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Rationale

The issuer credit rating of **PRS Aaa (corp.)** assigned to Philippine Savings Bank (PSBank) is based on the following considerations:

- Healthy revenue generation from its core business, given the bank's strong market franchise;
- Sound capitalization;
- Well-experienced management team; and
- Positive prospects for the domestic economy, in general and the banking industry, in particular.

PSBank is one of Philippines' leading thrift banks (TBs). As of end-December 2014, PSBank was the second largest TB in the Philippines in terms of assets, net loans, deposits and capital. Based on its published balance sheet, PSBank's market share of the thrift banking sector stood at 16.5% of assets, 17.4% of net loans, 16.7% of deposits and 15.4% of capital. As of March 31, 2015 PSBank's branch network stood at 246, while its total number of automated teller machines (ATMs) was 597.

For the period ended December 31, 2014, net income registered a double-digit decline of 20.8% to P2.3 billion, from a historical high of P2.9 billion in 2013. The decrease in net income was due to lesser trading opportunities in 2014. Nevertheless, core income continued to grow in 2014. Total interest income posted a marked increase of 12% to P10.1 billion, resulting mainly from increases in interest income on loans and receivables (+8.5%) and interest income on interbank loans receivables (+79.4%). Net interest income contributed 73% of revenues in 2014, significantly up from 52.7% in 2013 and 61.2% in 2012.

Net interest income will continue to account for bulk of revenues in 2015 and 2016. The growth in net interest income, coupled with the expected slowdown in the growth of other operating expenses, will allow net income to improve in 2015. Revenues in 2016, on the other hand, will benefit from faster growth in net interest income, as well as from a recovery in other operating income after two-year consecutive declines.

While licensed as a savings bank, PhilRatings notes that the amount of PSBank's capital was higher than selected mid-size commercial banks, as of end-2014. Total equity slightly went up by 9% to P17.7 billion as of December 31, 2014, as earnings were re-invested into operations. The bank had a capital adequacy ratio (CAR) of 19.6% of end-2014, which was well above the regulatory minimum of 10%. PSBank's CAR stood at 19.3% as of March 31, 2015.

The Philippine banking industry continued to benefit from the country's strong macroeconomic growth in 2014. Full year Gross Domestic Product (GDP) growth was registered at 6.1%. Despite falling investment yields due to volatilities in the local and global markets, banking performance remained positive as banks increased lending activities.

TBs, known to have carved their niche in consumer financing, particularly registered strong loan demand in 2014. Net loans grew by 13.8% to P555.3 billion, with consumer loans (CL) accounting for 57.9% of total. As of December 31, 2014, total CLs amounted to P330.5 billion, a 33.7% growth from last year's P247.1 billion. The favorable movement was mainly driven by an expansion in residential real estate loans (RREL) and auto loans (AL) which were likewise the largest components of CLs, with shares of 49.6% and 34.8%, respectively. TBs accounted for 36.6% of the banking industry's total CL portfolio, better than its 34.2% share in 2013.

Profile

PSBank is one of Philippines' leading TBs. It was incorporated on June 30, 1959 to primarily engage in savings and mortgage banking. Today, PSBank offers a wide array of products and services such as deposit products, loans, treasury and trust functions that mainly serve the retail and consumer markets.

As of end-December 2014, PSBank was the second largest TB in the Philippines in terms of assets, net loans, deposits and capital. Based on its published balance sheet, PSBank's market share of the thrift banking sector stood at 16.5% of assets, 17.4% of net loans, 16.7% of deposits and 15.4% of capital. While licensed as a TB, PSBank was comparable with selected mid-size domestic KBs in terms of assets, loans, deposits, and capital.

As part of its efforts to further solidify the bank's market presence, PSBank continues to expand its branch and ATM networks. In 2014, PSBank opened 21 new branches and installed 44 additional ATMs across the country. PSBank ended the year with 245 and 595 branches and ATMs, respectively. In the first quarter of 2015, PSBank further added one branch and two ATMs to its distribution network. As of March 31, 2015 PSBank's branch network stood at 246, while its total number of ATMs was 597.

Ownership and Legal Status

As of March 31, 2015, PSBank was 76% owned by Metropolitan Bank and Trust Company (Metrobank). Metrobank is a publicly-listed universal bank (unibank) which offers a variety of commercial and investment banking services through a network of over 2,000 local and international branches, subsidiaries, representative offices and remittance correspondents and agencies. As of December 31, 2014, Metrobank was the second¹ largest bank in the Philippines based on assets (P1.3 trillion), net loans (P681.5 billion), deposits (P1.1 trillion) and capital (P143.8 billion).

