That moment you realized there's a bank that can surprise and delight you

PSBank
PHILIPPINE SAVINGS BANK
Metrobank Group

2017 AUDITED FINANCIAL STATEMENTS

WHO WE ARE

Philippine Savings Bank (PSBank) is the consumer and retail thrift bank arm of the Metrobank Group, one of the Philippines' largest and leading banks. For more than 50 years, PSBank has built a reputation for its *Simple Lang. Maaasahan* (simple and reliable) brand of banking. Enabled by digital technology, we are able to delight our customers at every encounter.

OUR VISION

To be the country's consumer and retail bank of choice.

OUR MISSION

- As an INSTITUTION
  To conform to the highest standards of integrity, professionalism and teamwork.
- For our CLIENTS
  To provide superior products and reliable, top-quality services responsive to their banking needs.
- For our EMPLOYEES
  To place a premium on their growth, and nurture an environment of teamwork where outstanding performance is recognized.
- For our SHAREHOLDERS
  To enhance the value of their investments.

OUR BUSINESS MODEL

The core business of PSBank is focused on expansion of the consumer business by growing its retail deposit and consumer loans, including SME, through various channels which include, but are not limited to, branch and digital channels.

What's Inside

02
MANAGEMENT'S DISCUSSION AND ANALYSIS

05
SUPPLEMENTARY MANAGEMENT DISCUSSION

12
STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

14
INDEPENDENT AUDITOR'S REPORT

18
STATEMENTS OF CONDITION

19
STATEMENTS OF INCOME

20
STATEMENTS OF COMPREHENSIVE INCOME

21
STATEMENTS OF CHANGES IN EQUITY

22
STATEMENTS OF CASH FLOWS

24
NOTES TO FINANCIAL STATEMENTS

116
SHAREHOLDERS INFORMATION

Making that Aha! Moment

Every company talks about how good they are when it comes to serving their customers. But the Holy Grail of customer service is the 'Aha!' moment. That's when customers realize that your product or service is exactly what they absolutely need.

For PSBank, finding these delightful 'Aha!' moments requires more than reaching out to our customers through various touchpoints. It takes a clear vision and a roadmap, a deeper analysis of customer insights, and an entire organization moving with a singular focus to delight customers. Since embarking on a customer experience journey, making 'Aha!' moments consistently for our customers has become our North Star.

May you discover your own 'Aha!' moments, too, while reading this.

BALANCE SHEET

Assets

Our Total Assets as of December 31, 2017 amounted to PhP223.32 billion, 13.45% higher than the PhP196.85 billion the previous year. The growth was primarily due to the expansion of our loan and investment portfolio.

Loans and Receivables

Loans and Receivables increased by 13.95% to PhP144.96 billion with the continued upsurge in our consumer lending business. Auto loans rose by 20.97% while Mortgage loans expanded by 5.92%.

Securities and Investments

Due from Other Banks decreased by 17.96% to PhP1.51 billion in 2017 from PhP1.84 billion in 2016. Interbank Loans Receivable and Securities Purchased under Resale Agreement posted a 43.40% decline to PhP1.84 billion.

Available-for-Sale Investments increased by 29.05% to PhP16.93 billion from PhP13.12 billion in 2016. Held-to-Maturity Investments rose by 27.28% to PhP29.47 billion in December 2017 from PhP23.16 billion in the previous year. On the other hand, Fair Value through Profit or Loss Investments decreased to PhP366.24 million from PhP1.36 billion in 2016.

Investment in a Joint Venture decreased by 16.50% to PhP607.16 million. We currently have a 30.00% stake in Sumisho Motor Finance Corporation.

Goodwill and Intangible Assets went up to PhP714.92 million from PhP505.17 million posted in 2016.

Deferred Tax

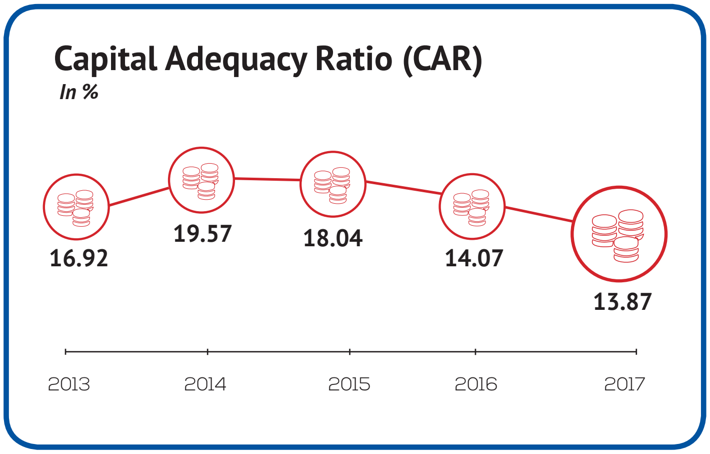
Deferred Tax Assets was higher by 9.89% at PhP1.43 billion as we recognized deferred tax benefits from the loan-loss provisioning during the year.

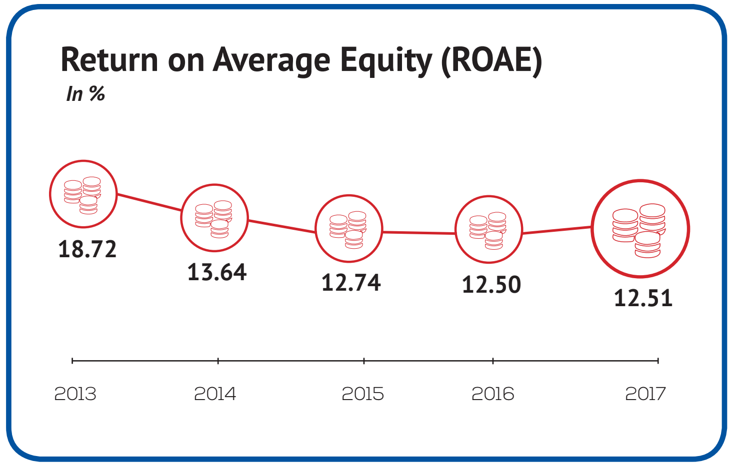
Deposit Liabilities

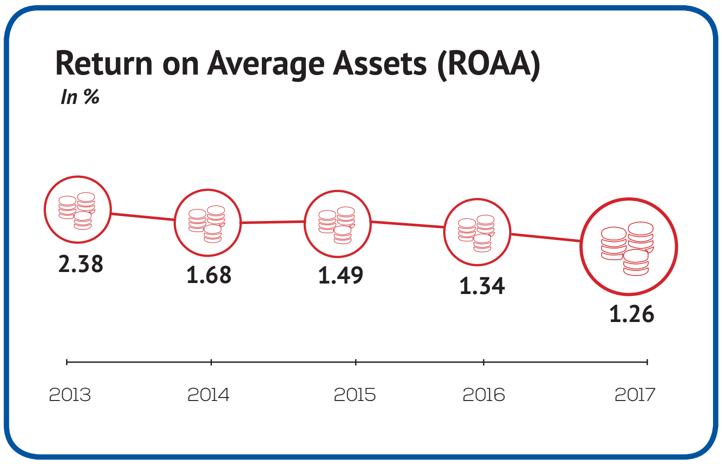
Total Deposit Liabilities went up by 19.27% year on year to PhP188.91 billion. Demand deposit was higher by 24.60% to PhP19.11 billion while Savings deposits grew by 11.56% to PhP30.38 billion. Meanwhile, Time deposits, including Long-term Negotiable Certificates of Deposits (LTNCDs), increased by 20.38% to PhP139.42 billion. On December 8, 2016, the BSP authorized the Bank to issue LTNCDs up to PhP10.00 billion through one or multiple tranches over a period of one year. On January 30, 2017, the Bank issued the first tranche of LTNCDs amounting to PhP3.38 billion due on April 30, 2022 with fixed interest rate of 3.50% per annum payable quarterly.

Bills Payable

Bills Payable decreased by 75.51% to PhP1.49 billion from PhP6.09 billion in 2016 as this was replaced by deposits.







Tier 2 Notes

The Subordinated Notes or Tier 2 Notes, net of debt issuance cost was recorded at PhP2.98 billion in December 2017, 50.15% or PhP3.00 billion lower than the 2016 year-end level of PhP5.98 billion as the Bank exercised the call option of its PhP3.00 billion Tier 2 Notes issued in February 2012. The Tier 2 Notes issued in May 2014 qualified as Tier 2 Capital in the BSP's revised risk-based capital adequacy framework in line with Basel III standards.

Capital

Capital was higher by 11.76% at PhP22.39 billion from PhP20.04 billion in 2016. Net Unrealized Loss on Available-for-Sale Investments decreased by 51.18%. We declared quarterly dividends of PhP0.75 per quarter, consistent with our dividend policy.

As of end 2017, Common Equity Tier 1 (CET1) Ratio was at 11.09% while Total Capital Adequacy Ratio (CAR) was at 13.87%. Both ratios are above the Bank's 2017 minimum regulatory requirements of 9.33% and 10.00% for CET1 and Total CAR, respectively.

INCOME STATEMENT

Net Income

We ended 2017 with a Net Income of PhP2.65 billion. This is higher by 8.31% compared to the reported Net Income last year of PhP2.45 billion. The higher income was primarily due to the consistent growth of the Bank's core consumer loans business.

Net Interest Income

Net Interest Income increased to PhP11.08 billion in 2017 from PhP9.66 billion the same period last year. Interest Income on Loans and Receivables rose to PhP12.48 billion from the growth in loan portfolio. Interest Income on Investment Securities was also higher at PhP1.82 billion.

On the other hand, Interest Expense on Deposit Liabilities rose by 33.39% to PhP3.21 billion versus the previous year's PhP2.41 billion on account of our higher deposit levels. Interest Expense on Subordinated Notes amounted to PhP191.06 million in 2017.

Non-Interest Income

Net Service Fees and Commission Income increased by 21.07% to PhP1.38 billion from PhP1.14 billion in 2016. We reflected a Gain on Foreclosure and Sale of Chattel Mortgage Properties of PhP584.95 million, or 66.31% higher compared to the 2016 level. Foreign Exchange Gain increased to PhP56.48 million.

The Bank recorded its Share in Net Income of a Joint Venture in Sumisho Motor Finance Corporation at PhP71.84 million from PhP35.47 million last year. This was higher by 102.55% versus the same period last year.

Operating Expenses and Provisions

Total Operating Expenses amounted to PhP11.04 billion in 2017, increasing by 12.15% or PhP1.20 billion, year on year. Compensation and Fringe Benefits increased by PhP337.71 million or 11.55% to PhP3.26 billion while Taxes and Licenses went up by 19.88% to PhP1.27 billion compared to last year. We booked a total of PhP2.27 billion in Provision for Credit and Impairment Losses as of end-December 2017.

On January 15, 2013, the Bangko Sentral ng Pilipinas, through its Circular No. 781, issued the Basel III Implementing Guidelines on Minimum Capital Requirements. The guidelines took effect on January 01, 2014 wherein the risk-based capital ratio of the Bank, expressed as a percentage of qualifying capital to risk weighted assets, shall not be less than ten percent (10%) for both solo and consolidated basis. Other minimum capital ratios include Common Equity Tier 1 (CET1) ratio and Tier 1 capital ratios of 6.0% and 7.5%, respectively. A capital conservation buffer of 2.5%, comprised of CET1 capital, was likewise imposed.

As of December 31, 2017 and 2016, the Bank maintains these ratios above minimum requirements.

The capital-to-risk assets ratio of the Bank as reported to the BSP as of December 31, 2017 and 2016 based on BASEL III are shown in the table below (in millions):

	2017	2016
Common Equity Tier 1 capital	**₱20,898**	₱18,768
Less: Regulatory Adjustments to CET1 capital	**3,583**	3,281
Total Tier 1 Capital	**17,315**	15,487
Tier 2 capital	**4,346**	4,168
Less: Regulatory Adjustments to Tier 2 capital	**–**	–
Total Tier 2 capital	**4,346**	4,168
Total qualifying capital (Note 21)	**₱21,661**	₱19,655
Credit risk-weighted assets	**₱136,570**	₱119,006
Market risk-weighted assets	**346**	913
Operational risk-weighted assets	**19,224**	19,819
Risk weighted-assets (Note 21)	**₱156,140**	₱139,738

	2017	2016
Common equity tier 1 ratio*		
Common equity tier 1 capital		
Divided by: Total Risk-weighted assets	**11.09%**	11.08%
Tier 1 capital ratio (Note 21)		
Adjusted tier 1 capital		
Divided by: Total risk-weighted assets	**11.09%**	11.08%
Total capital adequacy ratio (Note 21)		
Total qualifying capital		
Divided by: Total risk-weighted assets	**13.87%**	14.07%

*As of December 31, 2017 and 2016, the capital conservation buffer was 5.09% and 5.08%, respectively.

The regulatory qualifying capital of the Bank consists of Tier 1 (going concern) capital and Tier 2 (gone-concern) capital. Tier 1 capital is composed of Common Equity Tier 1 (CET1) and Additional Tier 1 (AT1) capital. The Common Equity Tier 1 consists of paid-up common stock, additional paid-in capital, retained earnings, undivided profits and other comprehensive income including net unrealized gains or losses on AFS securities, cumulative foreign currency translation and remeasurement of net defined benefit assets less regulatory adjustments to CET1 capital, such as unsecured credit accommodations to DOSRI, deferred tax assets, goodwill, other intangible assets, significant minority investments in a joint venture. The other component of regulatory capital is Tier 2 capital, which includes instruments issued by the bank that are eligible as Tier 2 capital and general loan loss provision.

The components of Tier 1 capital and regulatory adjustments as follow (in millions):

	2017	2016
	CET1	CET1
Paid-up common stock	**₱2,403**	₱2,403
Additional paid-in capital	**2,818**	2,818
Retained Earnings	**14,139**	12,489
Undivided Profits	**2,497**	2,366
Other comprehensive income		
Net unrealized gains (losses) on AFS securities	**(412)**	(837)
Cumulative foreign currency translation	**(6)**	(0)
Remeasurement Losses on Retirement Plan	**(541)**	(471)
Sub-total	**₱20,898**	₱18,768
Less Regulatory adjustments:		
Total outstanding unsecured credit accommodations, both direct and indirect, to directors, officers, stockholders and their related interests (DOSRI)	**₱247**	₱218
Deferred tax asset	**2,037**	1,860
Goodwill	**30**	30
Other intangible assets	**662**	452
Significant minority investments	**607**	721
Total deductions	**3,583**	3,281
Total Common Equity Tier 1 capital	**₱17,315**	₱15,487
Additional Tier 1 (AT1) capital	**–**	–
Total Tier 1 capital	**₱17,315**	₱15,487

Full reconciliation of all regulatory capital elements back to the balance sheet in the audited financial statements as follow (in millions):

	2017			2016		
	Common Equity Tier 1 Capital	**Reconciling Items**	**Audited Financial Statements**	Common Equity Tier 1 Capital	Reconciling Items	Audited Financial Statements
Paid-up common stock	**₱2,403**	**₱–**	**₱2,403**	₱2,403	₱–	₱2,403
Additional paid-in capital	**2,818**	**–**	**2,818**	2,818	–	2,818
Retained Earnings	**14,139**	**1,339**	**15,478**	12,489	1,259	13,748
Undivided Profits	**2,497**	**157**	**2,654**	2,366	85	2,451
Net unrealized gains on AFS securities	**(412)**	**0**	**(412)**	(837)	(6)	(843)
Remeasurement Losses on Retirement Plan	**(541)**	**(3)**	**(544)**	(471)	(69)	(540)
Cumulative foreign currency translation	**(6)**	**2**	**(4)**	(0)	1	1
Tier 1 (CET1) Capital/Total Equity	**₱20,898**	**₱1,495**	**₱22,393**	₱18,768	₱1,270	₱20,038

Certain adjustments are made to PFRS-based results and reserves, as prescribed by the BSP and vice versa.

