to 1.15% in 2013, from 0.10% to 0.40% in 2012 and from 0.10% to 0.29% in 2011, while SPURA bears nominal annual interest rate of 3.50% in 2013, and rates ranging from 3.50% to 4.41% in 2012 and from 4.00% to 4.70% in 2011.

The Bank is not permitted to sell or repledge the related collateral on SPURA in the absence of default by the counterparty.

8. Trading and Investment Securities

Held-for-trading financial assets
As of December 31, 2013, HFT financial assets pertain to the Bank's investments in USD-denominated government securities amounting to ₱104.91 million.

Both realized and unrealized gains and losses on HFT financial assets are included under 'Trading and securities gain - net' in the statements of income (see Note 22).

AFS investments
This account consists of investments in:

	2013	2012
Quoted:		
Government securities (Notes 15 and 21)	**₱20,047,034,488**	₱16,744,365,118
Equity securities	**31,740,000**	23,130,000
	20,078,774,488	16,767,495,118
Unquoted:		
Equity securities at cost	**18,476,933**	18,329,753
Less allowance for impairment losses (Note 13)	**7,169,500**	7,022,320
	11,307,433	11,307,433
	₱20,090,081,921	₱16,778,802,551

As of December 31, 2013 and 2012, the Bank's quoted government securities include government securities amounting to ₱7.70 billion and ₱7.58 billion, respectively, which are pledged as collateral to PDIC to secure loans under the FAA (Note 1). As of December 31, 2013 and 2012, the fair values of these government securities amounted to ₱7.90 billion and ₱8.41 billion, respectively.

On September 29, 2011, the Bank requested for the substitution of the government securities which are pledged as collateral for the ₱7.64 billion loan to PDIC with other government securities and/or other acceptable risk-free instruments. On January 5, 2012, the PDIC approved the Bank's request for the substitution. On February 10, 2012, the Bank started implementing the substitution with an initial tranche of new pledge amounting to ₱2.00 billion.

As of December 31, 2013 and 2012, net unrealized gains (losses) on AFS investments amounted to (₱1.22) billion and ₱0.67 billion, respectively.

The movements in net unrealized gains (losses) on AFS investments follow:

	2013	2012
Balance at beginning of year	**₱672,789,188**	₱1,723,163,315
Changes in fair value of AFS investments	**(371,619,220)**	(312,305,083)
Securities gains from sale of AFS investments taken to profit or loss (Note 22)	**(1,520,582,609)**	(738,069,044)
	(1,892,201,829)	(1,050,374,127)
Balance at end of year	**(₱1,219,412,641)**	₱672,789,188

Reclassification

The 2008 global credit crunch had prompted the IASB to issue the Amendments to International Accounting Standards 39 and International Financial Reporting Standards 7, which was adopted by the Philippine Financial Reporting Standards Council as amendments to PAS 39 and PFRS 7, respectively. These amendments permitted the Bank to revisit the existing classification of its financial assets.

The Bank identified financial assets eligible under the amendments amounting to ₱164.63 million, for which it had a clear change of intent to hold for the foreseeable future rather than to exit or trade in the short-term and reclassified such assets from HFT financial assets to HTM investments under rare circumstance (i.e., global credit crunch) on July 1, 2008.

These securities and the rest of the HTM investments were subsequently reclassified to AFS investments in 2010 due to tainting. The HTM investments were tainted after the Bank exchanged ROP 19 bonds with carrying value of ₱102.87 million for ROP 34 with carrying value of ₱125.85 million under the bond exchange program of the Philippine Government on October 6, 2010. Gain realized in 2010 from the exchange amounting to ₱22.98 million is included under trading and securities gain - net.

As at the date of reclassification, the EIR of the outstanding reclassified security was 7.75%. The Bank expects to recover approximately the reclassified instrument's carrying amounts as of December 31, 2013 and 2012.

Had the above investments not been reclassified out of HFT financial assets, market gains of ₱4.19 million, ₱4.00 million and ₱4.51 million would have been credited to the statements of income in 2013, 2012 and 2011, respectively.

9. Loans and Receivables

This account consists of:

	December 31, 2013	December 31, 2012
Receivables from customers:		
Corporate loans	**₱17,477,436,832**	₱13,376,808,134
Consumer loans	**2,143,850,613**	51,075,494
	19,621,287,445	13,427,883,628
Unearned discounts and capitalized interest	**(23,554,403)**	(13,110,367)
	19,597,733,042	13,414,773,261
Unquoted debt securities	**5,696,615,467**	3,376,220,500
Accrued interest receivable	**952,622,683**	831,144,496
Accounts receivable	**563,590,529**	542,078,966
Sales contracts receivable	**109,029,192**	125,758,447
	26,919,590,913	18,289,975,670
Less allowance for credit losses (Note 13)	**(1,922,167,081)**	(2,332,481,130)
	₱24,997,423,832	₱15,957,494,540

BSP Reporting

Information on the concentration of credit as to industry of the Bank before taking into account the allowance for credit losses follows (amounts in thousands):

	2013		2012	
	Amount	%	Amount	%
Wholesale and retail trade	**₱6,345,555**	**32.38**	₱4,959,398	36.97
Manufacturing	**4,022,305**	**20.52**	3,765,339	28.07
Real estate, renting and business activities	**2,097,601**	**10.70**	1,249,292	9.31
Financial intermediaries	**1,645,643**	**8.40**	706,166	5.26
Transport, storage and communication	**1,334,560**	**6.81**	1,193,988	8.90
Construction	**985,457**	**5.03**	804,709	6.00
Agriculture, hunting and forestry	**481,643**	**2.46**	156,220	1.16
Mining and quarrying	**447,580**	**2.28**	129,183	0.96
Others	**2,237,389**	**11.42**	450,478	3.37
	₱19,597,733	**100.00**	₱13,414,773	100.00

The information (gross of unearned discounts and capitalized interest) relating to receivable from customers as to secured and unsecured and as to collateral follows (amounts in thousands):

	2013		2012	
	Amount	%	Amount	%
Loans secured by:				
Real estate	**₱1,220,218**	**6.22**	₱2,170,653	16.16
Deposit hold-out	**942,980**	**4.80**	1,755,978	13.08
Chattel	**784,156**	**4.00**	804,179	5.99
Securities and others	**47,265**	**0.24**	56,204	0.42
Secured	**2,994,619**	**15.26**	4,787,014	35.65
Unsecured loans	**16,626,668**	**84.74**	8,640,870	64.35
	₱19,621,287	**100.00**	₱13,427,884	100.00

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

	December 31	
	2013	2012
Secured	**₱116,277,159**	₱201,252,355
Unsecured	**1,124,707,054**	1,101,833,767
	₱1,240,984,213	₱1,303,086,122

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.

As of December 31, 2012, under previous banking regulations, NPLs net of those which are fully provided with allowance for credit losses of ₱1.17 billion, amounted to ₱131.37 million.

As of December 31, 2013, based on the revised definition of NPLs under Circular No. 772, NPLs of ₱117.90 million which the Bank reported to the BSP are net of specific allowance amounting to ₱1.12 billion. Gross and net NPL ratios of the Bank are 6.36% and 0.60%, respectively.

Unquoted Debt Securities

As of December 31, 2013 and 2012, unquoted debt securities consist of the following:

	2013	2012
Investments in:		
Fixed-Rate Corporate Notes	**₱3,297,000,000**	₱–
Metro Rail Transit (MRT) bonds	**2,399,615,467**	2,249,847,364
Home Guaranty Corporation bonds	**–**	1,004,123,136
RFM Corporation bonds	**–**	122,250,000
	₱5,696,615,467	₱3,376,220,500

In 2012, the Bank changed its estimates of the timing of collection of its investment in MRT bonds which are now based on the expected settlement dates. The change in estimate resulted in acceleration of the accretion of discount on and increased the carrying value of MRT bonds. The effect of the change in estimate amounting to $4.99 (₱204.84) million, which was accounted for prospectively, is credited to income in accordance with PAS 39 (Note 3). Under PAS 39, if an entity revises its estimates of receipts, the entity shall adjust the carrying amount of the financial asset to reflect actual and revised estimated cash flows. The entity is required to recalculate the carrying amount by computing the present value of estimated future cash flows at the original effective interest rate. The adjustment is recognized in profit or loss.

As of December 31, 2013, unquoted debt instruments include corporate notes with par value of ₱3.30 billion which contain embedded prepayment options that allow the issuers to redeem these notes prior to the notes' respective maturities. The notes have maturities ranging from 7 to 10 years. The Bank assessed that these options are clearly and closely related to the host note instruments, since their redemption price approximate the notes' amortized cost on redemption dates. Accordingly, these prepayment options were not accounted for separately from the host note instruments.

<u>Accounts Receivable</u>
Included in Accounts receivable is the tax withheld by the Bureau of Treasury (BTr) from the payment of the face value of the PEACe bonds upon their maturity. The receivable from BTr constitutes 75.53% and 90.96% of the total carrying amount of the accounts receivable as of December 31, 2013 and 2012, respectively. The Bank's investments in PEACe bonds with a total face value of ₱3.00 billion matured on October 18, 2011.

Upon investing until the PEACe bonds matured, the Bank treated these PEACe bonds as tax-exempt investments in accordance with Bureau of Internal Revenue (BIR) Ruling 020-2001 which the BIR has issued in 2001 to address the taxation of interest income from such bonds. Under BIR Ruling 020-2001, PEACe bonds were not considered to be a "public" borrowing having been issued to less than 20 investors, thus the bonds are not considered as "deposit substitutes" by virtue of Section 22Y of the 1997 Tax Code. Accordingly, interest income realized from the issuance of PEACe bonds was not subjected to the 20.00% final withholding tax (FWT).

However, on October 7, 2011, the BIR issued Ruling No. 370-2011 citing that the PEACe bonds are in the nature of deposit substitutes, thus the interest income on such bonds is subject to the 20.00% FWT. The decision under BIR Ruling No. 370-2011 was based on Rulings DA-491-04 and Ruling No. 008-05 which the BIR issued on September 13, 2004 and July 28, 2005, respectively.

These rulings effectively reversed BIR Ruling 020-2001 by stating that the mere issuance of government debt instruments and securities is deemed as falling within the coverage of "deposit substitutes" irrespective of the number of lenders at the time of the origination and therefore interest income derived therefrom shall be subject to the applicable final tax rate as provided under Section 27(D)(1) of the 1997 Tax Code.

Due to BIR Ruling No. 370-2011, which imposes the withholding of the 20.00% FWT, the Bank and seven other investor banks have filed a case against the Government, the BIR, the BIR Commissioner, the Department of Finance (DoF), the Secretary of Finance, the BTr and the National Treasurer (collectively the 'Respondents') with the following prayers:

a) annul BIR Ruling 370-2011 and related BIR rulings of the same tenor and import, for being unconstitutional; and

b) prohibit the Respondents from imposing the 20.00% FWT or collecting it from the investor banks and/or the Respondents, particularly the BTr, to pay the full amount of the PEACe bonds in full upon maturity.