PSBank serves as Metrobank's consumer and retail banking arm. PSBank's strategic and operating direction is seen to be heavily influenced by Metrobank, given both banks' common directors and key officers. PSBank's Vice Chairman of the Board, Mr. Arthur V. Ty, is also Metrobank Chairman while Mr. Vicente R. Cuna, Jr., PSBank President, is at the same time Director and Senior Executive Vice President of Metrobank. Mr. Cuna was elected Director of Metrobank on April 30, 2014.

¹ Based on published balance sheet submitted to the BSP, for market share comparisons

In February 2015, Ms. Margaret Ty Cham resigned as director of PSBank due to personal reasons. Ms. Ty Cham was elected as director of PSBank in 2004. During PSBank's Annual Stockholders' Meeting on April 28, 2015, Mr. Severinus Petrus P. Hermans was elected as a director of the bank. Mr. Hermans is the President and Chief Executive Officer of Philippine AXA Life Insurance Corporation (AXA Philippines). AXA Philippines is one of the leading life insurance companies in the country. He previously held key positions in various financial institutions such as the ING Financial Services (Poland), ING Insurance Malaysia and ING Life Philippines.

In July 2014, PSBank appointed Mr. Emmanuel A. Tuazon as Senior Vice President for Marketing. Mr. Tuazon has 25 years of experience in banking, particularly in the areas of marketing and project management. Prior to joining PSBank, Mr. Tuazon served as Chief Marketing Officer of Philippine National Bank.

Although its ownership is concentrated, PhilRatings believes that PSBank remains professionally managed, given its management team's extensive knowledge of and experience in the banking industry.

PSBank also continued to be compliant with regulatory policies on lending to directors, officers, stockholders, and related interests (DOSRI). As of December 31, 2014, the ratio of PSBank's DOSRI loans to total loans stood at 2.8%. Under existing banking regulations, loans extended to DOSRI should not exceed total equity or 15% of total loan portfolio, whichever is lower.

Although its employees are unionized, PSBank has been strike-free throughout its entire history. The current Collective Bargaining Agreement (CBA) with its employees' union is set to expire on December 31, 2015.

Strategy

Throughout the years, PSBank has consistently launched new business initiatives which have contributed positively to its already-strong market franchise in the fast-growing consumer and retail markets.

In March 2014, PSBank introduced the PSBank Money Market Fund, its first Unit Investment Trust Fund (UITF) product. Targeting young professionals and Overseas Filipinos (OFs), the product aims to make investing easy and affordable. The PSBank Money Market Fund requires a minimum initial investment of P10,000. Pooled funds are invested in treasury bonds and other instruments with minimal risk, providing customers with a liquid and low volatility investment option.

To address the needs of its increasingly mobile client base, PSBank launched the PSBank Online Mobile App (PSBank Mobile App). The features of the product include account checking and bills payment, among others.

In September 2014, PSBank introduced the PSBank LiveChat as part of its support services. Through the PSBank website, existing and potential customers can now communicate with PSBank customer service assistants regarding their product inquiries and other banking concerns using real-time chat service. As this platform is internet-based, clients (particularly Overseas Filipinos and those who are active online) no longer need to make a call to the bank's customer service hotline for their service concerns. The PSBank LiveChat is reportedly the first of its kind in the Philippine banking industry.

PSBank also forged a bancassurance partnership with AXA Philippines in 2014. Through this partnership, PSBank customers can have access to group and individual life insurance products offered by AXA Philippines. AXA Philippines is one of the largest life insurance companies in the Philippines. Based on statistics from the Insurance Commission as of December 31, 2014, AXA Philippines' industry ranking was as follows: second, based on premium income (P18.3 billion); third in net income (P1.2 billion); fifth, based on assets (P66.8 billion); and ninth in net worth (P2.9 billion). It is the first company to start structured distribution of life insurance products in 2004, through bank branch networks. AXA Philippines is a joint venture between Metrobank, PSBank's parent company, and AXA Group, a global leader in insurance and asset management. As of May 31, 2015, there were 207 PSBank branches offering bancassurance.

PSBank's strategies will continue to focus on customer/deposit generation and customer service improvement, going forward. PSBank sees an expanded customer base as a means to achieve a more stable and resilient operating environment amid market fluctuations, while a growing deposit base is considered as a source of inexpensive funding and consequently, provides an opportunity to improve margins.