The components of Tier 2 capital and deductions, as reported to BSP as of December 31, 2017 and 2016 consist of the following (in millions):

	2017	2016
Unsecured subordinated debts	**₱2,979**	₱2,976
General loan loss provision*	**1,367**	1,192
Less: Regulatory adjustments	**–**	–
Total Tier 2 capital	**₱4,346**	₱4,168

*Limited to a maximum of 1% of credit risk-weighted assets, and any amount in excess thereof shall be deducted from the credit risk-weighted assets in computing the denominator of the risk-based capital ratio

Risk weighted assets by type of exposure as of December 31, 2017 and 2016 consist of the following (in millions):

	2017		
	Credit Risk	**Market Risk**	**Operational Risk**
On-Balance Sheet	**₱136,452***	**₱–**	**₱–**
Off-Balance Sheet	**33**	**–**	**–**
Counterparty in the Banking Book	**142**	**–**	**–**
Counterparty in the Trading Book	**100**	**–**	**–**
Interest Rate Exposures	**–**	**240**	**–**
Foreign Exchange Exposures	**–**	**106**	**–**
Basic Indicator	**–**	**–**	**19,224**
Total	**₱136,727**	**₱346**	**₱19,224**
Capital Requirements	**₱13,673**	**₱35**	**₱1,922**

*net of General loan loss provision [in excess of the amount permitted to be included in Tier 2]

	2016		
	Credit Risk	Market Risk	Operational Risk
On-Balance Sheet	₱118,498*	₱–	₱–
Off-Balance Sheet	34	–	–
Counterparty in the Banking Book	442	–	–
Counterparty in the Trading Book	32	–	–
Interest Rate Exposures	–	864	–
Foreign Exchange Exposures	–	49	–
Basic Indicator	–	–	19,819
Total	₱119,006	₱913	₱19,819
Capital Requirements	₱11,901	₱91	₱1,982

*net of General loan loss provision [in excess of the amount permitted to be included in Upper Tier 2]

The Bank's total risk-weighted on-balance sheet assets, net of specific provision broken down by type of exposures as follow (in millions):

2017	Exposures, Net of Specific Provisions	Exposures Covered by CRM, Gross of Materiality Threshold	Exposures, not covered by CRM	Risk Weights 0%	20%	50%	75%	100%	150%	Total
Cash on Hand	₱2,597	₱–	₱2,597	₱2,597	₱–	₱–	₱–	₱–	₱–	₱2,597
Due from Bangko Sentral ng Pilipinas (BSP)	15,213	–	15,213	15,213	–	–	–	–	–	15,213
Due from Other Banks	1,491	–	1,491	–	315	269	–	907	–	1,491
Available for sale (AFS) Financial Assets	17,179	502	16,678	6,886	3,455	3,551		2,785		16,677
Held to Maturity (HTM) Financial Assets	29,927	–	29,927	23,160	2,035	2,715	–	2,017	–	29,927
Loans and Receivables										
Interbank Loans Receivable	1,264	–	1,264	–	1,264	–	–	–	–	1,264
Loans and Receivables – Others	144,452	23,794	120,658	–	1,883	5,210	–	111,276	2,289	120,658
Loans and Receivables Arising from Repurchase Agreements	578	–	578	578	–	–	–	–	–	578
Sales Contract Receivable	73	–	73	–	–	–	–	54	19	73
Real and Other Properties Acquired	3,006	–	3,006	–	–	–	–	–	3,006	3,006
Total Exposures, Excluding Other Assets	215,780	24,296	191,484	48,434	8,952	11,745	–	117,039	5,314	191,484
Other Assets	3,779	–	3,779	–	–	–	–	3,779	–	3,779
Total Exposures, Including Other Assets	₱219,559	₱24,296	₱195,263	₱48,434	₱8,952	₱11,745	₱–	₱120,818	₱5,314	₱195,263
Total Risk-weighted On-Balance Sheet Assets not covered by CRM				–	1,790	5,873	–	120,818	7,971	136,452
Total risk-weighted On-Balance Sheet Assets covered by CRM				–	–	–	–	–	–	–
Total Risk-weighted On-Balance Sheet Assets				–	1,790	5,873	–	120,818	7,971	136,452
Total Risk-weighted Off-Balance Sheet Assets				–	–	–	–	33	–	33
Total Gross Risk-weighted Assets				–	1,790	5,873	–	120,851	7,971	136,485
Addition:				–						
Counterparty Risk-weighted Assets in the Banking Book				–	–	142	–	–	–	142
Counterparty Risk-weighted Assets in the Trading Book				–	–	–	–	100	–	100
Deduction:										
General loan loss provision [in excess of the amount permitted to be included in Upper Tier 2]				–	–	–	–	157	–	157
Total Credit Risk-weighted Assets				₱–	₱1,790	₱6,015	₱–	₱120,794	₱7,971	₱136,570

2016				Risk Weights						
	Exposures, Net of Specific Provisions	Exposures Covered by CRM, Gross of Materiality Threshold	Exposures, not covered by CRM	0%	20%	50%	75%	100%	150%	Total
Cash on Hand	₱3,038	₱–	₱3,038	₱3,038	₱–	₱–	₱–	₱–	₱–	₱3,038
Due from Bangko Sentral ng Pilipinas (BSP)	13,987	–	13,987	13,987	–	–	–	–	–	13,987
Due from Other Banks	1,820	–	1,820	–	23	331	–	1,466	–	1,820
Available for sale (AFS) Financial Assets	13,350	522	12,828	4,335	2,526	3,781		2,186		12,828
Held to Maturity (HTM) Financial Assets	23,545	–	23,545	18,069	1,238	2,334	–	1,904	–	23,545
Loans and Receivables										
Interbank Loans Receivable	–	–	–	–	–	–	–	–	–	–
Loans and Receivables - Others	127,067	24,026	103,041	–	1,902	3,723	–	95,275	2,141	103,041
Loans and Receivables Arising from Repurchase Agreements	3,254	–	3,254	3,254	–	–	–	–	–	3,254
Sales Contract Receivable	119	–	119	–	–	–	–	88	31	119
Real and Other Properties Acquired	2,894	–	2,894	–	–	–	–	–	2,894	2,894
Total Exposures, Excluding Other Assets	189,074	24,548	164,526	42,683	5,689	10,169	–	100,919	5,066	164,526
Other Assets	3,909	–	3,909	–	–	–	–	3,909	–	3,909
Total Exposures, Including Other Assets	₱192,983	₱24,548	₱168,435	₱42,683	₱5,689	₱10,169	₱–	₱104,828	₱5,066	₱168,435
Total Risk-weighted On-Balance Sheet Assets not covered by CRM				–	1,138	5,085	–	104,828	7,599	118,650
Total risk-weighted On-Balance Sheet Assets covered by CRM				–	–	–	–	–	–	–
Total Risk-weighted On-Balance Sheet Assets				–	1,138	5,085	–	104,828	7,599	118,650
Total Risk-weighted Off-Balance Sheet Assets				–	–	–	–	34	–	34
Total Gross Risk-weighted Assets				–	1,138	5,085	–	104,862	7,599	118,684
Addition:				–						
Counterparty Risk-weighted Assets in the Banking Book				–	–	442	–	–	–	442
Counterparty Risk-weighted Assets in the Trading Book				–	–	–	–	32	–	32
Deduction:										
General loan loss provision [in excess of the amount permitted to be included in Upper Tier 2]				–	–	–	–	140	–	140
Total Credit Risk-weighted Assets				₱–	₱1,138	₱5,527	₱–	₱104,742	₱7,599	₱119,006

The total other assets are computed as follow (in millions):

	2017	2016
Total Assets	**₱221,985**	₱196,308
General Loan Loss Provisions	**1,524**	1,344
Deductions:		
Total Exposures Excluding Other Assets	**215,780**	189,077
Financial Assets Held for Trading	**294**	1,384
Unsecured DOSRI	**247**	219
Deferred Tax Assets	**2,037**	1,860
Goodwill	**30**	30
Other Intangible Assets	**662**	452
Significant minority investments	**607**	721
Derivatives with positive fair value held for trading	**73**	0
Total Deductions	**219,730**	193,743
Total Other Assets	**₱3,779**	₱3,909

The Bank's total risk-weighted off-balance sheet assets broken down by type of exposures as follow (in millions):

2017				**Risk Weights**						
	Notional Principal Amount	**Credit Conversion Factor (CCF)**	**Credit Equivalent Amount**	**0%**	**20%**	**50%**	**75%**	**100%**	**150%**	**Total**
Stand-by LCs										
Trade-related contingencies arising from movement of goods	**₱26**	**20%**	**₱5**	**₱–**	**₱–**	**₱–**	**₱–**	**₱5**	**₱–**	**₱5**
Transaction-related contingencies	**56**	**50%**	**28**					**28**		**28**
Spot foreign exchange contracts (sold)	**–**	**0%**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Late deposits/payments received	**6**	**0%**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Trust Department accounts	**5,596**	**0%**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Others	**3**	**0%**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Sub-Total	**₱5,605**		**₱33**	**₱–**	**₱–**	**₱–**	**₱–**	**₱33**	**₱–**	**₱33**
Total Notional Principal Amount	**₱5,687**									
Total Risk-Weighted Off-Balance Sheet Assets				**₱–**	**₱–**	**₱–**	**₱–**	**₱33**	**₱–**	**₱33**

2016				Risk Weights						
	Notional Principal Amount	Credit Conversion Factor (CCF)	Credit Equivalent Amount	0%	20%	50%	75%	100%	150%	Total
Stand-by LCs										
Trade-related contingencies arising from movement of goods	₱25	20%	₱5	₱–	₱–	₱–	₱–	₱5	₱–	₱5
Transaction-related contingencies	58	50%	29					29		29
Spot foreign exchange contracts (bought and sold)	50	0%	–	–	–	–	–	–	–	–
Late deposits/payments received	63	0%	–	–	–	–	–	–	–	–
Trust Department accounts	3,991	0%	–	–	–	–	–	–	–	–
Others	–									
Sub-Total	4,104		₱34	₱–	₱–	₱–	₱–	₱34	₱–	₱34
Total Notional Principal Amount	₱4,187									
Total Risk-Weighted Off-Balance Sheet Assets				₱–	₱–	₱–	₱–	₱34	₱–	₱34

Risk-weighted on-balance sheet assets covered by credit risk mitigants were based on collateralized transactions as well as guarantees by the Philippine National Government (PNG) and those guarantors and exposures with highest credit rating. Third party credit assessments were based on the ratings by Standard & Poor's, Moody's, Fitch and PhilRatings on exposures to Sovereigns, MDBs, Banks, LGUs, Government Corporations and Corporates. The Bank has no exposures to securitization structures. Further, it has no structured products issued or purchased.

The Bank uses the standardized approach to compute the market risk exposures for the Capital Adequacy Ratio. For each separate risk area (credit, market, operational, interest rate risk), the details of risk exposures and assessments are disclosed in Note 5 of the audited financial statements.

The Bank uses the Basic Indicator Approach in computing for the operational risk capital charge.

The description of the main features of capital instruments issued on common shares and those eligible as Tier 2 capital are presented in Note 21 and Note 17 of the audited financial statements, respectively.

SECURITIES AND EXCHANGE COMMISSION
G/F Secretariat Building
PICC Complex, Roxas Boulevard
Pasay City, 1307

The management of **Philippine Savings Bank** is responsible for the preparation and fair presentation of the financial statements including the schedules attached therein, for the years ended December 31, 2017 and 2016, in accordance with the prescribed financial reporting framework indicated therein, 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.

In preparing the financial statements, management is responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so.

The Board of Directors is responsible for overseeing the company's financial reporting process.

The Board of Directors reviews and approves the financial statements including the schedules attached therein, and submits the same to the stockholders or members.

SyCip, Gorres, Velayo & Co., the independent auditor appointed by the stockholders, has audited the financial statements of the company in accordance with Philippine Standards on Auditing, and in its report to the stockholders or members, has expressed its opinion on the fairness of presentation upon completion of such audit.

JOSE T. PARDO	**VICENTE R. CUNA, JR.**	**LEAH M. ZAMORA**
Chairman of the Board	*President*	*Controller*

Signed this day 06 of March 2018.

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

SUBSCRIBED AND SWORN TO before me this 0 6 MAR 2018 affiants exhibiting to me their passports as follow:

Name	Passport No.	Date of Issue	Place of Issue
Jose T. Pardo	P1032165A	11/29/2016	Manila
Vicente R. Cuna, Jr.	EC7752811	05/19/2016	Manila
Leah M. Zamora	P2244078A	03/11/2017	Manila

Doc. No. 395
Page No. 80
Book No. 11
Series of 2018.

ATTY. ROMEO S. MASANGYA, JR.
NOTARY PUBLIC FOR MAKATI CITY
APPOINTMENT NO. M-12 UNTIL DECEMBER 31, 2018
MCLE COMPLIANCE NO. V-0003774, SEPT. 25'14
IBP NO. 019590, 1/3/16, MAKATI CITY
PTR NO. 5307859, 1/5/16, MAKATI CITY
17TH FLR. PSBANK CENTER NO. 777 PASEO DE ROXAS
COR. SEDENO ST. MAKATI CITY
TEL NO. (02)511-8042
ROLL NO. 45264

The Stockholders and the Board of Directors
Philippine Savings Bank

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Philippine Savings Bank ("the Bank"), which comprise the statements of condition as at December 31, 2017 and 2016 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, 2017, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2017 and 2016, and its financial performance and its cash flows for each of the three years in the period ended December 31, 2017, in accordance with Philippine Financial Reporting Standards (PFRSs).

Basis for Opinion

We conducted our audits in accordance with Philippine Standards on Auditing (PSAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Bank in accordance with the Code of Ethics for Professional Accountants in the Philippines (Code of Ethics) together with the ethical requirements that are relevant to our audit of the financial statements in the Philippines, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.

Adequacy of allowance for credit losses on loans and receivables

The Bank's loans and receivables consist of consumer loans and corporate loans. The appropriateness of the allowance for credit losses on these loans and receivables is a key area of judgment for management. The Bank determines the provisions for credit losses on an individual basis for individually significant loans and receivables, and collectively for loans and receivables that are not individually significant. The identification of impairment and the determination of the recoverable amount are inherently uncertain processes involving various assumptions and factors. These include the financial condition of the counterparty, estimated future cash flows, observable market prices and estimated net selling prices of the collateral. The use of assumptions could produce significantly different estimates of provisions for credit losses.

The disclosures in relation to the allowance for credit losses are included in Notes 3 and 15 of the financial statements.

Audit Response

We obtained an understanding of the Bank's impairment calculation process, including the source of the underlying data and supporting systems, and performed tests over relevant controls. For provisions for credit losses calculated on an individual basis, we selected a sample of impaired loans and obtained an understanding of the borrower's business and financial capacity. We also tested the assumptions underlying the impairment identification and quantification of the allowance for credit losses. This was done by assessing whether the forecasted cash flows are based on the borrower's current financial condition, checking the payment history of the borrower including payments made subsequent to yearend, agreeing the value of the collateral to the appraisal reports, checking whether the discount rate represents the original effective interest rate (EIR) or the current EIR of the loan, and re-performing the impairment calculation.

For provisions for credit losses calculated on a collective basis, we tested the underlying models and the inputs to those models, such as historical loss rates, recovery rates and net flow rates. This was done by agreeing the details of the loan information used in the calculation of loss rates and net flow rates to the Bank's records and subsidiary ledgers, checking the delinquency age buckets of the loans, loan grades and loan groupings, and re-performing the calculation of the provisions for credit losses.

Recoverability of deferred tax assets

The analysis of the recoverability of deferred tax assets is significant to our audit because the assessment process is complex and judgmental. It is also based on assumptions that are affected by expected future market or economic conditions and the expected performance of the Bank.

The disclosures in relation to deferred income taxes are included in Notes 3 and 27 of the financial statements.

Audit Response

We obtained an understanding of the Bank's deferred income tax calculation process, including the applicable tax regulations. We reviewed management's assessment on the availability of future taxable income in reference to financial forecast and tax strategies. We evaluated management's forecast by comparing the loan portfolio and deposit growth rates with that of the industry and the historical performance of the Bank. We also reviewed the timing of the reversal of future taxable and deductible temporary differences.

Other Information

Management is responsible for the other information. The other information comprises the information included in the SEC Form 17-A, SEC Form 20-IS (Definitive Information Statement) and Annual Report for the year ended December 31, 2017, but does not include the financial statements and our auditor's report thereon. The SEC Form 17-A, SEC Form 20-IS (Definitive Information Statement) and Annual Report for the year ended December 31, 2017 are expected to be made available to us after the date of this auditor's report.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audits of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audits, or otherwise appears to be materially misstated.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with PFRSs, 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.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with PSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with PSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Bank to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on the Supplementary Information Required Under Revenue Regulations No. 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 15-2010 in Note 36 to the financial statements 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 Savings Bank. 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.

The engagement partner on the audit resulting in this independent auditor's report is Miguel U. Ballelos, Jr.

SYCIP GORRES VELAYO & CO.

Miguel U. Ballelos Jr.