On October 18, 2011, the Supreme Court (SC) issued a temporary restraining order (TRO) in favor of the investor banks which ordered the following:
a) the Government to remit the full payment for the PEACe bonds to the banks; and
b) the banks to deposit in an escrow account an amount equivalent to the 20.00% FWT.

However, the BTr did not observe the TRO claiming that it was received only a day after withholding of the FWT was made. On November 8, 2011, the investor banks filed a Manifestation with Urgent Ex Parte Motion to the SC to direct the Government to comply with the TRO.

On November 2, 2011, the BIR filed its comments on the petition filed by the investor banks to the SC. On December 1, 2011, the investor banks filed its replies in response to the BIR comments. The SC has yet to provide its decision on the case based on the replies received from the investor banks and the BIR. The banks filed a Manifestation with Urgent Reiterative Motion to Direct Respondents to comply with the TRO dated November 27, 2012 to which the Public Respondents filed their Comment dated April 11, 2013. On June 5, 2013, the banks filed a Motion for Leave to File and Admit Attached Reply.

As discussed in more detail in Note 2, the Bank considers several factors in determining whether a financial asset is impaired, including the present value of the expected future cash flows discounted at the asset's original contractual effective rate. As of December 31, 2013 and 2012, the Bank, in consultation with its legal counsel has determined that the principal amount of the PEACe bonds is collectible.

<u>Interest Income</u>
Interest income on loans and receivables consists of interest income on:

	2013	2012	2011
Receivables from customers:			
Corporate	**₱725,062,511**	₱586,140,537	₱505,547,827
Consumer	**136,136,278**	4,929,818	11,263,032
Unquoted debt securities	**403,144,415**	498,716,490	432,973,001
Others	**11,185,843**	10,962,185	12,795,162
	₱1,275,529,047	₱1,100,749,030	₱962,579,022

There were no interest income accreted from impaired loans and receivables in 2013, 2012 and 2011.

Of the total receivables from customers of the Bank as of December 31, 2013 and 2012, 79.07% and 85.68%, respectively, are subject to periodic interest repricing. The remaining peso-denominated receivables from customers earn annual fixed interest rates ranging from 1.38% to 34.90% in 2013, from 4.00% to 15.00% in 2012 and from 4.50% to 18.00% in 2011, respectively, while foreign currency-denominated receivables from customers earn annual fixed interest rates of from 3.70% to 9.82% in 2013, from 4.00% to 9.25% in 2012 and from 5.00% to 9.82% in 2011.

Unquoted debt securities have effective interest rates ranging from 5.25% to 11.90% in 2013, from 3.75% to 11.90% in 2012 and from 4.25% to 11.90% in 2011. Sales contracts receivable bears interest rate ranging from 5.55% to 24% in 2013, from 7.00% to 24.00% in 2012, and from 8.00% to 18.00% in 2011.

10. Property and Equipment

The composition of and movements in property and equipment carried at cost follow:

	2013				
	Condominium Properties (Note 11)	**Buildings and Improvements**	**Furniture, Fixtures and Equipment**	**Leasehold Improvements - Net**	**Total**
Cost					
Balance at beginning of year	**₱773,468,661**	**₱303,389,013**	**₱657,975,669**	**₱29,152,395**	**₱1,763,985,738**
Additions	**27,220,153**	**63,547,883**	**203,664,050**	**114,907,446**	**409,339,532**
Disposals	**–**	**–**	**(69,893,599)**	**–**	**(69,893,599)**
Transfers (Note 11)	**87,851,798**	**–**	**–**	**–**	**87,851,798**
Amortization	**–**	**–**	**–**	**(15,432,989)**	**(15,432,989)**
Balance at end of year	**888,540,612**	**366,936,896**	**791,746,120**	**128,626,852**	**2,175,850,480**
Accumulated Depreciation					
Balance at beginning of year	**106,651,556**	**234,332,505**	**460,145,060**	**–**	**801,129,121**
Depreciation	**21,424,845**	**9,322,422**	**66,513,244**	**–**	**97,260,511**
Disposals	**–**	**–**	**(52,079,077)**	**–**	**(52,079,077)**
Balance at end of year	**128,076,401**	**243,654,927**	**474,579,227**	**–**	**846,310,555**
Accumulated Impairment (Note 13)					
Balance at beginning of year	**–**	**–**	**2,694,838**	**–**	**2,694,838**
Reversals	**–**	**–**	**(2,694,838)**	**–**	**(2,694,838)**
Balance at end of year	**–**	**–**	**–**	**–**	**–**
Net Book Value at End of Year	**₱760,464,211**	**₱123,281,969**	**₱317,166,893**	**₱128,626,852**	**₱1,329,539,925**

	2012				
	Condominium Properties (Note 11)	Buildings and Improvements	Furniture, Fixtures and Equipment	Leasehold Improvements - Net	Total
Cost					
Balance at beginning of year	₱514,259,019	₱313,491,727	₱514,057,927	₱25,259,119	₱1,367,067,792
Additions	6,689,752	1,561,470	180,672,158	16,447,814	205,371,194
Disposals	–	–	(36,754,416)	–	(36,754,416)
Transfers (Note 11)	252,519,890	(11,664,184)	–	–	240,855,706
Amortization	–	–	–	(12,554,538)	(12,554,538)
Balance at end of year	773,468,661	303,389,013	657,975,669	29,152,395	1,763,985,738
Accumulated Depreciation					
Balance at beginning of year	96,949,918	229,855,476	453,527,473	–	780,332,867
Depreciation	9,701,638	10,858,815	37,809,315	–	58,369,768
Disposals	–	–	(31,191,728)	–	(31,191,728)
Transfers (Note 11)	–	(6,381,786)	–	–	(6,381,786)
Balance at end of year	106,651,556	234,332,505	460,145,060	–	801,129,121
Accumulated Impairment (Note 13)					
Balance at beginning of year	–	3,967,216	–	–	3,967,216
Provisions (Reversals)	–	(3,967,216)	2,694,838	–	(1,272,378)
Balance at end of year	–	–	2,694,838	–	2,694,838
Net Book Value at End of Year	₱666,817,105	₱69,056,508	₱195,135,771	₱29,152,395	₱960,161,779

The condominium properties and buildings have fair values of ₱992.63 million and ₱223.84 million, respectively, as of December 31, 2013 and ₱846.93 million and ₱206.25 million, respectively, as of December 31, 2012.

Details of land carried at appraised value are as follows:

	2013	2012
Cost		
Balance at beginning of year	**₱117,677,688**	₱130,092,688
Transfers (Note 11)	**–**	(12,415,000)
Balance at end of year	**117,677,688**	117,677,688
Appraisal Increment		
Balance at beginning of year	**266,984,012**	247,515,062
Additions	**52,164,000**	39,964,950
Reversals	**(19,796,700)**	(20,496,000)
Balance at end of year	**299,351,312**	266,984,012
Less Allowance for Impairment Losses (Note 13)	**–**	6,994,000
	₱417,029,000	₱377,667,700

Depreciation and Amortization
Details of this account are as follows:

	2013	2012	2011
Property and equipment	**₱112,693,500**	₱70,924,306	₱50,402,924
Software cost (Note 12)	**20,545,357**	6,967,828	8,403,727
	₱133,238,857	₱77,892,134	₱58,806,651

11. **Investment Properties**

The composition of and movements in this account follow:

	2013			
	Foreclosed Properties			
	Land	**Building and improvements**	**Total**	**Condominium units for lease**
Balance at beginning of year	**₱277,267,857**	**₱98,545,444**	**₱375,813,301**	**₱3,220,308,474**
Additions	**94,479,990**	**3,753,376**	**98,233,366**	**20,478,820**
Disposals	**(37,351,799)**	**(14,324,701)**	**(51,676,500)**	**–**
Transfers (Note 10)	**–**	**–**	**–**	**(87,851,798)**
Net gain from fair value adjustments	**31,829,597**	**28,354,195**	**60,183,792**	**188,729,530**
Balance at end of year	**₱366,225,645**	**₱116,328,314**	**₱482,553,959**	**₱3,341,665,026**

	2012			
	Foreclosed Properties			
	Land	Building and improvements	Total	Condominium units for lease
Balance at beginning of year	₱321,915,270	₱110,319,124	₱432,234,394	₱3,466,407,778
Additions	–	–	–	6,420,586
Disposals	(55,391,163)	(14,235,630)	(69,626,793)	–
Transfers (Note 10)	12,415,000	5,282,398	17,697,398	(252,519,890)
Net loss from fair value adjustments	(1,671,250)	(2,820,448)	(4,491,698)	–
Balance at end of year	₱277,267,857	₱98,545,444	₱375,813,301	₱3,220,308,474

Condominium units for lease represents the contributed cost of developing the Bank's Ayala Avenue property, originally consisting of land and fully depreciated building, into a 52-storey building named PBCom Tower under a joint development agreement with Filinvest Asia Corporation (Filinvest Asia).

The agreement provided for equal sharing of the cost of the project and, correspondingly, of the net usable area of the building, which was converted into a condominium property. Under the agreement, the Bank's share in such cost included its land along Ayala Avenue, which was given an appraised value of ₱900.00 million in 1995. The related appraisal increment was closed to surplus, net of applicable deferred tax liability, upon completion of the project in 2000.

In November 2007, by virtue of condominiumization, various CCTs under the name of the Bank were derived from TCT No. 134599 wherein the declaration of restrictions and scope of coverage were annotated on October 23, 2007.

In November 2012, management, for administrative purposes and operational efficiencies, decided to use half of 15th floor and the entire 18th floor of PBCom Tower in order to house the Bank's employees working in the Binondo and Makati Offices. In June 2013, management decided to use the other half of 15th floor for the same purpose. Accordingly, the carrying values of these units were reclassified to property and equipment as of December 31, 2013 and 2012.

As of December 31, 2013 and 2012, about 76.60% and 78.57%, respectively, of the usable area that the Bank acquired under such project is held for lease or sale, with the balance used for the Bank's operations. Accordingly, the cost allocable to the area held for lease is carried as investment properties, while the remaining balance is carried as condominium property and included in 'Property and equipment' at cost (Note 10).

The Bank recognized rental income (shown under 'Rent income' in the statements of income) amounting to ₱248.35 million, ₱287.78 million and ₱281.49 million in 2013, 2012 and 2011, respectively, on condominium properties leased out under operating leases.

In 2013, 2012 and 2011, gain recognized by the Bank arising from foreclosure of loan collaterals amounted to ₱23.38 million, nil and ₱1.67 million, respectively.