Deposit expansion will be done by raising deposit levels from new and existing customers, while at the same time minimizing attrition. Focus will also be on electronic enhancements and mobile banking, as the bank's tech-savvy customers become a growing market.

In order to prevent incidences of ATM fraud, PSBank looks towards fully making all its ATMs EMV-compliant. EMV, which stands for Europay, MasterCard and Visa, is a global standard for chip-based credit and debit transactions that is considered more secure than magnetic stripe cards. EMV-chip enabled cards carry unique codes for every transaction, reducing card fraud resulting from counterfeit, lost and stolen cards. It should be noted that the BSP has required the adoption of this new technology by 2017. As of report writing date, almost 90% of PSBank ATM machines are already EMV-enabled. PSBank targets to make all its ATMs EMV-enabled by end-2015. Furthermore, PSBank is targeting to migrate to EMV chip technology for its ATM cards by the first quarter of 2016.

PSBank recently launched the PSBank ATM Lock for its ATM cards as an additional safety feature against ATM fraud. This feature allows clients to lock their ATM cards from use and unlock them when needed. Clients with locked cards will not be able to use them for ATM or POS transactions nor pay for online purchases that require the ATM card number. The cardholders, on the other hand, are still allowed to pay bills and transfer funds through PSBank's internet banking facility, PSBank Mobile and over-the-counter. The lock and unlock service is accessible through PSBank Mobile wherein users are sent a confirmation message immediately after request to either lock or unlock their ATM cards. An additional notification is sent to users' registered email address. The confirmation messages allow users to keep track of the status of their ATM cards. The PSBank ATM Lock service is exclusively for PSBank Mobile App users and for clients who have accounts linked to a PSBank Regular ATM card, PSBank Debit MasterCard, PSBank Prepaid MasterCard, and PSBank Flexi Personal Loan ATM. This service will also be made available through short message service (SMS) for all networks in the near future.

Outlook for Consumer Lending

The Philippine banking industry continued to benefit from the country's strong macroeconomic growth in 2014. Full year GDP growth was registered at 6.1%. Despite falling investment yields due to volatilities in the local and global markets, banking performance remained positive as banks increased lending activities.

TBs, known to have carved their niche in consumer financing, particularly registered strong loan demand in 2014. Net loans grew by 13.8% to P555.3 billion, with CL accounting for 57.9% of total. As of December 31, 2014, total CLs amounted to P330.5 billion, a 33.7% growth from last year's P247.1 billion. The favorable movement was mainly driven by an expansion in RREL and AL which were likewise the largest components of CLs, with shares of 49.6% and 34.8%, respectively.

RREs grew by 31.2% to P163.8 billion given sustained optimism in the Philippine property market. ALs reached P115.1 billion, 23% higher than the P93.5 billion booked as at end-2013. Growth in ALs was on the back of relatively low interest rates and increased demand for automobiles. The remaining 15.6% of CLs consisted of credit card receivables, salary loans and other consumer loans.

Overall, TBs managed to grow their business in 2014, as reflected in the increases of the sector's total assets (+13.9%), deposits (+10.3%) and capital (+26.7%). TBs also regained some footing in the banking industry in terms of share in total CLs. TBs accounted for 36.6% of the industry's total CL portfolio, better than its 34.2% share in 2013.

In May 2014, BSP implemented the Real Estate Stress Test (REST) as part of its effort to improve governance and risk management of the banking industry. The objective of REST is for domestic banks to maintain a healthy exposure to the real estate industry. Under REST guidelines, a bank is required to maintain Tier I capital of at least 6% and Tier II capital of at least 10% against its credit exposures in real estate.

During the first quarter of 2015, the Philippine economy grew at its slowest pace since 2011. GDP growth rate for the first quarter of 2015 was registered at 5.2%, lower than the 6.6% recorded in the previous quarter and down from that for the same period in 2014 (5.6%). The slowdown was due to slower-than-planned public spending, particularly the decline in public construction spending given delays in several projects of government agencies. Public construction spending amounted to P56.3 billion, 24.6% lower compared to the P73.9 billion from a year ago.

The services sector continued to account for the bulk of GDP, contributing 3.1%. The services sector expanded by 5.6% during the first quarter of 2015. The industry and agriculture sectors, on the other hand, grew by 5.5% and 1.6%, respectively. On the demand side, household spending remained robust albeit growth was lower than the 6.1% registered during the same period in 2014. Total household final consumption grew by 5.4% in first quarter.