Miguel U. Ballelos, Jr.
Partner
CPA Certificate No. 109950
SEC Accreditation No. 1566-A (Group A),
June 9, 2016, valid until June 9, 2019
Tax Identification No. 241-031-088
BIR Accreditation No. 08-001998-114-2016,
February 15, 2016, valid until February 14, 2019
PTR No. 6621218, January 9, 2018, Makati City
February 22, 2018

	December 31	
	2017	2016
ASSETS		
Cash and Other Cash Items	**₱2,596,872,801**	₱2,778,009,185
Due from Bangko Sentral ng Pilipinas (Note 16)	**15,265,387,772**	13,986,784,696
Due from Other Banks (Note 29)	**1,508,489,309**	1,838,630,022
Interbank Loans Receivable and Securities Purchased Under Resale Agreements (Note 7)	**1,842,023,049**	3,254,311,599
Fair Value Through Profit or Loss Investments (Note 8)	**366,235,689**	1,360,792,147
Available-for-Sale Investments (Note 8)	**16,925,485,941**	13,115,812,858
Held-to-Maturity Investments (Note 8)	**29,473,724,384**	23,156,886,629
Loans and Receivables (Note 9)	**144,964,513,221**	127,221,847,151
Investment in a Joint Venture (Notes 10 and 29)	**607,162,821**	727,176,484
Property and Equipment (Note 11)	**2,480,012,354**	2,667,170,455
Investment Properties (Note 12)	**3,930,317,479**	3,861,708,308
Deferred Tax Assets (Note 27)	**1,429,327,369**	1,300,724,234
Goodwill and Intangible Assets (Note 13)	**714,924,056**	505,165,868
Other Assets (Note 14)	**1,219,566,379**	1,078,083,056
	₱223,324,042,624	₱196,853,102,692

LIABILITIES AND EQUITY		
Liabilities		
Deposit Liabilities (Note 16)		
Demand	**₱19,112,561,892**	₱15,339,143,653
Savings	**30,383,783,001**	27,236,228,764
Time	**136,042,056,714**	115,811,946,185
Long-term Negotiable Certificates of Deposits	**3,375,000,000**	–
	188,913,401,607	158,387,318,602
Bills Payable (Note 17)	**1,492,418,518**	6,093,796,533
Subordinated Notes (Note 17)	**2,978,997,695**	5,975,732,110
Treasurer's, Cashier's and Manager's Checks	**2,213,869,703**	1,760,505,822
Accrued Taxes, Interest and Other Expenses (Note 18)	**1,658,423,304**	1,193,816,372
Financial Liabilities at FVPL (Note 8)	–	65,316,678
Income Tax Payable	**375,277**	466,880
Other Liabilities (Note 19)	**3,673,232,353**	3,338,477,499
	200,930,718,457	176,815,430,496
Equity		
Common Stock (Note 21)	**2,402,524,910**	2,402,524,910
Capital Paid in Excess of Par Value	**2,818,083,506**	2,818,083,506
Surplus Reserves (Note 30)	**1,035,402,901**	1,035,275,317
Surplus (Note 21)	**17,097,046,504**	15,163,512,433
Net Unrealized Loss on Available-for-Sale Investments (Note 8)	**(411,510,218)**	(842,908,364)
Remeasurement Losses on Retirement Plan (Note 24)	**(545,392,541)**	(541,701,193)
Equity in Remeasurement Gains on Retirement Plan of a Joint Venture (Note 10)	**1,245,144**	1,443,599
Cumulative Translation Adjustment	**(4,076,039)**	1,441,988
	22,393,324,167	20,037,672,196
	₱223,324,042,624	₱196,853,102,692

See accompanying Notes to Financial Statements.

	Years Ended December 31		
	2017	2016	2015
INTEREST INCOME			
Loans and receivables (Note 9)	**₱12,477,133,237**	₱11,066,862,854	₱9,929,658,464
Investment securities (Note 8)	**1,823,591,316**	1,347,949,127	727,768,591
Due from Bangko Sentral ng Pilipinas	**179,406,826**	13,905,374	146,667,295
Interbank loans receivable and securities purchased under resale agreements (Note 7)	**61,037,150**	61,530,255	190,814,354
Due from other banks	**2,608,271**	2,222,421	7,818,217
	14,543,776,800	12,492,470,031	11,002,726,921
INTEREST EXPENSE			
Deposit liabilities (Note 16)	**3,214,665,720**	2,409,979,204	2,170,741,412
Subordinated notes (Note 17)	**191,058,261**	361,766,713	342,650,259
Bills payable (Note 17)	**58,953,437**	56,801,997	7,388,984
	3,464,677,418	2,828,547,914	2,520,780,655
NET INTEREST INCOME	**11,079,099,382**	9,663,922,117	8,481,946,266
Service fees and commission income (Note 22)	**1,470,202,440**	1,226,015,157	1,293,699,761
Service fees and commission expense (Note 22)	**94,428,291**	89,667,951	98,207,711
NET SERVICE FEES AND COMMISSION INCOME	**1,375,774,149**	1,136,347,206	1,195,492,050
OTHER OPERATING INCOME (CHARGES)			
Gain on foreclosure and sale of chattel mortgage properties - net (Note 14)	**584,947,874**	351,721,775	377,657,511
Gain on foreclosure and sale of investment properties - net (Note 12)	**348,813,362**	364,392,867	258,030,111
Foreign exchange gain - net	**56,483,920**	23,992,498	18,823,668
Gain on sale of property and equipment (Note 11)	**1,731,001**	2,639,304	17,739,663
Trading and securities gains (losses) - net (Note 8)	**(65,237,826)**	509,665,576	(63,569,750)
Miscellaneous (Notes 12, 23 and 25)	**507,510,359**	426,147,878	515,413,451
	1,434,248,690	1,678,559,898	1,124,094,654
TOTAL OPERATING INCOME	**13,889,122,221**	12,478,829,221	10,801,532,970
OTHER EXPENSES			
Compensation and fringe benefits (Note 24)	**3,260,605,852**	2,922,900,798	2,613,867,706
Provision for credit and impairment losses (Note 15)	**2,270,178,805**	2,222,503,257	1,588,298,396
Taxes and licenses	**1,268,907,979**	1,058,437,943	961,093,132
Occupancy and equipment-related costs (Note 25)	**740,050,501**	710,941,317	671,728,902
Depreciation (Note 11)	**635,436,103**	557,648,750	501,311,146
Security, messengerial and janitorial services	**477,533,030**	383,670,587	334,030,017
Amortization of intangible assets (Note 13)	**135,432,343**	111,160,451	100,224,715
Miscellaneous (Notes 12 and 26)	**2,251,333,506**	1,876,476,264	1,742,754,431
	11,039,478,119	9,843,739,367	8,513,308,445
INCOME BEFORE SHARE IN NET INCOME OF A JOINT VENTURE AND INCOME TAX	**2,849,644,102**	2,635,089,854	2,288,224,525
SHARE IN NET INCOME OF A JOINT VENTURE (Notes 10 and 29)	**71,836,533**	35,466,690	20,213,935
INCOME BEFORE INCOME TAX	**2,921,480,635**	2,670,556,544	2,308,438,460
PROVISION FOR (BENEFIT FROM) INCOME TAX (Note 27)			
Current	**394,082,636**	295,879,413	351,871,466
Deferred	**(127,021,129)**	(76,166,179)	(394,333,106)
	267,061,507	219,713,234	(42,461,640)
NET INCOME	**₱2,654,419,128**	₱2,450,843,310	₱2,350,900,100
Basic/Diluted Earnings Per Share (Note 28)	**₱11.05**	₱10.20	₱9.79

See accompanying Notes to Financial Statements.

	Years Ended December 31		
	2017	2016	2015
NET INCOME	**₱2,654,419,128**	₱2,450,843,310	₱2,350,900,100
OTHER COMPREHENSIVE INCOME (LOSS)			
Items that recycle to profit or loss in subsequent periods:			
Net unrealized gain (loss) from AFS investments (Note 8)	**431,398,146**	(843,088,139)	(26,420,688)
Cumulative translation adjustment	**(5,518,027)**	44,573,963	(1,475,493)
	425,880,119	(798,514,176)	(27,896,181)
Items that do not recycle to profit or loss in subsequent periods:			
Remeasurement losses on retirement plan (Note 24)	**(5,273,354)**	(100,471,688)	(227,153,249)
Equity in remeasurement gains (losses) on retirement plan of a joint venture (Note 10)	**(198,455)**	1,375,957	1,513,370
Income tax effect (Note 27)	**1,582,006**	30,141,506	68,145,975
	(3,889,803)	(68,954,225)	(157,493,904)
OTHER COMPREHENSIVE LOSS FOR THE YEAR, NET OF TAX	**421,990,316**	(867,468,401)	(185,390,085)
TOTAL COMPREHENSIVE INCOME (LOSS), NET OF TAX	**₱3,076,409,444**	₱1,583,374,909	₱2,165,510,015

See accompanying Notes to Financial Statements.

Statements of Changes in Equity

	Common Stock (Note 21)	Capital Paid in Excess of Par Value	Surplus Reserves (Note 30)	Surplus (Note 21)	Net Unrealized Gain (Loss) on Available-for-Sale Investments (Note 8)	Remeasurement Losses on Retirement Plan (Note 24)	Equity in Remeasurement Gains (Losses) on Retirement Plan of a Joint Venture (Note 10)	Cumulative Translation Adjustment	Total
Balance at January 1, 2017	**₱2,402,524,910**	**₱2,818,083,506**	**₱1,035,275,317**	**₱15,163,512,433**	**(₱842,908,364)**	**(₱541,701,193)**	**₱1,443,599**	**₱1,441,988**	**₱20,037,672,196**
Total comprehensive income (loss) for the year	–	–	–	**2,654,419,128**	**431,398,146**	**(3,691,348)**	**(198,455)**	**(5,518,027)**	**3,076,409,444**
Cash dividends (Note 21)	–	–	–	**(720,757,473)**	–	–	–	–	**(720,757,473)**
Appropriation of surplus to trust business (Note 30)	–	–	**127,584**	**(127,584)**	–	–	–	–	–
Balance at December 31, 2017	**₱2,402,524,910**	**₱2,818,083,506**	**₱1,035,402,901**	**₱17,097,046,504**	**(₱411,510,218)**	**(₱545,392,541)**	**₱1,245,144**	**(₱4,076,039)**	**₱22,393,324,167**
Balance at January 1, 2016	₱2,402,524,910	₱2,818,083,506	₱1,035,275,317	₱13,433,426,596	₱179,775	(₱471,371,011)	₱67,642	(₱43,131,975)	₱19,175,054,760
Total comprehensive income (loss) for the year	–	–	–	2,450,843,310	(843,088,139)	(70,330,182)	1,375,957	44,573,963	1,583,374,909
Cash dividends (Note 21)	–	–	–	(720,757,473)	–	–	–	–	(720,757,473)
Balance at December 31, 2016	₱2,402,524,910	₱2,818,083,506	₱1,035,275,317	₱15,163,512,433	(₱842,908,364)	(₱541,701,193)	₱1,443,599	₱1,441,988	₱20,037,672,196
Balance at January 1, 2015	₱2,402,524,910	₱2,818,083,506	₱1,035,275,317	₱11,803,283,969	₱26,600,463	(₱312,363,737)	(₱1,445,728)	(₱41,656,482)	₱17,730,302,218
Total comprehensive income (loss) for the year	–	–	–	2,350,900,100	(26,420,688)	(159,007,274)	1,513,370	(1,475,493)	2,165,510,015
Cash dividends (Note 21)	–	–	–	(720,757,473)	–	–	–	–	(720,757,473)
Balance at December 31, 2015	₱2,402,524,910	₱2,818,083,506	₱1,035,275,317	₱13,433,426,596	₱179,775	(₱471,371,011)	₱67,642	(₱43,131,975)	₱19,175,054,760

See accompanying Notes to Financial Statements.

	Years Ended December 31		
	2017	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax	**₱2,921,480,635**	₱2,670,556,544	₱2,308,438,460
Adjustments to reconcile income before income tax to net cash used in operations:			
Provision for credit and impairment losses (Note 15)	**2,270,178,805**	2,222,503,257	1,588,298,396
Amortization of premium (discount) on available-for-sale investments	**345,911,497**	(490,197,593)	2,024,746,125
Depreciation (Note 11)	**635,436,103**	557,648,750	501,311,146
Gain on foreclosure and sale of:			
Chattel mortgage properties (Note 14)	**(584,947,873)**	(351,721,775)	(377,657,511)
Investment properties (Note 12)	**(348,813,361)**	(364,392,867)	(258,030,111)
Amortization of:			
Intangible assets (Note 13)	**135,432,343**	111,160,451	100,224,715
Debt issuance costs (Note 17)	**3,265,585**	23,680,529	5,150,260
Realized loss (gain) on sale of available-for-sale investments (Note 8)	**49,756,366**	(456,628,139)	(36,343,321)
Unrealized trading (gain) loss on fair value through profit or loss investments (Note 8)	**(12,181,153)**	(9,808,773)	24,171,844
Share in net income of a joint venture (Note 10)	**(71,836,533)**	(35,466,690)	(20,213,935)
Loss on sale of a joint venture	**2,052,642**	–	–
Gain on sale of property and equipment (Note 11)	**(1,731,001)**	(2,639,304)	(17,739,663)
Changes in operating assets and liabilities:			
Decrease (increase) in:			
Fair value through profit or loss investments	**941,420,934**	1,538,682,890	(2,566,807,850)
Loans and receivables	**(22,428,511,076)**	(17,801,956,529)	(21,526,724,867)
Other assets	**(35,731,437)**	(31,545,443)	73,185,939
Increase (decrease) in:			
Deposit liabilities	**30,523,557,488**	24,091,609,813	17,768,068,631
Accrued taxes, interest and other expenses	**464,596,545**	143,049,544	(77,668,853)
Treasurer's, cashier's and manager's checks	**453,363,881**	411,884,412	94,839,692
Other liabilities	**329,104,407**	232,467,904	(57,443,347)
Cash generated from (used in) operations	**15,591,804,797**	12,458,886,981	(450,194,250)
Income taxes paid	**(394,158,858)**	(303,467,934)	(350,950,721)
Net cash provided by (used in) operating activities	**15,197,645,939**	12,155,419,047	(801,144,971)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of:			
Available-for-sale investments	**(9,380,635,227)**	(40,630,855,364)	(13,996,913,431)
Held-to-maturity investments	**(6,917,136,761)**	(8,051,001,534)	(15,183,881,903)
Property and equipment (Note 11)	**(227,119,984)**	(319,030,433)	(639,489,221)
Other intangible assets (Note 13)	**(345,190,531)**	(171,866,198)	(175,544,810)
Proceeds from sale of:			
Available-for-sale investments (Note 8)	**5,879,947,979**	36,425,024,948	11,056,542,556
Chattel mortgage properties (Note 14)	**2,146,956,711**	1,564,228,669	1,378,234,489
Held to maturity investments (Note 8)	**324,545,000**	–	–
Investment properties (Note 12)	**784,512,544**	520,225,812	437,934,888
Property and equipment (Note 11)	**24,120,404**	32,128,996	39,834,213
Investment in a joint venture (Note 10)	**189,960,000**	–	–
Decrease (increase) in interbank loans receivable (Note 7)	–	–	1,386,320,000
Net cash used in investing activities	**(7,520,039,865)**	(10,631,145,104)	(15,696,963,219)

(Forward)

	Years Ended December 31		
	2017	2016	2015
CASH FLOWS FROM FINANCING ACTIVITIES			
Settlement of subordinated notes (Note 17)	**(₱3,000,000,000)**	₱–	₱–
Settlement of bills payable	**(4,601,585,608)**	(126,096,897,354)	(15,326,746,786)
Dividends paid (Note 21)	**(720,757,473)**	(720,757,473)	(897,647,381)
Availments of bills payable	**–**	127,696,110,553	19,821,347,358
Net cash provided (used in) by financing activities	**(8,322,343,081)**	878,455,726	3,596,953,191
Effect of exchange rate differences	**(225,564)**	1,713,236	(73,834)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(644,962,571)**	2,404,442,905	(12,901,228,833)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR			
Cash and other cash items	**2,778,009,185**	3,934,496,578	4,174,756,446
Due from Bangko Sentral ng Pilipinas (Note 16)	**13,986,784,696**	11,143,781,766	23,997,102,406
Due from other banks	**1,838,630,022**	1,861,110,141	3,382,662,578
Interbank loans receivable and securities purchased under resale agreements (Note 7)	**3,254,311,599**	2,513,904,112	800,000,000
	21,857,735,502	19,453,292,597	32,354,521,430
CASH AND CASH EQUIVALENTS AT END OF YEAR			
Cash and other cash items	**2,596,872,801**	2,778,009,185	3,934,496,578
Due from Bangko Sentral ng Pilipinas (Note 16)	**15,265,387,772**	13,986,784,696	11,143,781,766
Due from other banks	**1,508,489,309**	1,838,630,022	1,861,110,141
Interbank loans receivable and securities purchased under resale agreements (Note 7)	**1,842,023,049**	3,254,311,599	2,513,904,112
	₱21,212,772,931	₱21,857,735,502	₱19,453,292,597
OPERATIONAL CASH FLOWS FROM INTEREST			
Interest paid	**₱5,012,646,483**	₱2,772,406,654	₱2,483,813,667
Interest received	**10,936,013,646**	11,911,931,701	12,478,341,350

See accompanying Notes to Financial Statements.