In 2013, 2012 and 2011, gain recognized by the Bank for disposal of its foreclosed assets amounted to ₱10.70 million, ₱123.80 million, and ₱8.31 million, respectively.

Direct operating expenses (included under various operating expenses) arising from investment properties that generated rental income amounted to ₱84.12 million, ₱21.69 million, and ₱53.97 million in 2013, 2012, and 2011, respectively.

Direct operating expenses (included under various operating expenses) arising from investment properties that did not generate rental income amounted to ₱15.58 million, ₱31.81 million, and ₱25.52 million in 2013, 2012, and 2011, respectively.

The BSP, based on BSP Circular No. 494, requires that foreclosed assets be booked initially at the carrying amount of the loan plus booked accrued interest less allowance for probable losses plus transaction costs incurred upon acquisition.

Had the foreclosed assets been booked based on BSP Circular No. 494 and the condominium units for lease are booked using the cost model, investment properties as of December 31, 2013, 2012 and 2011 would have been ₱3.38 billion, ₱3.47 billion and ₱2.51 billion, respectively. Net income in 2013, 2012 and 2011 would have been decreased by ₱61.40 million, ₱29.50 million and ₱158.43 million, respectively.

12. Other Assets

This account consists of:

	2013	2012
Software cost	**₱333,533,377**	₱52,419,574
Receivable from BIR	**283,810,571**	304,516,212
Tax credits	**113,424,922**	66,078,128
Branch licenses	**102,100,153**	102,100,153
Prepaid expenses	**51,357,944**	63,500,523
Interoffice float items-net	**47,822,055**	–
Returned Checks and Other Cash Items (RCOCI)	**6,158,630**	5,691,411
Derivative assets (Note 20)	**–**	2,146,917
Miscellaneous	**340,744,375**	279,129,320
	1,278,952,027	875,582,238
Less allowance for impairment losses (Note 13)	**620,776,739**	657,774,839
	₱658,175,288	₱217,807,399

Software Cost
The movements of software cost follow:

	2013	2012
Balance at beginning of year	**₱52,419,574**	₱2,825,568
Additions during the year	**301,659,160**	56,561,834
	354,078,734	59,387,402
Amortization during the year (Note 10)	**(20,545,357)**	(6,967,828)
	₱333,533,377	₱52,419,574

Additions in 2013 include costs of the new core banking system of the Bank amounting to ₱171.61 million. These software costs will be available for use in February 2014. Also, licenses for internet banking solutions and enrollment application platform were included as software cost additions in 2013 and 2012.

Branch Licenses
As of December 31, 2013 and 2012, branch licenses have been provided with full allowance.

Miscellaneous
Refundable security deposits recorded under 'Miscellaneous' amounted to ₱25.20 million and ₱18.08 million as of December 31, 2013 and 2012, respectively.

As of December 31, 2013 and 2012, Miscellaneous included the amount of ₱6.08 million representing the balance of the escrow account which the Bank, the SPV and a local bank entered into under an Escrow Agreement as part of the Asset Sale Purchase Agreement (ASPA). The amount in the escrow represents the portion that has to be retained to secure the fulfillment by the Bank of its representations and warranties and to apply any adjustment in the purchase price in accordance with the ASPA.

Miscellaneous also includes assets amounting to ₱209.66 million and ₱209.56 million as of December 31, 2013 and 2012, respectively, which are provided with 100% allowance provision.

13. Allowance for Credit and Impairment Losses

Changes in the allowance for credit and impairment losses follow (amounts in thousands):

	2013	2012
Balance at beginning of year:		
AFS investments (Note 8)	**₱7,022**	₱6,081
Loans and receivables (Note 9)	**2,332,481**	2,418,271
Property and equipment (Note 10)	**9,689**	12,275
Other assets (Note 12)	**657,775**	582,520
	3,006,967	3,019,147
Reversal of credit and impairment losses	**(402,675)**	(1,265)
Revaluation of FCDU loans	**1,874**	(2,658)
Accounts written off and others	**(56,052)**	(8,257)
	(456,853)	(12,180)
Balance at end of year:		
AFS investments (Note 8)	**7,170**	7,022
Loans and receivables (Note 9)	**1,922,167**	2,332,481
Property and equipment (Note 10)	**–**	9,689
Other assets (Note 12)	**620,777**	657,775
	₱2,550,114	₱3,006,967

Below is the breakdown of provisions for (reversals of) credit and impairment losses (amounts in thousands):

	2013	2012	2011
AFS investments	**₱–**	₱941	₱–
Loans and receivables	**(389,935)**	–	14,147
Property and equipment	**(6,994)**	(2,586)	(3,498)
Other assets	**(5,746)**	380	–
	(₱402,675)	(₱1,265)	₱10,649

With the foregoing level of allowance for credit and impairment losses, management believes that the Bank has sufficient allowance to take care of any losses that the Bank may incur from the noncollection or nonrealization of its receivables and other risk assets. A reconciliation of the allowance for credit losses by class of loans and receivables follows (in thousands):

	2013			
	Corporate	**Consumer**	**Others***	**Total**
Balance at beginning of year	**₱1,662,444**	**₱6,069**	**₱663,968**	**₱2,332,481**
Revaluation	**1,874**	**–**	**–**	**1,874**
Provisions (reversal) during the year	**(421,680)**	**31,745**	**–**	**(389,935)**
Others**	**(35,585)**	**–**	**13,332**	**(22,253)**
Balance at end of year	**₱1,207,053**	**₱37,814**	**₱677,300**	**₱1,922,167**
Individual impairment	**₱828,563**	**–**	**₱489,462**	**₱1,318,025**
Collective impairment	**378,490**	**37,814**	**187,838**	**604,142**
	₱1,207,053	**₱37,814**	**₱677,300**	**₱1,922,167**
Gross amount of loans individually determined to be impaired	**₱1,162,900**	**₱14,383**	**₱597,157**	**₱1,774,440**

*This includes allowance for credit losses on accounts receivables, accrued interest receivables and sales contract receivables.
**This includes transfers and write-offs.

	2012			
	Corporate	Consumer	Others*	Total
Balance at beginning of year	₱1,782,566	₱6,069	₱629,636	₱2,418,271
Revaluation	(2,658)	–	–	(2,658)
Others**	(117,464)	–	34,332	(83,132)
Balance at end of year	₱1,662,444	₱6,069	₱663,968	₱2,332,481
Individual impairment	₱825,177	₱–	₱388,206	₱1,213,383
Collective impairment	837,267	6,069	275,762	1,119,098
	₱1,662,444	₱6,069	₱663,968	₱2,332,481
Gross amount of loans individually determined to be impaired	₱1,152,314	₱–	₱572,972	₱1,725,286

*This includes allowance for credit losses on accounts receivables, accrued interest receivables and sales contract receivables.
**This includes transfers and write-offs.

14. Deposit Liabilities

On March 29, 2012, BSP Circular No. 753 was issued providing unification of the statutory and liquidity reserve requirements, 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. As of December 31, 2013 and 2012, the Bank is in compliance with such regulation.

As of December 31, 2013 and 2012, Due from BSP amounting to ₱8.23 billion and ₱5.26 billion, respectively, were set aside as reserves for deposit liabilities.

Interest expense on deposit liabilities consists of:

	2013	2012	2011
Demand	**₱32,299,190**	₱46,215,337	₱44,271,797
Savings	**8,386,954**	15,005,957	16,541,586
Time	**648,792,954**	723,342,580	745,088,393
	₱689,479,098	₱784,563,874	₱805,901,776

Peso-denominated deposit liabilities earn annual fixed interest rates ranging from 0.13% to 3.50%, 0.50% to 4.00% and 0.75% to 4.50% in 2013, 2012 and 2011, respectively, while foreign currency-denominated deposit liabilities earn annual fixed interest rates ranging from 0.25% to 2.00%, 0.13% to 2.25% and 0.50% to 2.25% in 2013, 2012 and 2011, respectively.

15. Bills Payable

This account consists of borrowings from:

	2013	2012
Banks and other financial institutions	**₱7,852,560,353**	₱6,636,777,800
Private firms and individuals	**1,605,680,585**	1,186,734,856
	₱9,458,240,938	₱7,823,512,656

Borrowings from banks and other financial institutions include borrowing from the PDIC with loan principal amounting to ₱7.64 billion, which are fully secured by government securities under the FAA, as discussed in Note 1. The fair values of the government securities used as collateral for the PDIC loan amounted to ₱7.90 billion and ₱8.41 billion, as of December 31, 2013 and 2012, respectively. The borrowing from PDIC was measured initially at fair value and carried at amortized cost of ₱7.44 billion and ₱6.64 billion, as of December 31, 2013 and 2012, respectively. As of December 31, 2013 and 2012, the related unamortized day 1 gain on bills payable to PDIC which is presented as "Unearned income" under Other liabilities amounted to ₱197.64 million and ₱972.20 million, respectively (Note 17).

Interest expense on bills payable and other borrowings consists of:

	2013	2012	2011
Financial assistance	**₱802,372,613**	₱706,659,555	₱624,051,417
Borrowed funds	**120,457,942**	130,645,115	147,100,510
Net interest cost on defined benefit liability (Note 23)	**13,868,129**	13,011,512	12,187,013
	₱936,698,684	₱850,316,182	₱783,338,940

Dollar interbank borrowings amounted to ₱413.41 million and nil as of December 31, 2013 and 2012, respectively. Dollar interbank borrowings are subject to annual floating interest rates of 0.92% in 2013, 1.12% in 2012 and 0.88% to 0.90% in 2011. As of December 31, 2013, the dollar interbank borrowings of the Bank are collateralized by ROP bonds classified under AFS investments with fair value of ₱557.61 billion. The Bank has not availed of peso and dollar rediscounting facilities in 2013 and 2012. Further, it has no peso interbank borrowings as of December 31, 2013 and 2012.

Borrowings from private firms and individuals represent deposit substitutes with maturities of 30 to 90 days and bear annual interest rates ranging from 0.92% to 2.31%, from 2.50% to 4.00% and from 3.00% to 5.00%, in 2013, 2012 and 2011, respectively.

As of December 31, 2013 and 2012, Due from BSP amounting to ₱286.37 million and ₱211.97 million, respectively were set aside as reserves for deposit substitutes.

16. Accrued Interest, Taxes and Other Expenses

This account consists of:

	2013	2012 (As restated- Note 2)
Financial		
Accrued interest payable	**₱94,436,182**	₱80,613,386
Accrued other expenses	**169,203,128**	109,312,247
	263,639,310	189,925,633
Nonfinancial		
Retirement liability (Note 23)	**216,647,766**	239,105,664
Accrued taxes and licenses	**27,258,314**	16,378,085
	243,906,080	255,483,749
	₱507,545,390	₱445,409,382

Included in accrued taxes and licenses is income tax payable as of December 31, 2013 and 2012 amounting to nil and ₱67,668, respectively.