Although growth figures were below government and market expectations, the government expressed confidence that its full year growth target of 7- 8% is still achievable, with an expected acceleration in government spending, exports and the services sectors in the succeeding quarters.

The outlook for the Philippine banking industry remains positive, given the expectation of robust domestic demand as consumers and businesses benefit from increased government spending and sustained investment activities.

Asset Quality

As of December 31, 2014, PSBank's total bank resources stood at P145.6 billion, up by 12% from P130 billion in the previous year. Growth in total resources was mainly due to the expansion in loan portfolio and higher Special Deposit Accounts (SDA) placements with the BSP.

Net loans and receivables posted a 15.5% increase to P95.8 billion, as a result of strong demand for consumer loans on the back of the country's growing economy. As at end-2014, PSBank's loan portfolio² remained to be largely made up of auto loans (46.1% of total) and real estate loans (34.5%). ALs were at P46.3 billion while REL stood at P34.6 billion, higher by 18.3% and 20.4%, respectively, from end-2013.

PSBank's NPL ratio (gross) was kept at low single-digit levels, and further improved as of end-2014 due to the significant expansion in loan portfolio. Non-performing assets (NPAs) posted an increase as a result of higher foreclosures. Still, the bank's NPA ratio remained within acceptable levels as of end-2014.

Growth in the bank's loan portfolio will keep PSBank's NPL and NPA ratio at minimal levels, going forward. Loan loss reserves to NPAs will reach more than 100% as of end-2016, indicating more than sufficient buffer to absorb possible losses.

Due from BSP more than tripled to P24 billion, resulting in an increase in its share to total assets to 16.5%, from 5.7%. This was due to the higher balance of SDA maintained with the BSP given excess funds, as PSBank was not able to roll-over its reverse repurchase agreement (RRP) placement with BSP in December 2014. Interbank loans receivables and SPURA, on the other hand, decreased by 84.9% to P2.2 billion, from the P14.5 billion recorded as at end-2013.

With new investments in private bonds, held-to-maturity investments (HTM) were recorded at P1.7 billion. Available-for-sale investments (AFS), on the other hand, grew by 7.7% to P6.1 billion.

In 2014, PSBank sold its 25% ownership stake in Toyota Financial Services Philippines Corporation (TFSPC) to GT Capital Holdings Inc. The sale was in line with PSBank's capital planning initiatives in view of the implementation of Basel III. TFSPC provides financing and leasing services for customers of Toyota vehicles in the Philippines.

Total assets went down by 4% to P139.7 billion as of March 31, 2015, from end-2014. The downward movement was caused by a significant drop of 37.6% in due from BSP, which represented 10.7% of total assets. Core business, on the other hand, continued its expansion with net loans and receivables increasing to P100.3 billion, a 4.8% growth from end-2014.

Asset Composition

PSBank continued to focus on the retail and consumer markets, as indicated by its industry exposure. In terms of concentration, 85.1% of the company's portfolio consisted of exposure in activities of households: as employers and undifferentiated goods-and-services producing activities of households for

² Refers to loans gross of allowance for credit losses and net of unearned discounts

own use (52.9%), and real estate activities (32.2%). Although considerably concentrated, risks are counterbalanced by the bank's satisfactory asset quality. From a regulatory view point, TBs are not covered by the loan concentration limit of 30% prescribed by the BSP. PSBank's loan portfolio also remained largely secured as of December 31, 2014. Secured loans represented 74.6% of the portfolio, while unsecured loans accounted for the remaining 25.4%. In terms of type of collateral, credit was mostly secured by chattel (47.4% of total loans) and real estate (26.3%).

Profitability

Audited 2014

For the period ended December 31, 2014, net income registered a double-digit decline of 20.8% to P2.3 billion, from a historical high of P2.9 billion in 2013. The decrease in net income was due to lesser trading opportunities in 2014. The bank posted a 94.8% decline in trading and securities gain to P210 million, from P4.1 billion in 2013. Given lower net income for the year, return on average assets (ROAA) slipped to 1.7% from 2.4% in 2013.