1. Corporate Information

Philippine Savings Bank (the Bank) was incorporated in the Philippines primarily to engage in savings and mortgage banking. The Bank's shares are listed in the Philippine Stock Exchange (PSE). The Bank offers a wide range of products and services such as deposit products, loans, treasury and trust functions that mainly serve the retail and consumer markets. On September 6, 1991, the Bank was authorized to perform trust functions.

As of December 31, 2017 and 2016, the Bank had 250 and 255 branches, respectively. In 2017, the Bank had 346 Automated Tellering Machines (ATMs) in Metro Manila and 264 in provincial locations, bringing its total number of ATMs to 610 as of December 31, 2017.

The Bank's original Certificate of Incorporation was issued by the Securities and Exchange Commission (SEC) on June 30, 1959. On March 28, 2006, the Board of Directors (BOD) of the Bank approved the amendment of Article IV of its Amended Articles of Incorporation to extend the corporate term of the Bank, which expired on June 30, 2009, for another 50 years or up to June 30, 2059. This was subsequently approved by stockholders representing at least two-thirds of the outstanding capital stock of the Bank on April 25, 2006. The Amended Articles of Incorporation was approved by the SEC on September 27, 2006.

On April 27, 2010, by majority vote of the BOD and by stockholders representing two-thirds of the outstanding capital stock, the amendment of Article VI of its Amended Articles of Incorporation reducing the number of directors from a maximum of eleven (11) to a maximum of nine (9) has been approved. This was approved by the SEC on August 26, 2010.

On March 24, 2014, the BOD approved Article III of Articles of Incorporation to specify its principal address from Makati City to PSBank Center, 777 Paseo de Roxas corner Sedeño Street, Makati City 1226. The Amended Articles of Incorporation was approved by the SEC on December 22, 2014.

As of December 31, 2017 and 2016, Metropolitan Bank & Trust Company (MBTC), the Bank's ultimate parent, owned eighty-three percent (83%) of the Bank.

2. Significant Accounting Policies

Basis of Preparation
The accompanying financial statements have been prepared under the historical cost basis except for fair value through profit or loss (FVPL) investments, available-for-sale (AFS) investments, and derivative financial instruments that have been measured at fair value. All values are rounded to the nearest peso unless otherwise stated.

The accompanying 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 peso (see accounting policy on Foreign Currency Translation). The financial statements of these units are combined after eliminating inter-unit accounts.

The financial statements provide comparative information in respect of the previous period. In addition, the Bank presents an additional statement of condition 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 financial statements.

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

Presentation of Financial Statements
The Bank presents its statement of condition in order of liquidity. An analysis regarding recovery of assets or settlement of liabilities within twelve (12) months after the statement of condition date (current) and more than 12 months after the statement of condition date (non-current) is presented in Note 20.

Financial assets and financial liabilities are offset and the net amount is reported in the statement of condition 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. The Bank assesses that it has a currently enforeceable right of offset if the right is not contingent on a future event, and is legally enforeceable in the normal course of business, event of default, and event of solvency or bankruptcy of the Bank and all of the counterparties.

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, the following applicable new and revised accounting standards. Unless otherwise indicated, these new and revised accounting standards have no impact to the Bank. Except for these standards and amended PFRS which were adopted as of January 1, 2017, the accounting policies adopted are consistent with those of previous financial year.

Amendments

PFRS 12, *Disclosure of Interests in Other Entities – Clarification on the disclosure requirements on the investments in other entities.*
The amendments clarify that the disclosure requirements apply to an entity's interest in a subsidiary, a joint venture or an associate that is classified as held for sale. The amendment is applied retrospectively.

PAS 7, *Disclosure Initiative*
This requires entities to provide disclosure about changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes such as foreign exchange gains and losses. The Bank has provided the required information in the Note 32 to financial statements. As allowed under the transition provisions of the standard, the Bank did not present comparative information for the year ended December 31, 2016.

PAS 12, *Recognition of Deferred Tax Assets for Unrealized Losses – Clarification on the accounting for deferred tax assets on debt instruments measured at fair value.*
This requires entities to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. Entities should

determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than carrying amount.

Summary of Significant Accounting Policies

Foreign Currency Translation
The financial statements are presented in Philippine Peso, which is the Bank's functional and presentation currency.

The books of accounts of the RBU are maintained in Philippine Peso, while those of the FCDU are maintained in USD.

RBU
As at reporting date, foreign currency monetary assets and liabilities of the RBU are translated in Philippine Peso based on the Philippine Dealing System (PDS) closing rate prevailing at the statement of condition date, and foreign currency-denominated income and expenses, at the exchange rates as at the dates of the transactions. Foreign exchange differences arising from restatements 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 is determined.

FCDU
As at the reporting date, the assets and liabilities of the FCDU are translated to the Bank's presentation currency (the Philippine Peso) at the PDS closing rate prevailing at the statement of condition date, and its income and expenses are translated using the exchange rates as at the dates of the transactions. Exchange differences arising on translation to the presentation currency are taken to the statement of comprehensive income under 'Cumulative translation adjustment'. Upon disposal of the FCDU or upon actual remittance of FCDU profits to RBU, the deferred cumulative amount recognized in the statement of comprehensive income is recognized in the statement of income.

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

Fair value is the estimated 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 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.

If an asset or a liability measured at fair value has a bid price and an ask price (e.g., an input from a dealer market), the price between the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value regardless of where the input is categorized within the fair value hierarchy.

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 risks of the asset and liability and the level of the fair value hierarchy as explained above.

<u>Cash and Cash Equivalents</u>
For purposes of reporting cash flows, cash and cash equivalents include cash and other cash items, due from BSP and other banks, interbank loans receivable and securities purchased under resale agreements that are convertible to known amounts of cash which have original maturities of three months or less from date of placements and that are subject to an insignificant risk of changes in value. Due from BSP includes the statutory reserves required by the BSP which the Bank considers as cash equivalents as withdrawals can be made to meet the Bank's cash requirements as allowed by the BSP.

<u>Financial Instruments - Initial Recognition and Subsequent Measurement</u>
Date of recognition
Purchases or sales of financial assets, except for derivatives, that require delivery of assets within the time frame established by regulation or convention in the marketplace are recognized on the settlement date. Derivative financial instruments are recognized on a trade date basis. Deposits, amounts due to banks and loans and receivables are recognized when cash is received by the Bank or advanced to the borrowers.

Initial recognition of financial instruments
All financial instruments, including trading and investment securities and loans and receivables, are initially measured at fair value. Except for FVPL investments and liabilities, the initial measurement of financial instruments includes transaction costs. The Bank classifies its financial assets in the following categories: FVPL investments, AFS investments, held-to-maturity (HTM) investments, and loans and receivables. Financial liabilities are classified into liabilities at FVPL and other financial liabilities at amortized cost. The classification of financial instruments at initial recognition depends on their purpose and characteristics and the management's intention in acquiring them. Management determines the classification of its investments at initial recognition and, where allowed and appropriate, re-evaluates such designation at every statement of condition date.

Financial assets and financial liabilities at FVPL
Financial assets and financial liabilities at FVPL include financial assets and financial liabilities held for trading purposes and derivative instruments.

Financial instruments held-for-trading
Other financial assets or financial liabilities held for trading (HFT) are recorded in the statement of condition at fair value. Changes in fair value relating to the HFT positions are recognized in 'Trading and securities gains (losses) - net'. Interest earned or incurred is recorded as interest income or expense, respectively, while dividend income is recorded in other operating income under 'Miscellaneous' when the right to receive payment has been established.

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

Derivatives
Derivative financial instruments are initially recorded at fair value on the date at which the derivative contract is entered into and are subsequently remeasured at fair value. Any gains or losses arising from changes in fair values of derivatives (except those accounted for as cash flow hedges) are taken directly to the statement of income and are included in 'Foreign exchange gain - net'. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. As of December 31, 2017 and 2016, derivatives consist of foreign exchange swaps, forwards and Republic of the Philippines (ROP) paired warrants acquired to manage the Bank's foreign currency risk, lower the risk weighted assets and improve the capital adequacy ratio of the Bank.

AFS investments
AFS investments include equity and debt securities. Equity investments classified as AFS are those which are neither classified as HFT nor designated at FVPL. Debt securities in this category are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity or in response to changes in market conditions. The Bank has not designated any loans and receivables as AFS.

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 other comprehensive income. The unrealized gains and losses arising from the fair valuation of AFS investments are excluded, net of tax, from reported income and are reported as 'Net unrealized gain (loss) from AFS investments' in Other Comprehensive Income (OCI).

When the security is disposed of, the cumulative gain or loss previously recognized in OCI is recognized as 'Trading and securities gains (losses) - net' in the statement of income. Where the Bank holds more than one investment in the same security, these are deemed to be disposed on a weighted average basis. Interest earned on holding AFS debt investments are reported as interest income using the EIR. Dividends earned on holding AFS equity investments are recognized in the statement of income as other operating income under 'Miscellaneous' when the right of the payment has been established. The losses arising from impairment of such investments are recognized as 'Provision for credit and impairment losses' in the statement of income and removed from 'Net unrealized gain (loss) from AFS investments' in OCI.

HTM investments
HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Bank's management has the positive intention and ability to hold until maturity. After initial measurement, HTM investments are subsequently measured at amortized cost using the effective interest amortization method, less impairment in value. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the EIR. The amortization is included in 'Interest income on investment securities' in the statement of income. The losses arising from impairment of such investments are recognized in the statement of income under 'Provision for credit and impairment losses'. The effects of restatement on foreign currency-denominated HTM investments are recognized in the statement of income.

If the Bank were to sell or reclassify more than an insignificant amount of HTM investments before maturity (other than in certain specific circumstances), the entire category would be tainted and would be reclassified as AFS investments. Furthermore, the Bank would be prohibited from classifying any financial asset as HTM investments during the two preceding financial years.

Loans and receivables
This accounting policy relates to the Bank's 'Due from Bangko Sentral ng Pilipinas (BSP)', 'Due from Other Banks', 'Interbank Loans Receivable and Securities Purchased Under Resale Agreements (SPURA)', 'Loans and Receivables', 'Security Deposits', 'Returned Checks and Other Cash Items (RCOCI)', and 'Shortages'. These are non-derivative 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 recover substantially all of its initial investment, other than because of credit deterioration.

After initial measurement, these are subsequently measured at amortized cost using the effective interest amortization 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 credit and impairment losses' in the statement of income.

Other financial liabilities carried at amortized cost
This category represents issued financial instruments or their components, which are not designated at FVPL and comprises 'Deposit Liabilities','Bills Payable', 'Subordinated Notes','Treasurer's, Cashier's and Manager's Checks', 'Accrued Interest Payable', 'Accrued Other Expenses', 'Accounts Payable', 'Bills Purchased-Contra', 'Other credits', 'Due to BSP', 'Dividends Payable', 'Due to the Treasurer of the Philippines', 'Deposits for Keys-Safety Deposit Boxes (SDB)', and 'Overages', where 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.

After initial measurement, financial liabilities not qualified and not designated as FVPL are subsequently measured at amortized cost using the effective interest amortization 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.

A compound financial instrument which contains both a liability and an equity component is separated at the issue date. A portion of the net proceeds of the instrument is allocated to the debt component on the date of issue based on its fair value (which is generally determined based on quoted market prices for similar debt instruments). The residual amount determined after deducting the fair value of the debt component is assigned to the equity component. The value of any derivative features (such as a call option) embedded in the compound financial instrument other than the equity component is included in the debt component.

Derecognition of Financial Assets and Liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of financial assets) is primarily derecognized when:

- the rights to receive cash flows from the asset have expired; or
- the Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either:
  a. the Bank has transferred substantially all the risks and rewards of the asset, or
  b. the Bank has neither transferred nor retained the risks and rewards of the asset but has transferred 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. In this case, the Bank also recognizes an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained.

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.

Financial liabilities

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

Repurchase and Reverse Repurchase Agreements

Securities sold under agreements to repurchase (SSURA) at a specified future date ('repos') are not derecognized from the statement of condition as the Bank retains substantially all the risks and rewards of ownership. The corresponding cash received, including accrued interest, is recognized in the statement of condition as a loan to the Bank under ‘Bills Payable’, reflecting the economic substance of such transaction.

Conversely, securities purchased under agreements to resell (SPURA) at a specified future date (‘reverse repos’) are not recognized in the statement of condition. The consideration paid, including accrued interest, is recognized in the statement of condition as SPURA, and is considered a loan to the counterparty. The difference between the purchase price and resale price is treated as interest income and is accrued over the life of the agreement using the effective interest amortization method.

Reclassification of Financial Assets

The Bank may reclassify, in rare circumstances, non-derivative financial assets out of the HFT investments category and into the AFS financial assets, HTM financial assets or Loans and Receivables categories.

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

For a financial asset reclassified out of the AFS financial assets category, any previous gain or loss on the asset that has been recognized in OCI is amortized to profit or loss over the remaining life of the investment using the effective interest method. Any difference between the new amortized cost and the expected cash flows is also amortized over the remaining life of the asset using the effective interest method.

If the asset is subsequently determined to be impaired, the amount recorded in the OCI is recycled to the statement of income.

If, as a result of a change in intention or ability, it is no longer appropriate to classify an investment as HTM, it shall be reclassified as AFS and remeasured at fair value on the date of reclassification, and the difference between its carrying amount and fair value shall be recognized in other comprehensive income.

There was no reclassification of financial assets in 2017 and 2016.

Impairment of Financial Assets

The Bank assesses at each statement of condition date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or 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 have 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 loans and receivables, due from banks and HTM investments, the Bank first assesses individually at each statement of condition date whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. 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. Assets individually assessed for impairment for which no impairment loss was measured are also collectively assessed for impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of loss is charged to the statement of income. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Loans and receivables, together with the associated allowance accounts, are written off when there is no realistic prospect of future recovery and all collateral have 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 'Recovery of charged-off assets' under 'Miscellaneous income' in the statement of income.

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

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of credit risk characteristics such as industry and age of receivables.

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.

The details of allowance for credit and impairment losses on financial assets carried at amortized cost are disclosed in Note 15.

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 on new loan conditions. Once the terms have been renegotiated, any impairment is measured using the original EIR as calculated before the modification of terms and 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 subjected to an individual or collective impairment assessment, calculated using the loan's original EIR if the original loan has a fixed interest rate and the current repriced rate if the original loan is repriceable. The difference between the recorded value of the original loan and the present value of the restructured cash flows, discounted at the applicable interest rate, is recognized in 'Provision for credit and impairment losses' in the statement of income.

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

In the case of debt instruments classified as AFS investments, the Bank assesses individually whether there is objective evidence of impairment based on the same criteria as financial assets carried at amortized cost. However, the amount recorded as 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 the statement of income.

Future interest income continues to be accrued based on the reduced carrying amount using 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 a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized, the impairment loss is reversed through the statement of income.

In the case of equity investments classified as AFS investments, objective evidence would also include a 'significant' or 'prolonged' decline in the fair value of the investments below its cost. The Bank treats 'significant' generally as 20.00% and 'prolonged' generally as longer than twelve (12) months. When there is evidence of impairment, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the statement of income - is removed from equity and recognized in the statement of income. Impairment losses on equity investments are not reversed through the statement of income. Increases in fair value after impairment are recognized in the statement of comprehensive income.

Investment in a Joint Venture
A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control. The Bank's investment in a joint venture represents its 30.00% and 40.00% interest in Sumisho Motor Finance Corporation (SMFC) as of December 31, 2017 and 2016, respectively.

The considerations made in determining significant influence or joint control are similar to those necessary to determine control over subsidiaries.

The Bank's investment in its joint venture is accounted for using the equity method. Under the equity method, the investment in a joint venture is initially recognized at cost. The carrying amount of the investment is adjusted to recognize changes in the Bank's share of net assets of the joint venture since the acquisition date. Goodwill relating to the joint venture is included in the carrying amount of the investment and is neither amortized nor individually tested for impairment.

The statement of income reflects the Bank's share of the results of operations of the joint venture. Any change in OCI of those investees is presented as part of the Bank's OCI. In addition, when there has been a change recognized directly in the equity of the joint venture, the Bank recognizes its share of any changes, when applicable, in the statement of changes in equity. Unrealized gains and losses resulting from transactions between the Bank and joint venture are eliminated to the extent of the interest in the joint venture.

The aggregate of the Bank's share of profit or loss of a joint venture is shown on the face of the statement of profit or loss outside operating profit and represents profit or loss after tax and non-controlling interests in the subsidiaries of the joint venture.

The financial statements of a joint venture are prepared for the same reporting period as the Bank. The length of the reporting period is the same from period to period. When necessary, adjustments are made to bring the accounting policies in line with those of the Bank.