17. Other Liabilities

This account consists of:

	2013	2012
Unearned income (Note 15)	**₱197,641,949**	₱972,199,384
Accounts payable	**102,848,488**	63,896,481
Refundable security deposits	**82,573,144**	95,851,448
Deferred credits	**77,797,059**	46,043,529
Withholding taxes payable	**35,937,938**	24,751,612
Interoffice float items-net	–	41,087,486
Due to the Treasurer of the Philippines	**18,594,320**	10,796,171
Miscellaneous	**22,558,829**	27,545,196
	₱537,951,727	₱1,282,171,307

Unearned income primarily pertains to the difference between the principal amount and the present value of the FAA granted by PDIC (Notes 1 and 15). Unearned income is amortized over the term of the financial assistance using the effective interest method and is shown under 'Interest income - others' in the statements of income. In 2013, 2012 and 2011, amortization of unearned income amounted to ₱774.56 million, ₱684.02 million and ₱608.23 million, respectively.

Miscellaneous liabilities of the Bank include marginal deposit, cash letters of credit, and deposit liabilities classified as dormant.

18. Maturity Analysis of Assets and Liabilities

The table below shows an analysis of assets and liabilities analyzed according to when they are expected to be recovered or settled (amounts in thousands):

	2013			2012		
	Due Within One Year	**Due Beyond One Year**	**Total**	Due Within One Year	Due Beyond One Year	Total
Financial Assets - at gross						
Cash and other cash items	**₱740,012**	**₱–**	**₱740,012**	₱551,098	₱–	₱551,098
Due from BSP	**9,573,408**	**–**	**9,573,408**	5,511,067	–	5,511,067
Due from other banks	**661,308**	**–**	**661,308**	887,143	–	887,143
Interbank loans receivable and SPURA	**202,550**	**–**	**202,550**	993,804	–	993,804
HFT financial assets (Note 8)	**104,909**	**–**	**104,909**	–	–	–
AFS investments (Note 8)	**7,218,621**	**12,878,630**	**20,097,251**	90,562	16,695,263	16,785,825
Loans and receivables (Note 9)						
Receivables from customers	**11,917,626**	**7,703,661**	**19,621,287**	10,360,075	3,067,809	13,427,884
Unquoted debt securities	**1,011,556**	**4,685,059**	**5,696,615**	1,288,809	2,087,412	3,376,221
Accounts receivable	**65,715**	**497,876**	**563,591**	116,404	425,675	542,079
Accrued interest receivable	**420,386**	**532,237**	**952,623**	358,451	472,693	831,144
Sales contract receivable	**12,096**	**96,933**	**109,029**	15,848	109,910	125,758
Other assets (Note 12)						
Derivative assets	**–**	**–**	**–**	2,147	–	2,147
Refundable deposits	**–**	**25,200**	**25,200**	–	18,084	18,084
RCOCI	**6,159**	**–**	**6,159**	5,691	–	5,691
	31,934,346	**26,419,596**	**58,353,942**	20,181,099	22,876,846	43,057,945
Nonfinancial Assets - at gross						
Property and equipment (Note 10)	**–**	**2,592,879**	**2,592,879**	–	2,148,647	2,148,647
Investment properties (Note 11)						
Condominium units for lease	**–**	**3,341,665**	**3,341,665**	–	3,220,308	3,220,308
Foreclosed assets	**–**	**482,554**	**482,554**	–	375,813	375,813
Other assets (Note 12)	**–**	**1,247,594**	**1,247,594**	–	849,660	849,660
	–	**7,664,692**	**7,664,692**	–	6,594,428	6,594,428
	₱31,934,346	**₱34,084,288**	**66,018,634**	₱20,181,099	₱29,471,274	49,652,373
Less:						
Unearned interest and discounts (Note 9)			**(23,554)**			(13,110)
Accumulated depreciation and amortization (Notes 10 and 12)			**(846,311)**			(801,129)
Allowance for credit and impairment losses (Note 13)			**(2,550,114)**			(3,006,967)
Total			**₱62,598,655**			₱45,831,167
Financial Liabilities						
Deposit liabilities						
Demand	**₱7,183,261**	**₱–**	**₱7,183,261**	₱5,788,177	₱–	₱5,788,177
Savings	**3,089,981**	**–**	**3,089,981**	2,751,041	–	2,751,041
Time	**34,186,236**	**2,821,020**	**37,007,256**	15,700,097	7,117,000	22,817,097
Bills payable	**9,458,241**	**–**	**9,458,241**	1,186,735	6,636,778	7,823,513
Outstanding acceptances	**43,189**	**–**	**43,189**	32,322	–	32,322
Manager's checks	**173,501**	**–**	**173,501**	67,050	–	67,050
Accrued interest payable (Note 16)	**94,436**	**–**	**94,436**	80,613	–	80,613
Accrued other expenses (Note 16)	**169,203**	**–**	**169,203**	109,312	–	109,312
Other liabilities (Note 17)						
Refundable security deposits	**27,125**	**55,448**	**82,573**	37,351	58,500	95,851
Accounts payable	**102,848**	**–**	**102,848**	63,896	–	63,896
Due to the Treasurer of the Philippines	**18,594**	**–**	**18,594**	10,796	–	10,796
	54,546,615	**2,876,468**	**57,423,083**	25,827,390	13,812,278	39,639,668

(Forward)

	2013			2012		
	Due Within One Year	**Due Beyond One Year**	**Total**	Due Within One Year	Due Beyond One Year	Total
Nonfinancial Liability						
Deferred tax liabilities (Note 26)	**₱–**	**₱524,116**	**₱524,116**	₱–	₱432,716	₱432,716
Retirement liability (Notes 16 and 23)	**–**	**216,648**	**216,648**	–	239,106	239,106
Accrued taxes and licenses (Note 16)	**27,258**	**–**	**27,258**	16,378	–	16,378
Other liabilities (Note 17)						
Unearned income	**–**	**197,642**	**197,642**	–	972,199	972,199
Deferred credits	**–**	**77,797**	**77,797**	–	46,044	46,044
Miscellaneous	**–**	**58,497**	**58,497**	–	93,386	93,386
	27,258	**1,074,700**	**1,101,958**	16,378	1,783,451	1,799,829
	₱54,573,873	**₱3,951,168**	**₱58,525,041**	₱25,843,768	₱15,595,729	₱41,439,497

19. **Equity**

Capital Stock

Capital stock consists of:

	Shares		Amount	
	2013	2012	**2013**	2012
Preferred - ₱25 par value				
Authorized	**–**	120,000,000		
Issued and Outstanding				
Balance at the beginning of the period	**120,000,000**	120,000,000	**₱3,000,000,000**	₱3,000,000,000
Conversion of preferred to common shares	**(120,000,000)**	–	**(3,000,000,000)**	–
Balance at the end of period	**–**	120,000,000	**₱–**	₱3,000,000,000
Common - ₱25 par value*				
Authorized	**760,000,000**	145,000,000		
Issued and Outstanding				
Balance at the beginning of the period	**52,598,965**	52,598,965	**₱5,259,896,500**	₱5,259,896,500
Conversion of preferred shares to common shares	**120,000,000**	–	**3,000,000,000**	–
Reduction in par value of common shares	**–**	–	**(3,944,922,375)**	–
Issued common shares during the period	**126,965,590**	–	**3,174,139,750**	–
Balance at the end of period	**299,564,555**	52,598,965	**₱7,489,113,875**	₱5,259,896,500

* Par value per share is ₱100 prior to quasi-reorganization.

The Bank became listed in the Philippine Stock Exchange (PSE), formerly The Manila Stock Exchange, on May 12, 1988. After its listing to the PSE, there was no succeeding offer/selling to the public of the Bank's shares.

Subsequently, the SEC approved the increase in the capital stock of the Bank. The summarized information on the Bank's registration of securities under the Securities Regulation Code follows:

Date of SEC Approval	Type/Class	Authorized Shares	Par Value
November 23, 1988	Common Class A	7,000,000	100
	Common Class B	3,000,000	100
June 3, 1993	Common Class A	14,000,000	100
	Common Class B	6,000,000	100
September 11, 1997	Common	65,000,000	100
April 6, 2001	Common	145,000,000	100
March 31, 2006	Common	145,000,000	100
	Preferred	120,000,000	25
March 11, 2013	Common	760,000,000	25

As reported by the Bank's transfer agent, AB Stock Transfers Corporation, the total number of shareholders is 415 and 383 as of December 31, 2013 and 2012, respectively.

Preferred shares are non-redeemable, nonconvertible and have the same voting rights, dividend rights, and other rights as the holder of common shares.

Quasi-reorganization

On January 18, 2012, the BOD in its regular meeting approved the quasi-reorganization and increase in authorized capital stock of the Bank. The quasi-reorganization will reduce the par value of the Bank's 145.00 million authorized common shares from ₱100.00 to ₱25.00 and that the 120.00 million authorized preferred shares with par value of ₱25.00 will be declassified and converted to common shares with par value of ₱25.00. Further, the authorized capital stock will be increased to ₱19.00 billion divided into 760.00 million shares with par value of ₱25.00.

On March 28, 2012, the shareholders of the Bank representing at least two thirds (2/3) of the outstanding capital stock ratified the said quasi-reorganization and increase in authorized capital stock.

On December 19, 2012, the Bank applied for the said quasi-reorganization and increase in authorized capital stock with the BSP and SEC, respectively. On February 8, 2013, the BSP issued a Certicate of Authority to enable the Bank to register its Amended Articles of Incorporation and Amended By-Laws with the SEC.

On March 8, 2013, the Bank obtained the SEC's approval for the increase in its authorized capital stock.

The Bank incurred costs of ₱40.87 million for the approval/registration of the increase in its authorized capital stock with the SEC and documentary stamp taxes for issuance of new shares.

On December 3, 2013, the Bank received the "No Objection" Notice from the BSP relative to its application with the SEC for equity restructuring.

On December 11, 2013, the Bank received from the SEC the Certificate of Approval of Equity Restructuring which allowed the Bank to effect the partial wipe out of Deficit as of December 31, 2012 of ₱8.66 billion against APIC of ₱3.94 billion. However, any remaining APIC balance shall not be used to wipe out losses that may be incurred in the future without prior approval of the SEC.