Nevertheless, core income continued to grow in 2014. Total interest income posted a marked increase of 12% to P10.1 billion, resulting mainly from increases in interest income on loans and receivables (+8.5%) and interest income on interbank loans receivables (+79.4%). Total interest expense, on the other hand, slightly went up by 2.7% to P2.4 billion mainly due to the issuance of P3 billion Unsecured Subordinated Notes in May 2014. These movements resulted in net interest income of P7.7 billion, up by 15.3% from 2013. Reflecting industry trend, the bank's net interest income has been accounting for a larger share of revenues in the past three years. Net interest income contributed 73% of revenues in 2014, significantly higher than 52.7% in 2013 and 61.2% in 2012.

For the quarter ended March 31, 2015

For the first quarter of 2015, PSBank booked total revenues of P2.6 billion, a 2.1% improvement from that for the same period in 2014. The growth was driven by higher net interest income (+5.1%) offset by the decline in other operating income (-6.3%).

Total interest income expanded by 8.2% to P2.6 billion on the back of loan portfolio expansion. The increases in interest expense on deposit liabilities (+13.1%) due to higher average daily balance on time deposits and on subordinated notes payable (+84.4%), accounted for the higher total interest expense of P660.1 million (+19.1%). These developments resulted in a slowdown in net interest income growth of 5.1%. Net interest income for the period amounted to P2 billion.

Total other operating income decreased by 6.3% to P615.4 million as PSBank incurred a trading loss of P3.3 million (compared to a trading gain of P104.1 million during the same period in 2014).

Total other operating expenses (including provision for impairment and credit losses) rose by 5.5% to P2.2 billion primarily due to higher compensation and fringe benefits (+6%) and taxes and licenses (+9.6%). As a result of these developments, net income recorded a double-digit decline of 17.4% to P387.1 million, from the P468.7 million during the same period a year ago. ROAA for the first quarter of 2015 was 1.1%, marginally down from 1.4% in the same period of 2014.

Higher interest expense will temper the growth in PSBank's net interest income, albeit the latter will continue to account for bulk of revenues in 2015. After two years of consecutive declines, non-interest income is expected to post a recovery in 2016. Profitability measures in 2016, however, are projected to remain subdued due to higher operating expenses resulting from increases in wages and provision for probable losses. The expected increase in wages takes into account the renewal of the bank's CBA and additional manpower from branch expansion during the year, while the higher provision is relative to portfolio growth.

Asset-Liability Management

PSBank's funding profile remained largely made up of deposits, with the latter representing 91.1% of total liabilities as of end-2014. Total deposits of P116.5 billion marked a 9.4% growth as of end-2014, from the P106.5 billion recorded from a year ago. Time deposits continued to account for bulk of the bank's deposit base, at 75% of total. The figure, however, was lower from 76.3% as of end-2013 and 79.1% as of end-2012, and indicating the bank's continued effort to lower its cost of funding. PhilRatings also positively notes that the less expensive and less volatile current and savings accounts (CASA) posted faster growth rates of 17.2% and 14.3%, respectively relative to the 7.5% increase in time deposits. PSBank had time deposits of P87.4 billion, as of December 31, 2014. Current and savings deposits stood at P10.6 billion and P18.5 billion, respectively. As indicated by its net loans to deposits ratio of 82.2%, PSBank further strengthened its financial intermediation activities in 2014. The ratio was an improvement from 77.8% as of end-2013, and indicated faster loan growth vis-à-vis deposit growth. For the projected period 2015 and 2016, deposits will continue as PSBank's main funding source.

Total deposits as of March 31, 2015 stood at P110.6 billion, a 5.1% decline from end-2014. The decline was mainly due to a drop in time deposits (-9.1%), representing 71.9% of total deposits, on top of growth in CASA (+6.8%). Net loans to deposits ratio stood at a high of 90.7%, as of March 31, 2015.

Tier 2 capital is a subordinated debt that, in the event of bankruptcy when a company can no longer pay its debts, receives payment only after other secured claims are settled. However, considering the financial strength and very good performance of PSBank over the years, the possibility that it will become bankrupt in the future is highly improbable.

Capital

While licensed as a savings bank, PhilRatings notes that the peso amount of PSBank's capital was higher than selected mid-size commercial banks, as of end-2014. Total equity went up by 9% to P17.7 billion as of December 31, 2014, as earnings were re-invested into operations.

The bank had a CAR of 19.6% of end-2014, which was well above the regulatory minimum of 10%. PSBank's CAR stood at 19.3% as of March 31, 2015.

For the projected period 2015 and 2016, growth in equity will be done through the plowback of earnings into operations. CAR, however, will continue to be above the regulatory minimum.