After application of the equity method, the Bank determines whether it is necessary to recognize an impairment loss on its investment in its joint venture. At each statement of condition date, the Bank determines whether there is objective evidence that the investment in the joint venture is impaired. If there is such evidence, the Bank calculates the amount of impairment as the difference between the recoverable amount of the joint venture and its carrying value, then recognizes the loss as 'Share in net income (loss) of a joint venture'in the statement of income.

Upon loss of significant influence over the joint control over the joint venture, the Bank measures and recognizes any retained investment at its fair value. Any difference between the carrying amount of the joint venture upon loss of significant influence or joint control and the fair value of the retained investment and proceeds from disposal is recognized in profit or loss.

Property and Equipment

Land is stated at cost less any impairment in value and depreciable properties, including building, furniture, fixtures and equipment, and leasehold improvements, are stated at cost less accumulated depreciation and any accumulated impairment losses. The initial cost of property and equipment consists of its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the assets have been put into operation, such as repairs and maintenance, are normally charged against profit or loss 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 property and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as additional cost of property and equipment.

Depreciation is calculated using the straight-line method to write down the cost of the property and equipment to their residual values over their estimated useful lives. Land is not depreciated. The estimated useful lives are as follows:

Buildings	25-50 years
Furniture, fixtures and equipment	3-5 years depending on the type of assets
Leasehold improvements	5 years or the term of the related leases, whichever is shorter

The assets' residual values, useful lives and methods of depreciation are reviewed, and adjusted if appropriate, at each financial year-end to ensure that these are consistent with the expected pattern of economic benefits from the items of property and equipment.

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

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 asset is written down to its recoverable amount.

Investment Properties

Investment properties are measured initially at cost, including transaction costs. An investment property acquired through an exchange transaction is measured at the fair value of the asset acquired unless the fair value of such asset cannot be measured, in which case the investment property acquired is measured at the carrying amount of the asset given up. Foreclosed properties are classified under investment properties from foreclosure date. Expenditures incurred after the investment properties are recognized, such as repairs and maintenance costs, are normally charged to income in the period in which the costs are incurred.

Subsequent to initial recognition, investment properties are carried at cost less accumulated depreciation and impairment in value, except for land which is stated at cost less impairment in value. Depreciation is calculated using the straight-line method over the remaining useful lives from the time of acquisition of the investment properties.

The estimated useful life of building and condominium units ranges from 10 to 40 years.

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

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

Chattel Mortgage Properties
Chattel mortgage properties comprise of repossessed vehicles. Chattel mortgage properties are stated at cost less accumulated depreciation and impairment in value. Chattel mortgage properties acquired are initially recognized at fair value. Depreciation is calculated using the straight-line method over the remaining useful lives from the time of acquisition of the vehicles. The useful lives of chattel mortgage properties are estimated to be five years.

Intangible Assets
The Bank's intangible assets include branch licenses and computer software. An intangible asset is recognized only when the cost can be measured reliably and it is probable that the expected future economic benefits that are attributable to it will flow to the Bank.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is its fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. Internally generated intangible assets, excluding capitalized development costs, are not capitalized and expenditure is reflected in the statement of income in the year in which the expenditure is incurred.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible assets may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and they are treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the statement of income under 'Amortization of intangible assets'.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the CGU level. Such intangibles are not amortized. The useful life of an intangible asset with an indefinite 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.

Gains or losses arising from the derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the statement of income when the asset is derecognized.

Branch licenses
Branch licenses arise from the acquisition of branches from local banks and licenses to operate new branches from the BSP. Branch licenses have indefinite useful lives and are tested for impairment on an annual basis.

Software costs
Software costs are carried at cost less accumulated amortization and any impairment in value. Given the history of rapid changes in technology, computer software are susceptible to technological obsolescence. Therefore, it is likely that their useful life is short. Software costs are amortized on a straight-line basis over five years but maybe shorter depending on the period over which the Bank expects to use the asset.

Impairment of Non-financial Assets

Property and equipment, investment properties and chattel mortgage properties
At each statement of condition date, the Bank assesses whether there is any indication that its non-financial 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. An asset's 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 of those from 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 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. In determining fair value less cost to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples and other available fair value indicators.

An impairment loss is charged to operations in the year in which it arises.

An assessment is made at each statement of condition date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Bank estimates the asset's or CGU's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceeds the carrying amount that would have been determined, net of depreciation, had no impairment loss been previously recognized. Such reversal is recognized in the statement of income. After such reversal, the depreciation expense is adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining life.

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

Impairment is determined for goodwill by assessing the recoverable amount of the CGU (or group of CGU) to which the goodwill relates. Where the recoverable amount of the CGU (or group of CGU) is less than the carrying amount of the CGU (or group of CGU) to which goodwill has been allocated, an impairment loss is recognized immediately in the statement of income. Impairment losses relating to goodwill cannot be reversed for subsequent increases in its recoverable amount in future periods. The Bank performs its annual impairment test of goodwill as at December 31 of each year.

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

Intangible assets with finite lives are assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Investment in a joint venture
After application of the equity method, the Bank determines whether it is necessary to recognize an impairment loss on the Bank's investment in a joint venture. The Bank determines at each statement of condition date whether there is any objective evidence that the investment a joint venture is impaired. If this is the case, the Bank calculates the amount of impairment as being the difference between the fair value of the investment in the joint venture and the carrying amount and recognizes such amount in the statement of income.

<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 at inception date of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

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

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gives 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 a lessee
Leases where the lessor retains substantially all the risks and benefits of ownership of the assets 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 a lessor
Leases where the Bank does not transfer substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized over the lease term on the same basis as rental income. Contingent rents are recognized as income in the period in which they are earned.

<u>Common Stock</u>
Common stocks are recorded at par. Proceeds in excess of par value are recognized under equity as 'Capital Paid in Excess of Par Value' in the statement of condition. 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.

<u>Revenue Recognition</u>
Revenue is recognized to the extent that it is probable that future economic benefits will flow to the Bank and revenue can be measured reliably, 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 and payment 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 Bank concluded that it is acting as a principal in all of its revenue arrangements. The following specific recognition criteria must also be met before revenue is recognized:

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

The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original EIR and the change in carrying amount is recorded as 'Interest income'.

Once the recorded value of a financial asset or group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original EIR used to discount future cash flows for the purpose of measuring the impairment loss.

Service fees and commission income
Fees earned for the provision of services over a period of time are accrued over that period. These fees include fiduciary fees, credit-related fees and other service and management fees.

Income from sale of property and equipment, investment property and chattel mortgage properties
Income from sale of properties is recognized upon completion of the earning process when the significant risks and rewards of ownership of the goods have passed to the buyer and the collectibility of the sales price is reasonably assured.

Trading and securities gains (losses) - net
Trading and securities gain (loss) represents results arising from trading activities, including all gains and losses from changes in the fair values of financial instruments at FVPL. It also includes gains and losses realized from sale of AFS financial assets.

Realized gains and losses on disposals of financial instruments at FVPL are calculated using weighted average method. It represents the difference between an instrument's initial carrying amount and disposal amount.

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

Dividend income
Dividend income is recognized when the Bank's right to receive payment is established, which is generally when shareholders approve the dividend.

Other income
Income from sale of service is recognized when services are rendered.

Expense Recognition
Expenses are 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.

Interest expense
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.

Other expense
Expenses encompass losses as well as those expenses that arise in the ordinary course of business of the Bank. Expenses are recognized when incurred.

Business Combination and Goodwill
Business combinations are accounted for using the acquisition method. This involves recognizing identifiable assets (including previously unrecognized intangible assets) and liabilities (including contingent liabilities and excluding future restructuring) of the acquired business at fair value. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognized as goodwill. If the cost of acquisition is less than the fair values of the identifiable net assets acquired, the discount on acquisition is recognized directly in the statement of income in the year of acquisition.

Goodwill is initially measured at cost being the excess of the acquisition cost over the share in the net fair value of the acquired identifiable assets, liabilities and contingent liabilities. The Bank's goodwill arose from past purchases of branch business/offices from the Parent Company.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired is, from the acquisition date, allocated to each of the CGU or group of CGUs that are expected to benefit from the synergies of the combination, irrespective of whether the acquired other assets or liabilities are assigned to those units.

Where goodwill forms part of a CGU and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the CGU retained.

Retirement Cost

Defined Benefit Plan
The net defined benefit liability or asset is the aggregate of the present value of the defined benefit obligation at the statement of condition date reduced by the fair value of plan assets, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling. The present value of the defined benefit obligation is calculated annually by an independent actuary. 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 plan 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. These amounts are calculated periodically by independent qualified actuaries.

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 Philippine 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 or qualifying insurance policies. 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 risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligations). If the fair value of the plan assets is higher than the present value of the defined benefit obligation, the measurement of the resulting defined benefit asset is limited to the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

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.

Termination benefits
Termination benefits are employee benefits provided in exchange for the termination of an employee's employment as a result of either an entity's decision to terminate an employee's employment before the normal retirement date or an employee's decision to accept an offer of benefits in exchange for the termination of employment.

A liability and expense for a termination benefit is recognized at the earlier of when the entity can no longer withdraw the offer of those benefits and when the entity recognizes related restructuring costs. Initial recognition and subsequent changes to termination benefits are measured in accordance with the nature of the employee benefit, as either post-employment benefits, short-term employee benefits, or other long-term employee benefits.

Employee leave entitlement
Employee entitlements to annual leave are recognized as a liability when they are accrued to the employees. The undiscounted liability for leave expected to be settled after the end of the annual

reporting period is recognized for services rendered by employees up to the end of the reporting period.

Provisions
Provisions are recognized when the Bank has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources 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 'Interest expense'.

Contingent Liabilities and Contingent Assets
Contingent liabilities are not recognized in the financial statements but are disclosed unless the possibility of an outflow of resources 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.

Debt Issue Costs
Issuance, underwriting and other related expenses incurred in connection with the issuance of debt instruments are included in the measurement basis of the underlying debt instruments and are amortized as an adjustment to the interest on the underlying debt instruments using the effective interest method.

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

Current tax
Current income tax is the expected tax payable on the taxable income for the period, using the tax rates enacted at the statement of condition date, together with adjustments to tax payable in respect to prior years.

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

Deferred tax liabilities are recognized for all taxable temporary differences, including asset revaluations. Deferred tax assets are recognized for all deductible temporary differences and carry forward of unused tax losses and tax credits from excess minimum corporate income tax (MCIT) over the regular corporate income tax (RCIT), to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences and carry forward of unused tax losses and MCIT can be utilized.

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

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

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

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

Earnings Per Share
Basic earnings per share (EPS) is computed by dividing net income for the year by the weighted average number of common shares issued and outstanding during the year, after giving retroactive effect to stock dividends declared, stock rights exercised and stock splits, if any, declared during the year. As of December 31, 2017 and 2016, there were no potential common shares with dilutive effect on the basic EPS of the Bank.

Dividends on Common Shares
Dividends on common shares are recognized as a liability and deducted from equity when approved by the BOD of the Bank. Dividends for the year that are approved after the statement of condition date are dealt with as subsequent events.

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 generating revenues are all 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.

Subsequent Events
Post year-end events that provide additional information about the Bank's position at the statement of condition date (adjusting events) are reflected in the financial statements. Post year-end events that are not adjusting events are disclosed in the notes to the financial statements when material.

Standards issued but not yet effective
Pronouncements issued but not yet effective are listed below. Unless otherwise indicated, the Bank does not expect the future adoption of the said pronouncements to have a significant impact on its financial statements. The Bank intends to adopt the following pronouncements when they become effective.

Effective beginning on or after January 1, 2018

- Amendments to PFRS 2, *Share-based Payment*, *Classification and Measurement of Share-based Payment Transactions*
  The amendments to PFRS 2 address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and the accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled.

  On adoption, entities are required to apply the amendments without restating prior periods, but retrospective application is permitted if elected for all three amendments and if other criteria are met. Early application of the amendments is permitted.

  The amendments are not applicable to the Bank since it does not have share-based payment transactions.

- Amendments to PFRS 4, *Insurance Contracts*, *Applying PFRS 9, Financial Instruments, with PFRS 4*
  The amendments address concerns arising from implementing PFRS 9, the new financial instruments standard before implementing the forthcoming insurance contracts standard. They allow entities to choose between the overlay approach and the deferral approach to deal with the transitional challenges. The overlay approach gives all entities that issue insurance contracts the option to recognize in other comprehensive income, rather than profit or loss, the volatility that could arise when PFRS 9 is applied before the new insurance contracts standard is issued. On the other hand, the deferral approach gives entities whose activities are predominantly connected with insurance an optional temporary exemption from applying PFRS 9 until the earlier of application of the forthcoming insurance contracts standard or January 1, 2021.

  The overlay approach and the deferral approach will only be available to an entity if it has not previously applied PFRS 9.

  The amendments are not applicable to the Bank since it does not have activities that are predominantly connected with insurance or issue insurance contracts.

- Amendments to PAS 28, *Measuring an Associate or Joint Venture at Fair Value* (Part of *Annual Improvements to PFRSs* 2014 - 2016 Cycle)
  The amendments clarify that an entity that is a venture capital organization, or other qualifying entity, may elect, at initial recognition on an investment-by-investment basis, to measure its investments in associates and joint ventures at fair value through profit or loss. They also clarify that if an entity that is not itself an investment entity has an interest in an associate or joint venture that is an investment entity, the entity may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which (a) the investment entity associate or joint venture is initially recognized; (b) the associate or joint venture becomes an investment entity; and (c) the investment entity associate or joint venture first becomes a parent. The amendments should be applied retrospectively, with earlier application permitted.

- Amendments to PAS 40, *Investment Property*, *Transfers of Investment Property*
  The amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. The amendments should be applied prospectively to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. Retrospective application is only permitted if this is possible without the use of hindsight.

- Philippine Interpretation IFRIC-22, *Foreign Currency Transactions and Advance Consideration*
  The interpretation clarifies that in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognizes the nonmonetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine a date of the transactions for each payment or receipt of advance consideration. The interpretation may be applied on a fully retrospective basis. Entities may apply the interpretation prospectively to all assets, expenses and income in its scope that are initially recognized on or after the beginning of the reporting period in which the entity first applies the interpretation or the beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which the entity first applies the interpretation.

New Standards

PFRS 9, *Financial Instruments*
PFRS 9 reflects all phases of the financial instruments project and replaces PAS 39, *Financial Instruments: Recognition and Measurement*, and all previous versions of PFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. Retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions. The Bank plans to adopt the new standard on the mandatory effective date and will not restate comparative information. The Bank has performed an assessment of the population of financial instruments impacted by the classification and measurement requirements of PFRS 9 and has developed impairment methodologies to support the calculation of expected credit losses (ECL) for qualified credit exposures.

a. Classification and Measurement
   PFRS 9 requires that the Bank classifies debt instruments based on the contractual cash flow characteristics of the assets and the business model for managing those assets. These factors determine whether the financial assets are measured at amortized cost, fair value through other comprehensive income (FVOCI), or fair value through profit or loss (FVTPL).

   As a result of the application of the classification and measurement requirements of PFRS 9, debt securities currently held as AFS investments under PAS 39 are expected to be classified as either at amortized cost for securities belonging to portfolios managed under a "hold-to-collect" (HTC) business model or at FVOCI with recycling to profit or loss for securities belonging to portfolios managed under a "hold-to-collect-and-sell" business model. The Bank expects to reclassify more debt securities currently held as AFS investments to amortized cost than to FVOCI. Loans and other receivables are expected to be managed under an "HTC" business model and thus qualify for amortized cost measurement.

Investments in unquoted equity shares currently carried at cost under PAS 39 are expected to be measured at FVTPL. Quoted equity shares currently held as AFS investments can be measured at FVTPL, which will increase volatility in profit or loss, except for certain AFS investments that will be designated as FVOCI with no recycling to profit or loss.

b. Impairment

PFRS 9 requires the Bank to record ECL for all loans and other debt financial assets not classified as at FVTPL, together with loan commitments and financial guarantee contracts.

Incurred loss versus expected credit loss methodology

The application of ECL will significantly change the Bank's credit loss methodology and models. ECL represent credit losses that reflect an unbiased and probability-weighted amount which is determined by evaluating a range of possible outcomes, the time value of money and reasonable and supportable information about past events, current conditions and forecasts of future economic conditions. The objective of the new impairment standard is to record lifetime losses on all financial instruments which have experienced a significant increase in credit risk (SICR) since their initial recognition. As a result, ECL allowances will be measured at amounts equal to either (i) 12-month ECL or (ii) lifetime ECL for those financial instruments which have experienced a SICR since initial recognition (General Approach). The 12-month ECL is the portion of lifetime ECL that results from default events on a financial instrument that are possible within the 12 months after the reporting date. Lifetime ECL are credit losses that results from all possible default events over the expected life of a financial instrument. In comparison, the present incurred loss model recognizes lifetime credit losses only when there is objective evidence of impairment.