Deposit for Future Stock Subscription

On December 27, 2011, the Chung and Nubla Groups entered into a subscription agreement where the two shareholders subscribed to the new common shares of the Bank at ₱27.88 per share. Cash received from the subscription amounting to ₱2.37 billion is shown under the Deposit for future stock subscription account in the equity section of the statement of financial position. To effect the subscription on the new common stock at the agreed price per share, the Bank implemented a quasi-reorganization and increase in authorized capital stock. The ratification of the Amendment of Article VII of the Articles of Incorporation in relation to the quasi-reorganization and increase in authorized capital stock was approved by the Bank's BOD on January 18, 2012 and was approved by the stockholders on March 28, 2012.

In March 2012, additional cash subscription payments of ₱155.55 million and ₱252.29 million were made by the Nubla and Chung Groups, respectively. On April 4, 2012, the Bank's stockholder, the ISM Group also made cash subscription payments amounting to ₱22.71 million. On May 31, 2012 and October 4, 2012, LFM Properties Group deposited the amount of ₱719.01 million and ₱30.00 million, respectively, as subscription payments. As of December 31, 2012 and 2011, the Bank met all the required conditions to account for deposit for future stock subscription as equity. On March 11, 2013, in accordance with the subscription agreements of the above stockholder and investors of the Bank, the deposits for future subscription were exchanged for 126.97 million shares.

Surplus Reserves
As of December 31, 2013 and 2012, surplus reserves consist of reserve for trust business, and self-insurance amounting to ₱88.65 million and ₱17.12 million, respectively.

In compliance with BSP regulations, 10.00% of the Bank's profit from trust business is appropriated to surplus reserves. This annual appropriation is required until the surplus reserves for trust business equals 20.00% of the Bank's authorized capital stock. Surplus reserve for self-insurance represents the amount set aside to cover for losses due to fire, defalcation by and other unlawful acts of the Bank's personnel or third parties.

Deficit
As of December 31, 2013 and 2012, deficit in the financial statements included fair value gain on investment property amounting to ₱489.79 million and ₱315.55 million, respectively, which are not available for dividend declaration. Further, declaration, distribution or payment of cash or stocks dividends requires prior approval from the PDIC pursuant to the FAA (Note 1).

The fair value gain on investment properties will be included as part of retained earnings available for dividend declaration when the properties are sold and the gain is realized.

The computation of surplus available for dividend declaration in accordance with SEC Memorandum Circular No. 11 differs to a certain extent from the computation following BSP Guidelines.

Capital Management
The primary objectives of the Banks's capital management are to ensure that the Bank complies with regulatory capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value.

The Bank manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, with the prior approval of PDIC pursuant to the Financial Assistance Agreement dated March 15, 2004, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("Bank for International Settlements rules/ratios") and adopted by the BSP in supervising the Bank. The Bank had complied in full with all its regulatory capital requirements.

Regulatory Qualifying Capital

Under existing BSP regulations, the determination of the Bank's compliance with regulatory requirements and ratios is based on the amount of the Bank's "qualifying capital" (regulatory net worth) as reported to the BSP, which is determined on the basis of regulatory accounting policies which differ from PFRS in some respects.

In addition to the required RBCAR of at least 12.50% under the FAA, the RBCAR of the Bank expressed as a percentage of qualifying capital to risk weighted assets, should not be less than 10.00%. Qualifying capital and risk weighted assets are computed based on BSP regulations.

The BSP, under BSP Circular No. 538 dated August 4, 2006, issued the prescribed guidelines implementing the revised risk-based capital adequacy framework for the Philippine banking system to conform to Basel II recommendations. The new BSP guidelines took effect on July 1, 2007.

Below is a summary of risk weights and selected exposure types:

Risk weight	Exposure/Asset type*
0.00%	Cash on hand; claims collateralized by securities issued by the national government, BSP; loans covered by the Trade and Investment Development Corporation of the Philippines; real estate mortgages covered by the Home Guarantee Corporation.
20.00%	COCI, claims guaranteed by Philippine incorporated banks/quasi-banks with the highest credit quality; claims guaranteed by foreign incorporated banks with the highest credit quality; loans to exporters to the extent guaranteed by Small Business Guarantee and Finance Corporation
50.00%	Housing loans fully secured by first mortgage on residential property; Local Government Unit (LGU) bonds which are covered by Deed of Assignment of Internal Revenue allotment of the LGU and guaranteed by the LGU Guarantee Corporation
75.00%	Direct loans of defined Small Medium Enterprise (SME) and microfinance loans portfolio; non-performing housing loans fully secured by first mortgage
100.00%	All other assets (e.g., real estate assets) excluding those deducted from capital (e.g., deferred income tax)
150.00%	All non-performing loans (except non-performing housing loans fully secured by first mortgage) and all non-performing debt securities

*Not all inclusive

The Bank's RBCAR as reported to BSP as of December 31, 2013 and 2012 are shown in the table below (amounts in millions):

	2013	2012
Paid-up common stock	**₱7,489**	₱5,260
Paid-up perpetual & non-cumulative preferred stock	−	3,000
Deposit for common stock subscription	−	3,553
Additional paid-in capital	**814**	476
Retained earnings	**(4,927)**	(9,754)
Undivided profits	**1,262**	877
Cumulative foreign currency translation	**23**	(15)
Core Tier 1 Capital	**4,661**	3,397
Deductions from Core tier 1 Capital	−	−
50% of significant minority investment in financial allied undertaking	**6**	6
Unsecured DOSRI	−	11
Deferred income tax	−	(563)
Net Tier 1 Capital	**4,655**	3,943
Appraisal increment reserve	**1,539**	1,524
General loan loss provision	**175**	109
Tier 2 Capital	**1,714**	1,633
Deductions from tier 2 Capital	**6**	6
Net Tier 2 Capital	**1,708**	1,627
Total Qualifying Capital	**6,363**	5,570
Credit risk-weighted assets	**35,464**	23,591
Market risk-weighted assets	**109**	25
Operational risk-weighted assets	**3,761**	3,630
Total Risk Weighted Assets	**₱39,334**	₱27,246
Tier 1 Capital Ratio	**11.83%**	14.47%
Total Capital Ratio	**16.18%**	20.44%
Capital Requirements		
Credit Risk	**₱3,546**	₱2,359
Market Risk	**11**	2
Operational Risk	**376**	363
Total Capital Requirements	**₱3,933**	₱2,724

The regulatory qualifying capital of the Bank consists of Tier 1 (core) capital, which comprises paid-up common and preferred stock, surplus including current year profit and surplus reserves less required deductions such as unsecured credit accommodations to directors, officers, stockholders and related interests (DOSRI) and deferred income tax and significant minority investments and other financial allied undertakings. The other component of regulatory capital is Tier 2 (supplementary) capital, which includes appraisal increment reserves on PBCom Tower (Note 1), as authorized by the monetary board of BSP, and general loan loss provision. As of December 31, 2013 and 2012, the Bank is in compliance with the required RBCAR under the FAA of at least 12.50%.

Appraisal increment reserves included in Tier 2 capital which pertain to PBCom Tower amounted to ₱1.36 billion in 2013 and ₱1.35 billion in 2012.

Internal Capital Adequacy Assessment Process (ICAAP)
The ICAAP methodology of the Bank was based on the minimum regulatory capital requirement under BSP Circular No. 639 which involved, first, an assessment of whether the risks covered by the Framework are fully captured; and second, an assessment of other risks the Bank is exposed to which are not fully captured and covered under the Framework, and an assessment of whether and how much capital to allocate against these other risks. The ICAAP Document was presented by the Bank to the BSP on January 31, 2014.

The ICAAP, which included the discussion on the 2014 Holistic Risk Appetite and Components as well as the ranges of capital that the Bank should sustain to support the five year Business Plan under going-concern and stress scenarios, was deliberated upon by the ICAAP Steering Committee, ROC and endorsed to the BOD for approval.

Basel III
On January 15, 2013, the BSP issued Circular No. 781, Basel III Implementing Guidelines on Minimum Capital Requirements, which provides the implementing guidelines on the revised risk-based capital adequacy framework particularly on the minimum capital and disclosure requirements for universal banks and commercial banks, as well as their subsidiary banks and quasi-banks, in accordance with the Basel III standards. The circular is effective on January 1, 2014.

The Circular sets out a minimum Common Equity Tier 1 (CET1) ratio of 6.0% and Tier 1 capital ratio of 7.5%. It also introduces a capital conservation buffer of 2.5% comprised of CET1 capital. The BSP's existing requirement for Total CAR remains unchanged at 10.0% and these ratios shall be maintained at all times.

Further, existing capital instruments as of December 31, 2010 which do not meet the eligibility criteria for capital instruments under the revised capital framework shall no longer be recognized as capital upon the effectivity of Basel III. Capital instruments issued under BSP Circular Nos.709 and 716 (the circulars amending the definition of qualifying capital particularly on Hybrid Tier 1 and Lower Tier 2 capitals), starting January 1, 2011 and before the effectivity of BSP Circular No. 781, shall be recognized as qualifying capital until December 31, 2015. In addition to changes in minimum capital requirements, this Circular also requires various regulatory adjustments in the calculation of qualifying capital.

The Bank has taken into consideration the impact of the foregoing requirements by conducting the Quantitative Impact Studies that are reported to the ROC and to BOD to ensure that the appropriate level and quality of capital are maintained on an ongoing basis.

20. **Commitments and Contingent Liabilities**

In the normal course of operations, the Bank has various outstanding commitments and contingent liabilities such as guarantees, forward exchange contracts, and commitments to extend credit, which are not presented in the accompanying financial statements. The Bank does not anticipate any material losses as a result of these transactions.

The following is a summary of the Bank's commitments and contingent liabilities at their equivalent peso contractual amounts:

	2013	2012
Trust department accounts	**₱5,200,110,997**	₱4,781,724,820
Standby LC	**1,155,844,848**	479,011,020
Spot exchange:		
Bought	**676,674,800**	451,690,000
Sold	**676,596,500**	451,575,000
Usance LC outstanding	**537,025,819**	99,555,666
Outstanding shipping guarantees	**500,477,838**	16,218,853
Sight LC outstanding	**323,915,763**	216,902,893
Deficiency claims receivable	**27,498,152**	27,498,152
Outward bills for collection	**24,102,868**	13,483,878
Late deposits/payment received	**17,161,680**	20,111,356
Currency forwards:		
Bought	**6,073,236**	697,937,000
Sold	**6,111,860**	697,850,000
Inward bills for collection	**5,541,806**	4,641,324
Items held for safekeeping	**17,380**	8,784
Items held as collateral	**2,787**	2,506
Other contingencies	**88,254,328**	7,000,000

In 2007, the Bank availed of the tax amnesty program under RA No. 9480 to settle outstanding tax assessments. Under RA No. 9480, taxpayers who availed of the tax amnesty program shall be immune from payment of taxes, including interests and surcharges and any civil, criminal or administrative penalties arising from failure to pay any and all internal revenue taxes for taxable year 2005 and prior years.

As of December 31, 2010, the Bank has an outstanding case with the CTA on tax assessments from the BIR covering taxable years 1996 to 1997. In 2011, the Bank received an "Entry of Judgment with finality" from the Supreme Court in its favor with regard to revenue related tax assessment. Accordingly, provisions charged against prior years (included under Miscellaneous liabilities) amounting to ₱197.87 million were recorded as a reversal of provision for tax assessments (Note 25).

The Bank has several loan-related suits and claims that remain unsettled. It is not practicable to estimate the potential financial statement impact of these contingencies. However, in the opinion of management, the suits and claims, if decided adversely, will not involve sums having a material effect on the financial statements.

The Bank is a defendant in legal actions arising from its normal business activities. Management believes that these actions are without merit or that the ultimate liability, if any, resulting from them will not materially affect the Bank's financial statements.

Derivative Financial Instruments
As of December 31, 2013 and 2012, the aggregate notional amount of the outstanding sell US dollar currency forwards amounted to US$0.14 million and US$17.00 million, respectively, and with terms ranging from 7 to 10 days and 2 to 28 days, respectively. As of December 31, 2013 and 2012, the weighted average sell US dollar forward rate is ₱44.40 and ₱41.06, respectively.

In 2013, 2012 and 2011, realized gain (loss) on currency forwards recorded under 'Trading and securities gain - net' in the statements of income amounted to (₱0.64) million, ₱6.78 million and ₱7.77 million, respectively (Note 22).

In 2013, 2012 and 2011, unrealized gain on currency forwards recorded under 'Trading and securities gain - net' in the statements of income amounted to (₱0.06) million, ₱2.15 million and ₱0.65 million, respectively (Note 22).

21. Trust Operations

Securities and other properties (other than deposits) held by the Bank in its fiduciary or agency capacity for its customers are not included in the statements of financial position since these are not assets of the Bank. Total assets held by the Bank's trust department amounted to ₱5.20 billion and ₱4.78 billion as of December 31, 2013 and 2012, respectively (Note 20).

As of December 31, 2013 and 2012, government securities (included in AFS investments) owned by the Bank with total face value of ₱100.00 million are deposited with the BSP in compliance with the requirements of the General Banking Law relative to the Bank's trust functions.

Income from the Bank's trust operations shown under 'Income for Trust Operations' in the statements of income amounted to ₱22.48 million, ₱15.39 million and ₱19.71 million in 2013, 2012 and 2011, respectively.

22. Income on Trading and Investment Securities

Interest income on trading and investment securities follows:

	2013	2012	2011
AFS investments	**₱1,248,016,976**	₱1,295,804,092	₱1,258,635,032
HFT financial assets	**8,046,361**	69,360	–
	₱1,256,063,337	₱1,295,873,452	₱1,258,635,032

In 2013, 2012 and 2011, the Bank's peso-denominated HFT financial assets and AFS investments earned annual interest rates ranging from 1.63% to 10.75%, 4.75% to 12.38% and 4.25% to 7.92%, respectively, while dollar-denominated financial assets at FVPL and AFS investments earned annual interest ranging from 3.37% to 8.41%, 5.00% to 9.50% and 3.82% to 8.41%, respectively.

Trading and securities gain - net follows:

	2013	2012	2011
AFS investments	**₱1,520,582,609**	₱738,069,044	₱220,166,698
HFT financial assets	**20,714,580**	7,079,654	7,409,526
Others	**(697,612)**	8,932,793	8,417,185
	₱1,540,599,577	₱754,081,491	₱235,993,409

23. **Employee Benefits**

The Bank has a noncontributory and funded retirement plan covering all its officers and regular employees. The retirement fund is administered by the Bank's Trust Department which acts as the trustee under the plan. Under the retirement plan, all covered officers and employees are entitled to cash benefits after satisfying certain age and service requirements. The latest actuarial valuation study of the retirement plan was made on December 31, 2013.

The Bank's annual contribution to the retirement plan consists of a payment covering the current service cost and unfunded actuarial accrued liability. The retirement plan provides a retirement benefit based on applicable percentage of salary (100-150%) depending on the number of years of service (minimum of five years), a fraction of a month being considered as one whole month.

The following table shows the actuarial assumptions used in determining the retirement liability of the Bank:

	December 31	
	2013	2012
Discount rate		
At January 1	**5.80%**	6.40%
At December 31	**5.40%**	5.80%
Salary rate increase	**7.00%**	8.00%
Estimated working lives	**13 years**	13 years

The amount of retirement liability recognized for the Bank in the statements of financial position (included under 'Accrued other expenses payable') follows:

	December 31	
	2013	2012 (As restated- Note 2)
Present value of retirement obligation	**₱505,849,532**	₱502,005,877
Fair value of plan assets	**(289,201,766)**	(262,900,213)
Deficit	**₱216,647,766**	₱239,105,664

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

	December 31	
	2013	2012 (As restated- Note 2)
Balance at beginning of period	**₱502,005,877**	₱497,002,024
Current service cost	**49,431,074**	36,651,203
Interest cost	**29,116,341**	31,808,130
Past service cost	**2,685,029**	–
Benefits paid by the Bank	**(10,356,863)**	–
Benefits paid by the plan assets	**(76,331,631)**	(107,945,356)
Remeasurement (gains) losses:		
Experience adjustments	**34,344,458**	14,526,220
Actuarial losses arising from changes in demographic assumptions	**2,782,511**	–
Actuarial losses (gains) arising from changes in financial assumptions	**(27,827,264)**	29,963,656
Balance at end of period	**₱505,849,532**	₱502,005,877

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

	December 31	
	2013	2012 (As restated- Note 2)
Balance at beginning of period	**₱262,900,213**	₱293,697,151
Actual contributions	**111,885,491**	63,821,454
Interest income	**15,248,212**	18,796,618
Return on assets	**(24,500,519)**	(5,469,654)
Benefits paid	**(76,331,631)**	(107,945,356)
Balance at end of period	**₱289,201,766**	₱262,900,213

The sensitivity analysis below has been determined based on reasonably possible changes of each significant assumption on the defined benefit obligation as of December 31, 2013, assuming if all other assumptions are held constant:

	Reasonably Possible Changes	Increase (decrease) in defined benefit liability
Discount rates	+0.50%	(₱26,315,358)
	-0.50%	28,602,667
Future salary increase rate	+0.50%	25,541,501
	-0.50%	(23,805,985)
Mortality	+1 year	(3,010,045)
	-1 year	10,012,738

The overall investment policy and strategy of the retirement plan is based on the client suitability assessment, as provided by the Bank's Trust Department, in compliance with the BSP. Benefits exceeding the allocated plan assets are paid out by the Bank.

The fair values of plan assets of the Bank by each class as at the end of the reporting periods are as follows:

	December 31	
	2013	2012
Cash and cash equivalents	**₱40,341,322**	₱107,948,493
Financial assets at FVPL - equity instruments		
Manufacturing	**29,686,316**	30,618,750
Real estate	**12,408,275**	–
Wholesale and retail trade	**11,144,610**	–
Financial intermediation	**6,163,024**	–
Electricity, gas and water	**2,461,800**	–
AFS debt instruments		
Financial intermediation	**74,550,000**	36,027,718
Government securities	**38,809,258**	32,041,259
Electricity, gas and water	**15,000,000**	10,263,993
Real estate	**10,000,000**	10,000,000
HTM	**46,000,000**	36,000,000
Others	**2,637,161**	–
Fair value of plan assets	**₱289,201,766**	₱262,900,213

The carrying values of the plan assets of the Bank amounted to ₱289.20 million and ₱262.90 million as of December 31, 2013 and December 31, 2012, respectively. The plan assets have diverse investments and do not have any concentration risk.

As of December 31, 2013 and 2012, the retirement fund plan assets do not include equity instruments issued by the Bank.

The movements in the retirement liability of the Bank recognized under 'Accrued other expenses payable' in the statements of financial position follow:

	December 31	
	2013	2012 (As restated - Note 2)
Balance at beginning of period	**₱239,105,664**	₱203,304,873
Retirement expense	**65,984,232**	49,662,715
Contributions	**(111,885,491)**	(63,821,454)
Benefits paid by the Bank	**(10,356,863)**	–
Remeasurement losses (gains):		
Experience adjustments	**₱34,344,458**	₱14,526,220
Actuarial losses arising from changes in demographic assumptions	**2,782,511**	–
Actuarial losses (gains) arising from changes in financial assumptions	**(27,827,264)**	29,963,656
Return on assets excluding amount in net interest cost	**24,500,519**	5,469,654
Balance at end of period	**₱216,647,766**	₱239,105,664

The amounts of retirement cost included in the statements of income are as follows:

	2013	2012 (As restated - Note 2)	2011 (As restated - Note 2)
Current service cost*	**₱49,431,074**	₱36,651,203	₱35,002,299
Net interest cost**	**13,868,129**	13,011,512	12,187,013
Past service cost*	**2,685,029**	–	–
	₱65,984,232	₱49,662,715	₱47,189,312

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

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

	2013	2012 (As restated - Note 2)	2011 (As restated - Note 2)
Actuarial loss on present value of retirement obligation	**(₱9,299,705)**	(₱44,489,876)	(₱1,488,296)
Return on plan assets	**(24,500,519)**	(5,469,654)	(15,143,848)
	(₱33,800,224)	(₱49,959,530)	(₱16,632,144)

The Bank expects to contribute ₱132.97 million to the defined benefit pension plans in 2014.

Collective Bargaining Agreement (CBA)
On April 12, 2013, the Bank signed the revised collective bargaining agreement with the Philippine Bank of Communications Employees' Association to amend the CBA that expired on December 31, 2012.

The amended CBA shall take effect on January 1, 2013 and shall continue to be in full force and effect for three (3) years or until December 31, 2015.

Provident Fund
The Bank employs a provident fund scheme where it and its employees contribute 11% and 5% of the employees' basic monthly salary. Contributions are maintained under the Provident Fund account administered by the Bank's Trust Department.

As approved by the Bank's BOD on November 27, 2013, new officers hired after December 31, 2013, except those whose terms of employment have been negotiated prior to December 1, 2013 are no longer eligible for inclusion in the Bank's provident fund.

24. Long-term Leases

The Bank leases certain premises occupied by most of its branches (about 68.00% of the branch sites). The lease contracts are for periods ranging from one to 20 years and renewable at the Bank's option under certain terms and conditions. Various lease contracts include escalation clauses, most of which bear an annual rent increase of 5.00 - 10.00%.

Rent expense charged to current operations (included in 'Occupancy and other equipment-related costs' in the statements of income) amounted to ₱95.11 million, ₱51.76 million and ₱56.98 million in 2013, 2012 and 2011, respectively.