Staging assessment

For non-credit-impaired financial instruments:

- Stage 1 is comprised of all non-impaired financial instruments which have not experienced a SICR since initial recognition. The Bank recognizes a 12-month ECL for Stage 1 financial instruments.
- Stage 2 is comprised of all non-impaired financial instruments which have experienced a SICR since initial recognition. The Bank recognizes a lifetime ECL for Stage 2 financial instruments.

For credit-impaired financial instruments:

- Financial instruments are classified as Stage 3 when there is objective evidence of impairment as a result of one or more loss events that have occurred after initial recognition with a negative impact on the estimated future cash flows of a loan or a portfolio of loans. The ECL model requires that lifetime ECL be recognized for impaired financial instruments.

Definition of "default" and "cure"

The Bank defines a financial instrument as in default, which is fully aligned with the definition of credit impaired, in all cases when the borrower becomes 90 days past due on its contractual payments. As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted. An instrument is considered to be no longer in default (i.e., to have cured) when it no longer meets any of the default criteria for a consecutive period of 180 days and has exhibited a satisfactory track record.

Credit risk at initial recognition
The Bank uses internal credit assessment and approvals at various levels to determine the credit risk of exposures at initial recognition. Assessment can be quantitative or qualitative and depends on the materiality of the facility or the complexity of the portfolio to be assessed.

Significant increase in credit risk
The criteria for determining whether credit risk has increased significantly vary by portfolio and include quantitative changes in probabilities of default and qualitative factors, including a backstop based on delinquency. The credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, based on the Bank's internal credit assessment, the borrower or counterparty is determined to require close monitoring or with well-defined credit weaknesses. For exposures without internal credit grades, if contractual payments are more than a specified days past due threshold, the credit risk is deemed to have increased significantly since initial recognition. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower. In subsequent reporting periods, if the credit risk of the financial instrument improves such that there is no longer a SICR since initial recognition, the Bank shall revert to recognizing a 12-month ECL.

Restructuring
In certain circumstances, the Bank modifies the original terms and conditions of a credit exposure to form a new loan agreement or payment schedule. The modifications can be given depending on the borrower's or counterparty's current or expected financial difficulty. The modifications may include, but are not limited to, change in interest rate and terms, principal amount, maturity date, date and amount of periodic payments and accrual of interest and charges. Distressed restructuring with indications of unlikeliness to pay are categorized as impaired accounts and are moved to Stage 3.

ECL parameters and methodologies
ECL is a function of the probability of default (PD), exposure at default (EAD) and loss given default (LGD), with the timing of the loss also considered, and is estimated by incorporating forward-looking economic information and through the use of experienced credit judgment.

The PD represents the likelihood that a credit exposure will not be repaid and will go into default in either a 12-month horizon for Stage 1 or lifetime horizon for Stage 2. The PD for each individual instrument is modelled based on historic data and is estimated based on current market conditions and reasonable and supportable information about future economic conditions. The Bank segmented its credit exposures based on homogenous risk characteristics and developed a corresponding PD methodology for each portfolio. The PD methodology for each relevant portfolio is determined based on the underlying nature or characteristic of the portfolio, behavior of the accounts and materiality of the segment as compared to the total portfolio.

EAD is modelled on historic data and represents an estimate of the outstanding amount of credit exposure at the time a default may occur. For off-balance sheet and undrawn amounts, EAD includes an estimate of any further amounts to be drawn at the time of default. LGD is the amount that may not be recovered in the event of default and is modelled based on historical cash flow recovery and reasonable and supportable information about future economic conditions, where appropriate. LGD takes into consideration the amount and quality of any collateral held.

Economic overlays
The Bank incorporates economic overlays into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. A broad range of economic overlays are considered as economic inputs, such as GDP growth, inflation rates, unemployment rates, interest rates and BSP statistical indicators. The inputs and models used for calculating ECL may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material.

The Bank has determined that the financial and operational aspects of the ECL methodologies under PFRS 9 will have an impact to the 2018 financial statements.

c. Hedge Accounting
The new hedge accounting model under PFRS 9 aims to simplify hedge accounting, align the accounting for hedge relationships more closely with an entity's risk management activities and permit hedge accounting to be applied more broadly to a greater variety of hedging instruments and risks eligible for hedge accounting. The Bank has assessed that the adoption of these amendments will not have any impact in the 2018 financial statements.

The Bank has applied its existing governance framework to ensure that appropriate controls and validations are in place over key processes and judgments in implementing PFRS 9. The Bank is continuously refining its internal controls and processes which are relevant in the proper implementation of the PFRS 9.

PFRS 15, *Revenue from Contracts with Customers*
PFRS 15 establishes a new five-step model that will apply to revenue arising from contracts with customers. Under PFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in PFRS 15 provide a more structured approach to measuring and recognizing revenue.

The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under PFRSs. Either a full or modified retrospective application is required for annual periods beginning on or after January 1, 2018. The Bank is currently assessing the impact of adopting PFRS 15.

Effective beginning on or after January 1, 2019

New Standards

PFRS 16, *Leases*
Under the new standard, lessees will no longer classify their leases as either operating or finance leases in accordance with PAS 17, *Leases*. Rather, lessees will apply the single-asset model. Under this model, lessees will recognize the assets and related liabilities for most leases on their balance sheets, and subsequently, will depreciate the lease assets and recognize interest on the lease liabilities in their profit or loss. Leases with a term of 12 months or less or for which the underlying asset is of low value are exempted from these requirements. The accounting by lessors is substantially unchanged as the new standard carries forward the principles of lessor accounting under PAS 17. Lessors, however, will be required to disclose more information in their financial statements, particularly on the risk exposure to residual value. Entities may early adopt PFRS 16 but only if they have also adopted PFRS 15. When adopting PFRS 16, an entity is permitted to use either a full retrospective or a modified retrospective approach, with options to use certain transition reliefs. The Bank is currently assessing the impact of adopting PFRS 16.

Amendments

Amendments to PFRS 9, *Prepayment Features with Negative Compensation*
The amendments to PFRS 9 allow debt instruments with negative compensation prepayment features to be measured at amortized cost or fair value through other comprehensive income. An entity shall apply these amendments for annual reporting periods beginning on or after January 1, 2019. Earlier application is permitted.

Amendments to PAS 28, *Long-term Interests in Associates and Joint Ventures*
The amendments to PAS 28 clarify that entities should account for long-term interests in an associate or joint venture to which the equity method is not applied using PFRS 9. An entity shall apply these amendments for annual reporting periods beginning on or after January 1, 2019. Earlier application is permitted.

Philippine Interpretation IFRIC 23, *Uncertainty over Income Tax Treatments*
Philippine Interpretation IFRIC 23 addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of PAS 12 and does not apply to taxes or levies outside the scope of PAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments.

The interpretation specifically addresses the following:
- Whether an entity considers uncertain tax treatments separately
- The assumptions an entity makes about the examination of tax treatments by taxation authorities
- How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates
- How an entity considers changes in facts and circumstances

An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed.

The Bank is currently assessing the impact of adopting this interpretation.

Impact of TRAIN on the Bank's 2017 financial statements:
- "Republic Act (RA) No. 10963 of the Tax Reform for Accelaration and inclusion Act (TRAIN) was signed into law on December 19, 2017 and took effect January 01, 2018, making the new tax law enacted as of the reporting date. Although the TRAIN changes existing tax law and includes several provisions that will generally affect business on a prospective basis, the management assessed that the same will not have any significant impact on the financial statement balances as of the reporting date."

Deferred effectivity

Amendments to PFRS 10, *Consolidated Financial Statements* and PAS 28, *Investments in Associates and Joint Ventures - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*

The amendments address the conflict between PFRS 10 and PAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that a full gain or loss is recognized when a transfer to an associate or joint venture involves a business as defined in PFRS 3, *Business Combinations*. Any gain or loss resulting from the sale or contribution of assets that does not constitute a business, however, is recognized only to the extent of unrelated investors' interests in the associate or joint venture. On January 13, 2016, the FRSC postponed the original effective date of January 1, 2016 of the said amendments until the IASB has completed its broader review of the research project on equity accounting that may result in the simplification of accounting for such transactions and of other aspects of accounting for associates and joint ventures.

3. Significant Accounting Judgments, Estimates and Assumptions

The preparation of the financial statements in accordance with PFRS requires the management to make judgments, estimates and assumptions that affect the reported amount of revenues, expenses, assets and liabilities, and the accompanying disclosures, as well as the disclosure of contingent assets and contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets and liabilities affected in future periods. The effects of any change in judgments, estimates and assumptions are reflected in the financial statements as they become reasonably determinable.

Judgments, estimates and assumptions 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.

<u>Judgments</u>

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

(a) *Fair value of financial instruments*

When the fair values of financial assets and financial liabilities in the statement of condition cannot be measured based on quoted prices in active markets, their fair value is measured using valuation techniques including the discounted cash flow model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgement is required in establishing fair values. Judgments include considerations of inputs such as liquidity risk, credit risk and volatility for longer-dated derivatives and discount rates, prepayments and default rates assumptions. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

The fair values of the Bank's financial instruments are disclosed in Note 4.

(b) *Classification of HTM investments*

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

<u>Estimates and Assumptions</u>

The key assumptions concerning the future and other key sources of estimation uncertainty at the statement of condition date, which have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next period, are described below. The Bank based its assumptions and estimates on parameters available when the financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances beyond the control of the Bank. Such changes are reflected in the assumptions when they occur.

(a) *Credit losses on loans and receivables*
The Bank reviews its loans and receivables at each statement of condition date to assess whether an impairment loss should be recorded in the statement of income. In particular, for provisions calculated on an individual basis, judgment made 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 including the assessment of the financial condition of the counterparty, and estimated net selling prices of collateral, and actual results may differ, at which event, the Bank adjusts the impairment loss and ensures that allowance for it remains adequate (Note 5).

In addition to specific allowance against individually significant loans and receivables, the Bank also provides 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 take into consideration historical loss rates, recovery rates and net flow rates.

The carrying value of loans and receivables and allowance for credit losses on loans and receivables are disclosed in Notes 9 and 15, respectively.

(b) *Impairment of non-financial assets*

Investment properties and chattel mortgage properties
The Bank assesses impairment on its non-financial 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 costs to sell for property and equipment, investment properties and chattel mortgage properties. Recoverable amounts are estimated for individual assets or, if it is not possible, for the CGU to which the asset belongs.

The carrying values of the Bank's investment properties and chattel mortgage properties are disclosed in Notes 11, 12 and 14, respectively.

Investment in a joint venture
The Bank assesses impairment on its investment in a joint venture whenever events or changes in circumstances indicate that the carrying amount of said asset may not be recoverable. Among others, the factors that the Bank considers important which could trigger an impairment review on its investment in a joint venture include the following:

- deteriorating or poor financial condition;
- recurring net losses; and
- significant changes (i.e., technological, market, economic, or legal environment in which the joint venture operates with an adverse effect on the joint venture have taken place during the period, or will take place in the near future).

An impairment loss is recognized whenever the carrying amount of an asset exceeds its recoverable amount. The recoverable amount is determined based on the asset's value in use. As of December 31, 2017 and 2016, the carrying values of the Bank's investment in a joint venture amounted to ₱607.2 million and ₱727.2 million, respectively (Note 10).

(c) *Present value of retirement obligation*
The cost of defined benefit pension plans as well as the present value of the pension 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 future pension increases. 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 statement of condition date.

In determining the appropriate discount rate, management considers the interest rates of Philippine government bonds that are denominated in the currency in which the benefits will be paid, with extrapolated maturities corresponding to the expected duration of the defined benefit obligation.

The details of assumptions used in the actuarial valuation are disclosed in Note 24.

As of December 31, 2017 and 2016 the net pension liability of the Bank amounted to ₱515.9 million and ₱748.8 million, respectively (Note 24).

(d) *Recognition of deferred tax assets*
Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that future taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the availability of future taxable income in reference to financial forecast, tax strategies and expected future market or economic conditions.

Estimates of future taxable income indicate that temporary differences will be realized in the future. Net deferred tax assets as of December 31, 2017 and 2016 amounted to ₱1.4 billion and ₱1.3 billion, respectively (Note 27).

(e) *Contingent liabilities*
The Bank is a defendant in legal actions arising from its normal business activities. Management believes that the ultimate liability, if any, resulting from these cases will not have a material effect on the Bank's financial statements (Note 31).

4. **Fair Value Measurement**

Financial Instruments
The following describes the methodologies and assumptions used to determine the fair values of financial instruments:

Cash and other cash items, due from BSP, due from other banks, interbank loans receivable and SPURA, accounts receivable, accrued interest receivable, bills purchased, RCOCI, shortages, and petty cash fund - Carrying amounts approximate fair values due to the relatively short-term maturities of these assets.

Debt investments - 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, using rates currently available for debt on similar terms, credit risk and remaining maturities.

Quoted AFS equity investments - Fair values are based on quoted prices published in markets.
Unquoted AFS equity investments - Fair values could not be reliably determined due to the unpredictable nature of future cash flows and the lack of suitable methods of arriving at a reliable fair value. Hence, these investments are carried at cost less allowance for impairment losses.

Currently, there is no available market to sell these unquoted AFS equity investments. The Bank will hold onto these investments until management decides to sell them when there will be offers to buy out such investments or the appearance of an available market where the investments can be sold.

Derivative instruments (included under FVPL) - Fair values are estimated based on quoted market prices provided by independent parties or derived using acceptable valuation models. The models utilize published underlying rates (e.g., foreign exchange (FX) rates and forward FX rates).

Receivable from customers, sales contract receivables and security deposits - Fair values are estimated using the discounted cash flow methodology, using the Bank's current lending rates for similar types of loans. The discount rates used range from 6.00% to 30.00% in 2017 and 2016.

Demand deposits, savings deposits, bills payable, treasurer's, cashier's and manager's checks, accrued interest payable, accounts payable, bills purchased-contra, other credits, due to the Treasurer of the Philippines, deposits for keys-SDB, payment orders payable and overages - Carrying amounts approximate fair values due to either the demand nature or the relatively short-term maturities of these liabilities.

Subordinated notes and time deposits - Fair values are estimated using the discounted cash flow methodology using the Bank's borrowing rates for similar borrowings with maturities consistent with those remaining for the liability being valued. The discount rates used for subordinated notes are 5.22% in 2017 and ranges from 5.63% to 5.89% in 2016. The discount rates used for time deposits range from 0.25% to 1.75% in 2017 and 2016, respectively.

The inputs used in the fair value measurement based on Level 2 are as follows:

Derivative assets and liabilities - fair values are calculated by reference to the prevailing spot exchange rate as of statement of condition date.

Government securities - interpolated rates based on market rates of benchmark securities as of statement of condition date.

Inputs used in estimating fair values of financial instruments carried at amortized cost and categorized under Level 3 include risk-free rates and applicable risk premium.

Non-financial Asset

Investment properties - Fair values of the investment properties have been determined based on valuations performed by independent external and in-house appraisers using valuation technique with significant inputs that are not based on observable market data (Level 3). The valuation of investment properties was based on the Sales Comparison Approach and considered recent sales of similar or substitute properties in the same areas where the investment properties are located, taking into account the economic conditions prevailing at the time of the valuation. Other factors considered were the location and shape of the properties, environmental issues, development controls such as the height restriction, building coverage and floor area ratio restrictions among others. Other significant unobservable inputs include shape, location, time element, discount and corner influence. The fair value of investment properties is based on its highest and best use, which is its current use.