Future minimum rentals payable under noncancellable operating leases are as follows:

	2013	2012
Within one year	**₱90,426,570**	₱53,826,915
Beyond one year but not more than five years	**201,447,123**	95,442,321
	₱291,873,693	₱149,269,236

The Bank has also entered into commercial property leases on its investment properties. These noncancellable leases have remaining noncancellable lease terms of between one to five years. Rent income of the Bank related to these property leases amounting to ₱249.38 million in 2013, ₱289.43 million in 2012 and ₱287.69 million in 2011 are shown under 'Rent income' in the statements of income.

Future minimum rentals receivable under noncancellable operating leases follow:

	2013	2012
Within one year	**₱286,177,622**	₱120,778,802
Beyond one year but not more than five years	**570,323,187**	452,917,196
Beyond five years	**901,935**	–
	₱857,402,744	₱573,695,998

25. Miscellaneous Expenses

The Bank's account consists of:

	2013	2012	2011
Management and professional fees	**₱172,823,512**	₱105,078,380	₱88,110,439
Entertainment, amusement and recreation (EAR) (Note 26)	**67,664,927**	22,866,666	10,803,627
Security, clerical, messengerial and janitorial services	**60,219,960**	53,353,630	48,818,169
Communications	**45,267,560**	36,944,540	34,429,235
Insurance	**38,594,024**	61,903,435	59,798,224
Information technology	**32,437,085**	9,390,403	13,943,364
Transaction dues	**20,809,817**	17,693,195	17,107,173
Stationery and supplies	**17,809,176**	14,244,124	11,501,961
Brokerage fees	**15,510,069**	11,336,027	9,209,980
Fines, penalties and other charges	**14,494,040**	3,814,021	598,545
Advertising	**13,381,725**	3,745,149	2,460,886
Travel	**13,254,088**	8,529,328	4,226,873
Litigation and assets acquired - related expenses	**12,557,138**	14,681,486	18,315,949
Fuel and lubricants	**11,065,799**	2,441,930	2,128,777
Freight	**4,104,267**	2,379,570	1,358,460
Reversal of provision for tax assessments (Note 20)	**–**	–	(197,871,861)
Others	**53,508,357**	29,385,492	35,186,230
	₱593,501,544	₱397,787,376	₱160,126,031

Others include account maintenance charges, waived charges and Philippine Dealing Exchange Corp. transaction fees.

26. Income and Other Taxes

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

RA No. 9337, An Act Amending National Internal Revenue Code, provides that starting January 1, 2009, the RCIT rate shall be 30.00% while interest expense allowed as a deductible expense is reduced to 33.00% of interest income subject to final tax.

An MCIT of 2.00% on modified gross income is computed and compared with the RCIT. Any excess MCIT over RCIT is deferred and can be used as a tax credit against future income tax liability for the next three years. In addition, the NOLCO is allowed as a deduction from taxable income in the next three years from the year of inception.

Offshore income (income from non-residents) is tax-exempt while gross onshore income (income from residents) is subject to 10.00% income tax. In addition, interest income on deposit placements with other FCDUs and Offshore Banking Units (OBU) is taxed at 7.50%.

On March 15, 2011, the BIR issued RR No. 4-2011 which prescribes the attribution and allocation of expenses between FCDUs/EFCDUs or OBUs and RBU and within RBU. Pursuant to the regulations, the Bank made an allocation of its expenses in calculating income taxes due for RBU and FCDU.

Current tax regulations also set a limit on the amount of EAR expenses that can be deducted for income tax purposes. EAR expenses are limited to 1.00% of net revenue for sellers of services. EAR expenses (included under ‘Miscellaneous expenses’ in the statements of income) amounted to ₱15.20 million in 2013, ₱22.87 million in 2012 and ₱10.80 million in 2011 (Note 25).

Provision for income tax consists of:

	2013	2012	2011
Current:			
Final	**₱300,946,997**	₱291,196,704	₱248,789,433
MCIT	**14,097,174**	309,849	215,402
RCIT	**312,349**	–	–
	315,356,520	291,506,553	249,004,835
Deferred	**81,689,491**	(1,347,510)	116,531,495
Effective income tax	**₱397,046,011**	₱290,159,043	₱365,536,330

Components of 'Deferred tax liabilities - net' are as follows:

	2013	2012
Deferred tax liability on:		
Revaluation increment credited to surplus free	**₱461,456,804**	₱429,365,867
Fair value gain on condominium units for lease	**444,348,143**	413,511,222
Revaluation increment on land (Note 10)	**89,805,394**	80,095,204
Unamortized transaction cost on bills payable	**962,291**	9,307,279
Unrealized foreign exchange gain	**–**	5,762,014
	996,572,632	938,041,586
Deferred tax assets on allowance for credit and impairment losses	**(472,456,541)**	(505,325,176)
	₱524,116,091	₱432,716,410

The ultimate realization of deferred tax assets is dependent on the generation of future taxable income. The Bank considers projected future taxable income, reversal of temporary differences, and tax planning strategies in making the assessment based on the historical income and projections of future taxable income.

The Bank believes that portion of the deferred tax assets may not be realized in the future. Accordingly, the Bank did not set up deferred tax assets on the following NOLCO and temporary differences:

	2013	2012
Allowance for credit and impairment losses	**₱513,979,966**	₱993,811,395
NOLCO	**467,452,389**	948,293,953
Retirement liability	**216,647,766**	239,105,664
Provision for year-end expenses	**115,301,499**	53,898,456
Unamortized past service cost	**60,731,177**	53,355,985
Advance rental income	**34,841,544**	28,954,628
Fair value loss on investment properties	**34,049,478**	71,065,071
Unrealized foreign exchange loss	**24,972,908**	–
Excess of MCIT over RCIT	**14,097,174**	–
	₱1,482,073,901	₱2,388,485,152

Details of the Bank's NOLCO are as follows:

Inception Year	Amount	Expired/Used	Balance	Expiry Year
2010	₱480,841,564	₱480,849,564	₱–	2013
2011	279,999,166	–	279,999,166	2014
2012	187,453,223	–	187,453,223	2015
	₱948,293,953	₱480,849,564	₱467,452,389	

In 2013, NOLCO utilized by the Bank against its taxable income amounted to ₱429.02 million.

In 2013, the Bank incurred MCIT amounting to ₱14.10 million which it can use against income tax liability for the next three years (until 2016).

A reconciliation between the statutory income tax and the effective income tax follows:

	2013	2012	2011
Statutory income tax	**₱608,979,174**	₱382,482,186	₱353,559,233
Tax effect of:			
Nondeductible expenses and others	**829,658,263**	241,710,155	423,774,303
Nontaxable income	**(637,730,864)**	(211,318,232)	(300,406,403)
Interest income subjected to final tax	**(73,535,880)**	(103,971,489)	(119,961,510)
FCDU income before income tax	**(68,269,328)**	(94,908,055)	(42,318,692)
Changes on unrecognized deferred tax assets	**(262,055,354)**	76,164,478	50,889,399
Effective income tax	**₱397,046,011**	₱290,159,043	₱365,536,330

27. **Related Party Transactions**

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. The Bank's related parties include key management personnel, close family members of key management personnel, affiliates (i.e. entities which are controlled, significantly influenced by or for which significant voting power is held by the Bank or key management personnel or their close family members and retirement plan for the benefit of the Bank's employees).

The Bank has several business relationships with related parties. Transactions with such parties are made in the ordinary course of business and on substantially same terms, including interest and collateral, as those prevailing at the time for comparable transactions with other parties. These transactions also did not involve more than the normal risk of collectability or present other unfavorable conditions.

Retirement Plan

Under PFRS, certain post-employment benefit plans are considered as related parties. The Bank has a business relationship with its retirement plan pursuant to which it provides trust and management services to this plan. Any investments made in the retirement plan are approved by the Bank's Retirement Board. The Bank's Retirement Board is comprised of senior officers of the Bank. Income earned by the Bank (presented as 'Income from trust operations' in the statements of income) from such services amounted to ₱1.34 million in 2013, ₱1.46 million in 2012 and ₱1.61 million in 2011. Total deposits maintained by the related party retirement plan with the Bank amounted to ₱11.78 million and ₱38.36 million as of December 31, 2013 and 2012, respectively.

Key Management Personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly. The Bank considers the members of the Senior Management Team to constitute key management personnel for purposes of PAS 24.

Total remunerations of key management personnel are as follows:

	2013	2012	2011
Short-term benefits	**₱136,532,220**	₱64,008,186	₱57,624,208
Post-employment benefits	**40,885,325**	5,905,507	36,282,139
	₱177,417,545	₱69,913,693	₱93,906,347

Details on significant related party transactions of the Bank follow:

	December 31, 2013		
Category	**Volume**	**Outstanding Balance**	**Nature, Terms and Conditions**
Significant investors			
Deposit	**₱73,822,850**	**₱139,976,708**	Savings and time deposit accounts with annual interests ranging from 0.13% to 3.00%.
Interest expense	**2,610,659**		
Rent expense	**1,806,009**		Branch office leased for five years ending on December 18, 2016, with 5% annual escalation.
Rent income	**1,033,094**		Five-year lease, subject for pre-termination with average escalation rate of 7.5%.
Affiliate			
Deposit	**3,677,463**	**9,909,077**	Demand, savings and time deposit accounts with annual interests ranging from 0.13% to 2.00%.
Interest expense	**206,803**		
Rent income	**85,000**		10-year lease expiring on July 31, 2013, fixed rental rate during the entire term of the contract, renewed in August 2013 for another 10 years.
Key management personnel			
Deposit	**55,492,875**	**72,053,382**	Savings and time deposit accounts with annual interests ranging from 0.13% to 3.50%.
Interest expense	**411,310**		
Employee benefit loans	**2,247,092**	**876,231**	Employee benefit loan with average annual interest of 7%.
Interest income	**78,482**		
Provident Fund			
Deposit	**(57,613,314)**	**25,720,007**	Savings and time deposit accounts with annual interests ranging from 0.13% to 3.25%.
Interest expense	**615,362**		
Trust Fee	**2,838,522**		A certain percentage of the monthly ending market value of the fund depending on agreement.
Retirement fund			
Deposit	**(26,581,191)**	**11,782,123**	Savings and time deposit accounts with annual interests ranging from 0.13% to 3.25%.
Interest expense	**212,698**	**15,274**	
Trust Fee	**1,336,601**		A certain percentage of the monthly ending market value of the fund depending on agreement.