The following tables summarize the carrying amount and fair values of the Bank's financial instruments and investment properties, analyzed based on the hierarchy described in Note 2 (in thousands):

	December 31, 2017				
	Carrying Value	Level 1	Level 2	Level 3	Total Fair Value
Assets measured at fair value:					
Financial Assets					
FVPL investments					
HFT - government securities	₱293,076	₱293,076	₱–	₱–	₱293,076
Derivative assets - foreign exchange swaps	73,160	–	73,160	–	73,160
AFS investments					
Government debt securities	10,762,411	10,260,902	501,509	–	10,762,411
Private debt securities	6,153,072	6,153,072	–	–	6,153,072
Quoted equity securities	7,703	163	8,760	–	8,923
	₱17,289,422	₱16,707,213	₱583,429	₱–	₱17,290,642
Assets for which fair values are disclosed:					
Financial Assets					
HTM investments					
Government	₱25,460,778	₱24,634,062	₱–	₱–	₱24,634,062
Private	4,012,946	4,046,020	–	–	4,046,020
Loans and receivables					
Receivables from customers					
Consumption loans	82,319,091	–	–	93,632,312	93,632,312
Real estate loans	45,961,973	–	–	45,844,118	45,844,118
Commercial loans	11,185,778	–	–	12,070,479	12,070,479
Personal loans	2,899,960	–	–	3,383,787	3,383,787
Sales contract receivable	72,892	–	–	107,448	107,448
Security deposits	179,436	–	–	288,467	288,467
Non-Financial Assets					
Investment properties	3,930,317	–	–	4,939,141	4,939,141
	₱176,023,171	₱28,680,082	₱-	₱160,265,752	₱189,945,834
Liabilities for which fair values are disclosed:					
Deposit liabilities – time	₱136,042,057	₱–	₱–	₱137,797,790	₱137,797,790
Deposit liabilities – LTNCD	3,375,000	–	–	3,198,056	3,198,056
Subordinated notes	2,978,998	–	–	3,046,819	3,046,819
Bills payable	1,492,419	–	–	1,492,419	1,492,419
	₱143,888,474	₱–	₱–	₱145,535,084	₱145,535,084

	December 31, 2016				
	Carrying Value	Level 1	Level 2	Level 3	Total Fair Value
Assets measured at fair value:					
Financial Assets					
FVPL investments					
HFT - government securities	₱1,360,293	₱1,360,293	₱–	₱–	₱1,360,293
Derivative assets - foreign exchange swaps	499	–	499	–	499
AFS investments					
Government debt securities	8,462,431	7,860,775	601,656	–	8,462,431
Private debt securities	4,645,669	4,645,669	–	–	4,645,669
Quoted equity securities	5,393	163	6,450	–	6,613
	₱14,474,285	₱13,866,900	₱608,605	₱–	₱14,476,505
Assets for which fair values are disclosed:					
Financial Assets					
HTM investments					
Government	₱20,046,355	₱14,700,636	₱3,121,158	₱–	₱17,821,794
Private	3,110,532	4,671,187	–	–	4,671,187
Loans and receivables					
Receivables from customers					
Consumption loans	68,049,723	–	–	77,057,592	77,057,592
Real estate loans	43,394,060	–	–	43,727,872	43,727,872
Commercial loans	10,724,488	–	–	11,602,071	11,602,071
Personal loans	2,923,628	–	–	3,471,046	3,471,046
Sales contract receivable	117,814	–	–	154,520	154,520
Security deposits	178,331	–	–	168,120	168,120
Non-Financial Assets					
Investment properties	3,861,708	–	–	4,675,355	4,675,355
	₱152,406,639	₱19,371,823	₱3,121,158	₱140,856,576	₱163,349,557
Liabilities measured at fair value:					
Financial Liabilities					
Derivative liabilities - foreign exchange swaps	₱65,317	₱–	₱65,317	₱–	₱65,317
Liabilities for which fair values are disclosed:					
Deposit liabilities – time	₱115,811,946	₱–	₱–	₱115,519,377	₱115,519,377
Subordinated notes	5,975,732	–	–	6,000,716	6,000,716
Bills Payable	6,093,797	–	–	6,093,797	6,093,797
	₱127,881,475	₱–	₱–	₱127,613,890	₱127,613,890

As of December 31, 2017 and 2016, 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.

As of December 31, 2017 and 2016, the Bank determined the market value of its warrants to be zero due to the absence of an active market for the Bank's ROP warrants, as evidenced by the unavailability of quoted market prices.

5. Financial Risk Management Policies and Objectives

The Bank has exposure to the following risks from its use of financial instruments:

- Credit risk
- Market risk
- Liquidity risk

Organization risk management structure continues to be a top-down organization, with the BOD at the helm of all major initiatives.

Discussed below are the relevant sections on roles and responsibilities from the Risk Oversight Committee (ROC) Charter:

BOD

The corporate powers of the Bank are vested in and are exercised by the BOD, who conducts its business and controls its property. The BOD approves broad risk management strategies and policies and ensures that risk management initiatives and activities are consistent with the Bank's overall objectives. The BOD appoints the members of the ROC.

ROC

The ROC is composed of at least three members of the Board, the majority of whom are independent directors including its Chairperson. The ROC Chairperson is not the Chairperson of the Board or of any other committee. Members of the ROC possess a range of expertise and adequate knowledge of the Bank's risk exposures to be able to develop appropriate strategies for preventing losses and minimizing the impact of losses when they occur.

The BOD may also appoint non-directors to the ROC as part of the Metrobank Group risk oversight measures. However, only Bank directors shall be considered as voting members of the ROC. Non-voting members are appointed in an advisory capacity.

The ROC oversees the system of limits to discretionary authority that the BOD delegates to the management and ensures that the system remains effective, the limits are observed, and that immediate corrective actions are taken whenever limits are breached.

The ROC meets on a monthly basis and is supported by the Risk Management Office (RMO). In the absence of the ROC Chairman, another Independent Director shall preside. ROC resolutions, which require the concurrence of the majority of its voting members, are presented to the BOD for confirmation.

RMO

The RMO, headed by the Chief Risk Officer, is a function that is independent from executive functions and business line responsibilities, operations and revenue-generating functions. It reports directly to the BOD, through the ROC. The RMO assists the ROC in carrying out its responsibilities by:

- analyzing, communicating, implementing, and maintaining the risk management policies approved by the ROC and the BOD;
- spearheading the regular review of the Bank's risk management policy manual and making or elevating recommendations that enhance the risk management process to the ROC and the BOD, for their approval; and
- ensuring that the risks arising from the Bank's activities are identified, measured, analyzed, reported to and understood by risk takers, management, and the board. The RMO analyzes limit exceptions and recommends enhancements to the limits structure.

The RMO does not assume risk-taking accountability nor does it have approving authority. The RMO's role is to act as liaison and to provide support to the BOD, ROC, the President, management committees, risk takers and other support and control functions on risk-related matters.

The Risk Management Function is responsible for:

- identifying the key risk exposures and assessing and measuring the extent of risk exposures of the Bank and its trust operations;

- monitoring the risk exposures and determining the corresponding capital requirement in accordance with the Basel capital adequacy framework and based on the Bank's internal capital adequacy assessment on an on-going basis;
- monitoring and assessing decisions to accept particular risks whether these are consistent with BOD-approved policies on risk tolerance and the effectiveness of the corresponding risk mitigation measures; and
- reporting on a regular basis to Senior Management and the BOD the results of assessment and monitoring.

President
The President is the Chief Executive Officer of the Bank and has the primary responsibility of carrying out the policies and objectives of the BOD. The President exercises the authorities delegated to him by the BOD and may recommend such policies and objectives he deems necessary for the continuing progress of the Bank.

Risk management
The risk management framework aims to maintain a balance between the nature of the Bank's businesses and the risk appetite of the BOD. Accordingly, policies and procedures are reviewed regularly and revised as the organization grows and as financial markets evolve. New policies or proposed changes in current policies are presented to the ROC and the BOD for approval.

a. Credit risk and concentration of assets and liabilities and off-balance sheet items

Credit risk is the risk that a counterparty will not settle its obligations in accordance with the agreed terms.

The Bank's lending business follows credit policy guidelines set by the BOD, ROC and RMO. These policies serve as minimum standards for extending credit. The people engaged in the credit process are required to understand and adhere to these policies.

Product manuals are in place for all loans and deposit products that actually or potentially expose the Bank to all types of risks that may result in financial or reputational losses. They define the product and the risks associated with the product plus the corresponding risk-mitigating controls. They embody the business plans and define the business parameters within which the product or activity is to be performed.

The system of checks around extension of credit includes approval by at least two credit approvers through the Credit Committee (CreCom), Executive Committee (ExCom) or BOD. The ROC reviews the business strategies and ensures that revenue-generating activities are consistent with the risk tolerance and standards of the Bank. The Internal Audit Group conducts regular audit across all functional units. The BOD, through the ExCom, CreCom and ROC, ensure that sound credit policies and practices are followed through all the business segments.

<u>Credit Approval</u>
Credit approval is the documented acceptance of credit risk in the credit proposal or application.

The Bank's credit decision-making for consumer loans utilizes the recommendation of the credit scoring and is performed at the CreCom level appropriate to the size and risk of each transaction, in conformity with corporate policies and procedures in regulating credit risk activities. The Bank's ExCom may approve deviations or exceptions, while the BOD approves material exceptions such as large exposures, loans to directors, officers, stockholders and other related interests (DOSRI), and loan restructuring.

Credit delegation limits are identified, tracked and reviewed at least annually by the Bank's Head of Credit and Collections together with the Credit Risk Manager.

Borrower Eligibility
The Bank's credit processing commences when a customer expresses his intention to borrow through a credit application. The Bank gathers data on the customer; ensures they are accurate, up-to-date and adequate to meet the minimum regulatory requirements and to render credit decision. These data are used for the intended purpose only and are managed in adherence to the customer information secrecy law.

The customer's credit worthiness, repayment ability and cash flow are established before credit is extended. The Bank independently verifies critical data from the customer, ensuring compliance with Know Your Customer requirements under the anti-money laundering laws. The Bank requires that customer income be derived from legitimate sources and supported with government-accepted statements of income, assets and liabilities.

The Bank ascertains whether the customer is legally capable of entering a credit contract and of providing a charge over any asset presented as collateral for a loan. Guarantors or sureties may be accepted, provided they are a relative, partner, and have financial interest in the transaction, and they pass all credit acceptance criteria applied to the borrower.

Loan Structure
The Bank structures loans for its customers based on the customer's capability to pay, the purpose of the loan, and for a collateralized loan, the collateral's economic life and liquidation value over time.

The Bank establishes debt burden guidelines and minimum income requirements to assess the customer's capacity to pay.

The Bank utilizes credit bureau data, both external and internal, to obtain information on a customer's current commitments and credit history.

The Bank takes into account environmental and social issues when reviewing credit proposals of small businesses and commercial mortgage customers. The Bank ensures that all qualified securities pass through the BOD for approval. Assignments of securities are confirmed and insurance are properly secured.

The Bank uses credit scoring models and decision systems for consumer loans as approved by the BOD. Borrower risk rating model and facility risk rating model, on the other hand, are available for SME loans, and supported with qualitative evaluation. Regular monitoring of all these tools and their performance is carried out to ensure that they remain effective.

Initial loan limits are recommended by the CreCom and ExCom and approved by the BOD. The Bank ensures that secured loans are within ceilings set by local regulators. Succeeding loan availments are based on account performance and customer's credit worthiness.

Credit Management
The Bank maintains credit records and documents on all borrowings and captures transaction details in its loan systems. The credit risk policies and system infrastructure ensure that loans are monitored and managed at all times.

The Bank's Management Information System provides statistics that its business units need to identify opportunities for improving rewards without necessarily sacrificing risk. Statistical data on product, productivity, portfolio, profitability, performance and projection are made available regularly.

The Bank conducts regular loan review through the ROC, with the support of the RMO. The Bank examines its exposures, credit risk ratios, provisions and customer segments. The Bank's unique customer identification and unique group identification methodology enables it to aggregate credit exposures by customer or group of borrowers. Aggregate exposures of at least ₱100.0 million are put on a special monitoring.

The ROC assesses the adequacy of provisions for credit losses regularly. The Bank's automated loan grading system enables the Bank to set up provision per account. The Bank also performs impairment analyses on loans and receivables, whether on an individual or collective basis, in accordance with PFRS.

The Bank carries out stress testing analyses using Board-approved statistical models relating the default trends to macroeconomic indicators.

In 2017, the Bank effected the necessary adjustments to its credit risk management systems and processes in transition to the Philippine Financial Reporting Standards 9 (PFRS 9) as well as the Amended Rules on Past Due and Non-Performing Loans per BSP Circular No. 941, both effective 01 January 2018. Credit risk management was likewise strengthened in preparation for the implementation of expected credit loss models which will allow the Bank to shift from the incurred loss methods for calculating allowance for losses to forward-looking loss provisioning. Further, credit scoring models were updated to optimize returns by growing profitable lending segments and exploring new markets whilst mitigating the risks.

Maximum Exposure to Credit Risk
The tables below show the analysis of the maximum exposure to credit risk of the Bank's financial instruments, excluding those where the carrying values as reflected in the statement of condition and related notes already represent the financial instrument's maximum exposure to credit risk, after taking into account collateral held or other credit enhancements (in thousands):

	2017			
	Carrying Amount	**Fair Value of Collateral**	**Maximum Exposure to Credit Risk**	**Financial Effect of Collateral or Credit Enhancement**
Due from other banks	**₱1,508,489**	**₱2,841,821**	**₱–**	**₱1,508,489**
SPURA	**1,842,023**	**577,932**	**–**	**1,842,023**
Receivables from customers				
Consumption loans	**82,319,091**	**102,691,262**	**21,424**	**82,297,667**
Real estate loans	**45,961,973**	**52,201,023**	**5,526,038**	**40,435,935**
Commercial loans	**11,185,778**	**13,138,025**	**2,716,368**	**8,469,410**
Other receivables				
Accrued interest receivable	**1,741,516**	**3,644,411**	**732,020**	**1,009,496**
Sales contract receivable	**72,892**	**104,882**	**46,235**	**26,657**
Total credit exposure	**₱144,631,762**	**₱175,199,356**	**₱9,042,085**	**₱135,589,677**

	2016			
	Carrying Amount	Fair Value of Collateral	Maximum Exposure to Credit Risk	Financial Effect of Collateral or Credit Enhancement
Due from other banks	₱1,838,630	₱788,154	₱1,054,476	₱788,154
SPURA	3,254,312	4,686,901	–	3,254,312
Receivables from customers				
Consumption loans	68,049,723	75,053,312	2,019,025	66,030,698
Real estate loans	43,394,060	49,133,794	5,354,204	38,039,856
Commercial loans	10,724,488	4,622,362	7,450,673	3,273,815
Other receivables				
Accrued interest receivable	1,614,842	1,527,477	87,365	1,527,477
Sales contract receivable	117,814	307,004	1,325	116,489
Total credit exposure	₱128,993,869	₱136,119,004	₱15,967,068	₱113,030,801

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 acceptability of types of collateral and valuation parameters.

The main types of collaterals obtained are as follows:

- For Due from other banks: investment securities
- For SPURA: investment securities
- For commercial lending: mortgages over real estate properties, deposit accounts and securities
- For consumer lending: mortgages over real estate and chattel

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for credit and impairment losses.

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

The Bank holds collateral against loans and receivables in the form of real estate and chattel mortgages, guarantees, and other registered securities over assets. Estimates of fair value are based on the value of the collateral assessed at the time of borrowing and generally are updated every two years and when a loan is assessed to be impaired, whenever applicable. Generally, collateral is not held over loans and advances to banks except for SPURA. The Bank is not allowed to sell or re-pledge collateral held under SPURA in the absence of default by the counterparty. Collateral is usually not held against holdings in investment securities, and no such collateral was held as of December 31, 2017 and 2016.

Concentration of risk is managed by borrower, by group of borrowers, by geographical region and by industry sector. As of December 31, 2017 and 2016, the maximum credit exposure to any borrower amounted to ₱1.9 billion, before taking into account any collateral or other credit enhancement.

The distribution of the Bank's financial assets before taking into account any collateral held or other credit enhancements can be analyzed by the following geographical regions (in thousands):

	2017				
	Loans and Receivables	**Loans and Advances to Banks***	**Investment Securities****	**Others*****	**Total**
Luzon	**₱129,574,601**	**₱18,612,324**	**₱46,755,443**	**₱273,268**	**₱195,215,636**
Visayas	**9,422,015**	**1,106**	**–**	**–**	**9,423,121**
Mindanao	**10,614,855**	**2,470**	**–**	**–**	**10,617,325**
	149,611,471	**18,615,900**	**46,755,443**	**273,268**	**215,256,082**
Less allowance for credit and impairment losses	**4,646,958**	**–**	**–**	**–**	**4,646,958**
Total	**₱144,964,513**	**₱18,615,900**	**₱46,755,443**	**₱273,268**	**₱210,609,124**

* Composed of due from BSP, due from other banks, interbank loans receivable and SPURA.
** Composed of FVPL investments, AFS investments (excluding equity securities not exposed to credit risk) and HTM investments.
*** Composed of financial assets classified under other assets (such as RCOCI, security deposits and shortages) and stand-by credit lines.

	2016				
	Loans and Receivables	Loans and Advances to Banks*	Investment Securities**	Others***	Total
Luzon	₱114,457,713	₱19,023,728	₱37,625,779	₱273,614	₱171,380,834
Visayas	8,125,298	23,421	–	–	8,148,719
Mindanao	9,401,569	32,577	–	–	9,434,146
	131,984,580	19,079,726	37,625,779	273,614	188,963,699
Less allowance for credit and impairment losses	4,762,733	–	–	–	4,762,733
Total	₱127,221,847	₱19,079,726	₱37,625,779	₱273,614	₱184,200,966

* Composed of due from BSP, due from other banks, interbank loans receivable and SPURA.
** Composed of FVPL investments, AFS investments (excluding equity securities not exposed to credit risk) and HTM investments.
*** Composed of financial assets classified under other assets (such as RCOCI, security deposits and shortages) and stand-by credit lines.