Category	Volume	Outstanding Balance	Nature, Terms and Conditions
	2012		
Significant investors			
Deposit	(₱22,083,172)	₱66,153,858	Savings and time deposit accounts with annual interests
Interest expense	271,766		ranging from 0.25% to 1.50%.
Rent expense	2,097,880		Five-year lease, ending on December 18, 2016, with 5% annual escalation.
Affiliate			
Deposit	4,327,206	6,231,614	Demand deposit account with annual
Interest expense	119,463		interests ranging from 0.50% to 1.00%.
Rent income	60,000		10-year lease expiring on July 31, 2013, fixed rental rate during the entire term of the contract.
Key management personnel			
Deposit	16,560,507	16,560,507	Savings and time deposit accounts with annual interests ranging from 0.13% to 3.50%.
Loans	1,370,861	1,370,861	Employee benefit loan.
Provident Fund			
Deposit	11,640,689	83,333,321	Savings and time deposit accounts with annual interests
Interest expense	949,260		ranging from 0.50% to 4.50%.
Trust Fee	3,098,940		A certain percentage of the monthly ending market value of the fund depending on agreement.
Retirement fund			
Deposit	22,009,856	38,363,314	Savings and time deposit accounts with annual interests
Interest expense	404,046	53,967	ranging from 0.50% to 4.50%.
Trust Fee	1,463,179		A certain percentage of the monthly ending market value of the fund depending on agreement.

Category	Volume	Outstanding Balance	Nature, Terms and Conditions
	2011		
Significant investors			
Deposit	₱77,824,305	₱88,237,030	Savings and time deposit accounts with annual interests
Interest expense	259,664		ranging from 0.75% to 1.75%.
Affiliate			
Deposit	(1,895,621)	1,904,408	Demand deposit account with annual
Interest expense	72,750		interest ranging from 0.75% to 1.00%.
Rent income			10-year lease expiring on July 31, 2013, fixed rental rate during the entire term of the contract.
Provident Fund			
Deposit	(247,898,990)	71,692,632	Savings and time deposit accounts with annual interests
Interest expense	3,523,345		ranging from 0.75% to 4.88%.
Trust Fee	3,384,002		A certain percentage of the monthly ending market value of the fund depending on agreement.
Retirement fund			
Deposit	(99,495,034)	16,353,458	Savings and time deposit accounts with annual interests
Interest expense	1,261,069	35,880	ranging from 0.75% to 4.88%.
Trust Fee	1,614,704		A certain percentage of the monthly ending market value of the fund depending on agreement.

Other Terms and Conditions of transactions with Related Parties
Outstanding balances at year-end are unsecured and settlement occurs in cash. The Bank has not recorded any impairment of receivables relating to amounts owed by related parties.

Regulatory Reporting
As required by BSP, the Bank discloses loan transactions with its associates, affiliates and with certain directors, officers, stockholders and related interests (DOSRI). Existing banking regulations limit the amount of individual loans to DOSRI, 70.00% of which must be secured, to the total of their respective deposits and book value of their respective investments in the lending company within the Bank. In the aggregate, loans to DOSRI generally should not exceed total equity or 15.00% of total loan portfolio, whichever is lower.

BSP Circular No. 423 dated March 15, 2004 amended the definition of DOSRI accounts. The following table shows information relating to the loans, other credit accommodations and guarantees classified as DOSRI accounts under regulations existing prior to said Circular, and new DOSRI loans, other credit accommodations granted under said circular:

	2013	2012
Total outstanding DOSRI loans	**₱220,983,359**	₱19,642,110
Total outstanding DOSRI loans granted under regulations existing prior to Circular No. 423	**20,983,359**	19,642,110
New DOSRI loans granted under Circular No. 423	**200,000,000**	–
Total outstanding non-DOSRI loans prior to Circular No. 423	**19,256,317,636**	14,074,724,847
Percent of DOSRI loans to total loans	**1.13%**	0.14%
Percent of unsecured DOSRI loans to total DOSRI loans	**5.16%**	53.47%
Percent of past due DOSRI loans to total DOSRI loans	**0.03%**	0.18%
Percent of nonperforming DOSRI loans to total DOSRI loans	**0.03%**	0.18%

The amounts of loans disclosed for related parties above differ with the amounts disclosed for key management personnel since the composition of DOSRI is more expansive than that of key management personnel.

BSP Circular No. 560 provides that the total outstanding loans, other credit accommodation and guarantees to each of the bank's/quasi-bank's subsidiaries and affiliates shall not exceed 10.00% of the net worth of the lending bank/quasi-bank, provided that the unsecured portion of which shall not exceed 5.00% of such net worth. Further, the total outstanding loans, credit accommodations and guarantees to all subsidiaries and affiliates shall not exceed 20.00% of the net worth of the lending bank/quasi-bank; and the subsidiaries and affiliates of the lending bank/quasi-bank are not related interest of any director, officer and/or stockholder of the lending institution, except where such director, officer or stockholder sits in the BOD or is appointed officer of such corporation as representative of the bank/quasi-bank. As of December 31, 2013 and 2012, the Bank is in compliance with these requirements.

Any violation of the provisions under BSP Circular No. 423 is subject to regulatory sanctions. However, loans, other credit accommodations and guarantees, as well as availments of previously approved loans and committed credit lines that are not considered DOSRI (non-DOSRI) accounts prior to the issuance of BSP Circular No. 423 are not covered by such sanctions for a transition period of two years from the effectivity of the Circular or until said loan, other credit accommodations and guarantees become past due, or are extended, renewed or restructured, whichever comes later.

28. **Financial Performance**

Basic EPS amounts are calculated by dividing the net income for the year by the weighted average number of common shares outstanding during the year.

The following reflects the income and share data used in the basic earnings per share computations:

		2013	2012	2011
a.	Net income	**₱1,632,884,569**	₱984,781,577	₱812,994,448
b.	Weighted average number of common shares outstanding* (Note 19)	**278,403,624**	278,403,624	278,403,624
c.	EPS (a/b)	**₱5.87**	₱3.54	₱2.92

* Weighted average number of outstanding common shares in 2013 was recomputed after giving effect to the quasi-reorganization on March 8, 2013 (see Note 19).

As of December 31, 2013, 2012 and 2011, there were no outstanding dilutive potential common shares.

Before consideration of quasi-reorganization, the EPS of the Bank amounted to ₱5.71 in 2012 and ₱4.71 in 2011.

The following basic ratios measure the financial performance of Bank:

	2013	2012	2011
Return on average equity	**38.58%**	25.62%	44.31%
Return on average assets	**3.01%**	2.26%	2.03%
Net interest margin	**4.34%**	4.77%	4.41%

29. **Notes to Statements of Cash Flows**

The amounts of interbank loans receivable and SPURA considered as cash and cash equivalents as of December 31, 2012, 2011 and 2010 follow:

	2013	2012	2011
Interbank loans receivables and SPURA shown under statements of cashflows	**₱157,878,880**	₱952,554,800	₱2,786,242,240
Interbank loans receivables and SPURA not considered as cash and cash equivalents	**44,671,131**	41,249,410	43,840,000
	₱202,550,011	₱993,804,210	₱2,830,082,240

The following is a summary of noncash activities:

	2013	2012
Noncash operating activities:		
Additions to loans and receivable from disposal of investment properties (Note 11)	**₱–**	₱10,593,720
Additions to investment properties from settlement of loans (Note 11)	**98,233,366**	–
Noncash investing activities:		
Increase in land due to revaluation (Note 10)	**32,367,300**	19,468,950
Changes in fair value of AFS investments (Note 8)	**(371,619,220)**	(312,305,083)
Transfer to property and equipment from investment properties (Notes 10 and 11)	**(87,851,798)**	(252,519,890)

30. Offsetting of Financial Assets and Liabilities

The amendments to PFRS 7, require the Bank 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 table.

December 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]**
Financial liabilities						
Bills payable	**₱7,852,560,353**	**₱–**	**₱7,852,560,353**	**₱8,459,097,099**	**₱–**	**₱–**

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]
Financial assets						
SPURA	₱500,000,000	₱–	₱500,000,000	₱–	₱499,575,000	₱42,500,000
Financial liabilities						
Bills payable	6,640,097,800	–	6,640,097,800	8,406,684,954	–	–

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.

31. Approval for Release of the Financial Statements

The accompanying comparative financial statements were authorized for issue by the BOD of the Bank on February 26, 2014.

32. Supplementary Information Under Revenue Regulations 19-2011

In its 2013 filing for income tax return, the Bank disclosed the following information on taxable income and deductions using the revised format as required under RR 19-2011:

Sales/Receipts/Fees	₱1,206,833,518
Rental income	281,026,399
Cost of Sales/Services	(237,483,941)
Non-Operating and Taxable Other Income	31,533,741
Itemized Deductions	(852,884,899)
	₱429,024,818

The details of the Sales/Receipts/Fees

Interest income	₱964,275,152
Service charges, fees, and commissions	213,741,568
Income from trust operations	22,481,120
Trading and securities gain	6,335,678
	₱1,206,833,518

The details of Cost of Sales follow:

Salaries and wages	₱99,333,080
Interest expense	120,931,301
Insurance	10,985,579
Banking fees	6,233,981
	₱237,483,941

The following composed the Non-operating and Taxable Other Income:

Profit from assets sold or exchanged	₱18,341,532
Trading and securities gain	740,008
Miscellaneous	12,452,201
	₱31,533,741

The following composed the itemized deductions:

Advertising and Promotions	₱2,298,706
Amortizations	13,602,352
Charitable Contributions	9,527
Commissions	9,320,798
Communications, Light and Water	28,966,896
Depreciation	34,566,938
Directors Fees	8,561,407
Fuel and Oil	4,138,184
Insurance	2,075,031
Losses	81,898
Miscellaneous	19,310,421
Professional Fees	65,135,568
Rental	31,617,477
Repairs and Maintenance	644,063
Representation and Entertainment	15,199,594
Salaries and Wages	302,788,169
Securities Services	24,010,898
Taxes and Licenses	122,522,354
Transportation and Travel	5,009,165
Others	163,025,453
	₱852,884,899

33. Supplementary Information Under Revenue Regulations 15-2010

In compliance with the requirements set forth by RR 15-2010 hereunder are the details of percentage and other taxes paid or accrued by the Bank in 2013.

Gross receipts tax	₱280,992,217
Documentary stamp tax	139,288,999
Local taxes	29,443,608
Fringe benefit tax	3,438,133
Others	3,762,933
	₱456,925,890

Withholding Taxes

Details of total remittances in 2013 and outstanding balance of withholding taxes as of December 31, 2013 follow:

	Total Remittances	Balance as of December 31
Final withholding taxes	₱151,723,954	₱18,484,487
Withholding taxes on compensation and benefits	181,559,039	12,620,485
Expanded withholding taxes	49,978,322	4,832,967
	₱383,261,315	₱35,937,939

Tax Assessments and Cases

As of December 31, 2013, the Bank has outstanding cases filed in courts for various claims for tax refund amounting to ₱283.81 million reported under ‘Other assets’ in the statement of financial position.