Additionally, the tables below show the distribution of the Bank's financial assets and off-balance sheet items before taking into account any collateral or other credit enhancements analyzed by industry sector as of December 31, 2017 and 2016 (in thousands):

	2017				
	Loans and Receivables	**Loans and Advances to Banks***	**Investment Securities****	**Others*****	**Total**
Activities of private households as employers and undifferentiated goods and services and producing activities of households for own use	**₱90,543,668**	**₱–**	**₱–**	**₱–**	**₱90,543,668**
Financial and insurance activities	**4,068,627**	**18,615,900**	**46,755,443**	**191,162**	**69,631,132**
Real estate activities	**42,251,639**	**–**	**–**	**–**	**42,251,639**
Wholesale and retail trade; repair of motor vehicles and motorcycles	**2,421,117**	**–**	**–**	**–**	**2,421,117**
Electricity, gas, steam and air-conditioning supply	**1,749,765**	**–**	**–**	**–**	**1,749,765**
Administrative and support service activities	**996,493**	**–**	**–**	**–**	**996,493**
Transportation and storage	**963,123**	**–**	**–**	**–**	**963,123**
Construction	**801,242**	**–**	**–**	**56,000**	**857,242**
Manufacturing	**644,735**	**–**	**–**	**–**	**644,735**
Information and communication	**592,890**	**–**	**–**	**–**	**592,890**
Accommodation and food service activities	**372,653**	**–**	**–**	**–**	**372,653**
Human health and social work activities	**326,297**	**–**	**–**	**–**	**326,297**
Water supply, sewage, waste management and remediation activities	**237,078**	**–**	**–**	**–**	**237,078**
Education	**198,609**	**–**	**–**	**–**	**198,609**
Professional, scientific and technical services	**137,853**	**–**	**–**	**–**	**137,853**

(Forward)

	2017				
	Loans and Receivables	**Loans and Advances to Banks***	**Investment Securities****	**Others*****	**Total**
Arts, entertainment and recreation	**₱85,099**	**₱–**	**₱–**	**₱–**	**₱85,099**
Agricultural, forestry and fishing	**25,302**	**–**	**–**	**–**	**25,302**
Mining and quarrying	**7,230**	**–**	**–**	**–**	**7,230**
Other service activities	**3,188,051**	**–**	**–**	**26,106**	**3,214,157**
	149,611,471	**18,615,900**	**46,755,443**	**273,268**	**215,256,082**
Less allowance for credit and impairment losses	**4,646,958**	**–**	**–**	**–**	**4,646,958**
Total	**₱144,964,513**	**₱18,615,900**	**₱46,755,443**	**₱273,268**	**₱210,609,124**

* Composed of due from BSP, due from other banks, interbank loans receivable and SPURA.
** Composed of FVPL investments, AFS investments (excluding equity securities not exposed to credit risk) and HTM investments.
*** Composed of financial assets classified under other assets (such as RCOCI, security deposits and shortages) and stand-by credit lines.

	2016				
	Loans and Receivables	Loans and Advances to Banks*	Investment Securities**	Others***	Total
Activities of private households as employers and undifferentiated goods and services and producing activities of households for own use	₱76,644,704	₱–	₱–	₱–	₱76,644,704
Financial and insurance activities	3,506,711	19,079,726	37,625,779	189,954	60,402,170
Real estate activities	39,499,089	–	–	–	39,499,089
Wholesale and retail trade; repair of motor vehicles and motorcycles	2,021,531	–	–	–	2,021,531
Electricity, gas, steam and air-conditioning supply	1,571,669	–	–	–	1,571,669
Information and communication	1,513,811	–	–	–	1,513,811
Administrative and support service activities	1,176,719	–	–	–	1,176,719
Accommodation and food service activities	709,800	–	–	–	709,800
Manufacturing	547,418	–	–	–	547,418
Construction	427,755	–	–	56,000	483,755
Human health and social work activities	356,752	–	–	–	356,752
Transportation and storage	326,725	–	–	–	326,725
Water supply, sewage, waste management and remediation activities	289,700	–	–	–	289,700
Education	203,247	–	–	–	203,247
Professional, scientific and technical services	81,247	–	–	–	81,247
Arts, entertainment and recreation	37,165	–	–	–	37,165
Agricultural, forestry and fishing	20,321	–	–	–	20,321
Mining and quarrying	4,514	–	–	–	4,514
Other service activities	3,045,702	–	–	27,660	3,073,362
	131,984,580	19,079,726	37,625,779	273,614	188,963,699
Less allowance for credit and impairment losses	4,762,733	–	–	–	4,762,733
Total	₱127,221,847	₱19,079,726	₱37,625,779	₱273,614	₱184,200,966

* Composed of due from BSP, due from other banks, interbank loans receivable and SPURA.
** Composed of FVPL investments, AFS investments (excluding equity securities not exposed to credit risk) and HTM investments.
*** Composed of financial assets classified under other assets (such as RCOCI, security deposits and shortages) and stand-by credit lines.

Credit Quality

Description of the loan grades for loans, receivables and stand-by credit lines:

Master Loan Classifications

The Bank rates accounts on a scale of 1 to 10, with 1 being the best, based on the Board-approved loan classifications which utilize the credit scoring results, credit experience and qualitative assessments.

Neither Past Due nor Individually Impaired
The Bank classifies those accounts under current status having the following master loan classification grades:

<u>High Grade (Master Loan Classification 1 - 4)</u>
1 - Excellent
This is considered as normal risk by the Bank. An excellent rating is given to a borrower who has the ability to meet credit obligation in full and is never delinquent.

2 - Strong
This is also considered as normal risk by the Bank. Borrower has the ability to meet credit obligation in full, except that the borrower had history of 1-29 days delinquency at worst.

3 - Good
This rating is given to a borrower who has the ability to meet credit obligation in full, except that the borrower had history of Loan Especially Mentioned rating (rating=7) at worst.

4 - Satisfactory
This rating is given to a borrower who has the ability to meet credit obligation in full, except that the borrower had history of Substandard rating (rating=8) at worst.

<u>Standard Grade (Master Loan Classification 5 - 7)</u>
5 - Acceptable
An acceptable rating is given to a borrower who meets present obligations, except that the borrower had history of Doubtful rating (rating=9) at worst.

6 - Watchlist
This rating is given to a borrower who meets present obligations, except that the borrower had history of Loss rating (rating=10) at worst.

7 - Loan Especially Mentioned
This rating is given to a borrower who has potential weaknesses which when left uncorrected, may affect the repayment of the loan and thus increase credit risk to the Bank.

<u>Substandard Grade (Master Loan Classification 8)</u>
8 - Substandard
A substandard rating is given to a borrower whose loan or portion thereof involves a substantial and an unreasonable degree of risk to the Bank because of unfavorable record or unsatisfactory characteristics. These loans show possibility of future loss to the Bank unless given closer supervision and well-defined weaknesses that jeopardize the loan liquidation.

<u>Unrated grade</u>
Other credit assets which cannot be classified as High, Standard or Sub-standard are tagged as Unrated.

Past Due but Not Individually Impaired
These are accounts which are classified as delinquent but are not subject to individual impairment as of statement of condition date.

9 - Doubtful
This rating is given to a borrower whose loans have characteristics where collection and liquidation in full is highly improbable and in which substantial loss is probable.

10 - Loss
This rating is given to a borrower whose loans or portions thereof are considered uncollectible or worthless and of such little value that their continuance as bankable assets is not warranted.

Individually Impaired
Accounts which are subject to individual impairment as of statement of condition date.

The tables below show the credit quality per class of financial assets under loans and receivables (in thousands)*:

	2017						
	Neither Past Due nor Individually Impaired				Past Due but not Individually Impaired	Individually Impaired	Total
	High Grade	Standard Grade	Substandard Grade	Unrated			
Loans and advances to banks							
Due from BSP	₱15,265,388	₱–	₱–	₱–	₱–	₱–	₱15,265,388
Due from other banks	–	1,508,489	–	–	–	–	1,508,489
Interbank loans receivable and SPURA	–	1,842,023	–	–	–	–	1,842,023
Receivables from customers							
Consumption loans	72,426,514	218,182	19,887	–	11,611,871	–	84,276,454
Real estate loans	40,436,431	690,957	124,237	–	4,311,333	1,031,117	46,594,075
Commercial loans	10,867,915	565,472	216,548	–	180,164	145,606	11,975,705
Personal loans	2,822,044	62,340	57,011	–	544,674	–	3,486,069
Other receivables							
Accrued interest receivable	881,262	680,976	4,693	–	296,242	48,199	1,911,372
Accounts receivable	723,178	99	198	–	341,973	185,139	1,250,587
Sales contract receivable	86,935	483	93	–	19,218	–	106,729
Bills purchased	–	–	–	10,482	–	–	10,482
Other assets							
Security deposits	–	–	–	179,996	–	–	179,996
RCOCI	–	–	–	10,349	–	–	10,349
Shortages	–	–	–	1,012	–	–	1,012
Total	₱143,509,667	₱5,569,021	₱422,667	₱201,839	₱17,305,475	₱1,410,061	₱168,418,730

*Shown gross of allowance for credit and impairment losses, net of unearned discount

	2016						
	Neither Past Due nor Individually Impaired				Past Due but not Individually Impaired	Individually Impaired	Total
	High Grade	Standard Grade	Substandard Grade	Unrated			
Loans and advances to banks							
Due from BSP	₱13,986,785	₱–	₱–	₱–	₱–	₱–	₱13,986,785
Due from other banks	–	1,838,630	–	–	–	–	1,838,630
Interbank loans receivable and SPURA	3,254,312	–	–	–	–	–	3,254,312
Receivables from customers							
Consumption loans	54,186,784	–	5,282,592	–	10,630,050	–	70,099,426
Real estate loans	33,239,048	4,778,346	458,589	–	4,375,855	1,047,721	43,899,559
Commercial loans	10,575,097	478,928	199,136	–	180,377	172,246	11,605,784
Personal loans	1,979,545	880,638	93,212	–	636,243	–	3,589,638
Other receivables							
Accrued interest receivable	1,109,075	252,348	42,217	–	269,821	100,007	1,773,468
Accounts receivable	301,282	2,719	71	–	312,557	184,652	801,281
Sales contract receivable	112,841	12,571	–	–	26,238	–	151,650
Bills purchased	–	–	–	63,774	–	–	63,774
Other assets							
Security deposits	–	–	–	178,331	–	–	178,331
RCOCI	–	–	–	10,316	–	–	10,316
Shortages	–	–	–	1,307	–	–	1,307
Total	₱118,744,769	₱8,244,180	₱6,075,817	₱253,728	₱16,431,141	₱1,504,626	₱151,254,261

*Shown gross of allowance for credit and impairment losses, net of unearned discount

External Ratings
In ensuring quality investment portfolio, the Bank uses the credit risk rating based on the rating of Moody's Investors Service (Moody's rating) as follows:

Credit Quality					**External Rating**					
High grade	Aaa	Aa1	Aa2	Aa3	A1	A2	A3	Baa1	Baa2	Baa3
Standard grade	Ba1	Ba2	Ba3	B1	B2	B3				
Substandard grade	Caa1	Caa2	Caa3	Ca	C					

High grade - represents those investments which fall under any of the following grade:

Aaa - fixed income obligations are judged to be of the highest quality, with the smallest degree of risk.

Aa1, Aa2, Aa3 - fixed income are judged to be of high quality and are subject to very low credit risk, but their susceptibility to long-term risks appears somewhat greater.

A1, A2, A3 - fixed income obligations are considered upper-medium grade and are subject to low credit risk, but have elements present that suggest a susceptibility to impairment over the long term.

Baa1, Baa2, Baa3 - fixed income obligations are subject to moderate credit risk. They are considered medium grade and as such protective elements may be lacking or may be characteristically unreliable.

Standard grade - represents those investments which fall under any of the following grade:

Ba1, Ba2, Ba3 - obligations are judged to have speculative elements and are subject to substantial credit risk.

B1, B2, B3 - obligations are considered speculative and are subject to high credit risk.

Substandard grade - represents those investments which fall under any of the following grade:

Caa1, Caa2, Caa3 - are judged to be of poor standing and are subject to very high credit risk.

Ca - are highly speculative and are likely in, or very near, default, with some prospect of recovery of principal and interest.

C - are the lowest rated class of bonds and are typically in default, with little prospect for recovery of principal or interest.

The tables below show the credit quality per class of investment securities (in thousands)*:

	2017						
	Neither Past Due nor Individually Impaired				Past Due but not Individually Impaired	Individually Impaired	Total
	High Grade	Standard Grade	Substandard Grade	Unrated			
FVPL							
HFT - government securities	**₱293,076**	**₱–**	**₱–**	**₱–**	**₱–**	**₱–**	**₱293,076**
Derivative asset	**–**	**73,160**	**–**	**–**	**–**	**–**	**73,160**
AFS investments							
Government debt securities	**10,762,411**	**–**	**–**	**–**	**–**	**–**	**10,762,411**
Private debt securities	**3,777,708**	**2,375,363**	**–**	**–**	**–**	**–**	**6,153,071**
Quoted equity securities	**–**	**–**	**–**	**8,923**	**–**	**–**	**8,923**
Unquoted equity securities	**–**	**–**	**–**	**3,269**	**–**	**–**	**3,269**
HTM investments							
Government debt securities	**25,460,778**	**–**	**–**	**–**	**–**	**–**	**25,460,778**
Private debt securities	**2,606,038**	**1,406,909**	**–**	**–**	**–**	**–**	**4,012,947**
Total	**₱42,900,011**	**₱3,855,432**	**₱–**	**₱12,192**	**₱–**	**₱–**	**₱46,767,635**

*Shown gross of allowance for credit and impairment losses

	2016						
	Neither Past Due nor Individually Impaired				Past Due but not Individually Impaired	Individually Impaired	Total
	High Grade	Standard Grade	Substandard Grade	Unrated			
FVPL							
HFT - government securities	₱1,360,293	₱–	₱–	₱–	₱–	₱–	₱1,360,293
Derivative asset	–	499	–	–	–	–	499
AFS investments							
Government debt securities	8,462,431	–	–	–	–	–	8,462,431
Private debt securities	2,358,046	2,287,623	–	–	–	–	4,645,669
Quoted equity securities	–	–	–	6,613	–	–	6,613
Unquoted equity securities	–	–	–	3,289	–	–	3,289
HTM investments							
Government debt securities	20,046,355	–	–	–	–	–	20,046,355
Private debt securities	516,161	2,594,371	–	–	–	–	3,110,532
Total	₱32,743,286	₱4,882,493	₱–	₱9,902	₱–	₱–	₱37,635,681

*Shown gross of allowance for credit and impairment losses

Impairment Assessment

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

Individually assessed allowances

The Bank determines the allowances appropriate for each significant loan or advance on an individual basis. Items considered when determining amounts of allowances include an account's age, payment and collection history, timing of expected cash flows and realizable value of collateral.

The Bank sets criteria for specific loan impairment testing and uses the discounted cash flow methodology to compute for impairment loss. Accounts subjected to specific impairment and that are found to be impaired shall be excluded from the collective impairment computation.

Collectively assessed allowances

Allowances are assessed collectively for losses on commercial loans and advances that are not individually significant or are found to be not individually impaired. Impairment losses are estimated by taking into consideration the historical losses using a lookback period of five years on the portfolio and the expected receipts and recoveries once impaired. The Bank is responsible for deciding the length of historical loss period which can extend for as long as five years. The impairment allowance is then reviewed by the Bank to ensure alignment with the Bank's overall policy.

The Bank uses the Net Flow Rate method to determine the credit loss rate of a particular delinquency age bucket based on historical data of flow-through and flow-back of loans across specific delinquency age buckets. The method applies to consumer loans, as well as salary and home equity loans granted to employees of the Bank. For commercial loans, the Bank uses Historical Loss Rate method in determining the credit loss rate based on the actual historical loss experienced by the Bank on each specific industry type.

Aging Analysis of Past Due but not Individually Impaired Loans per Class of Financial Assets
The succeeding tables show the total aggregate amount of gross past due but not individually impaired loans and receivables per delinquency bucket. PFRS defines that a financial asset is past due when the counterparty has failed to make a payment when contractually due (in thousands)*:

	2017					
	Past Due but not Individually Impaired					
	Less than 30 days	**31 to 60 days**	**61 to 90 days**	**91 to 180 days**	**Over 180 days**	**Total**
Loans and receivables						
Receivables from customers						
Consumption loans	**₱5,460,605**	**₱2,435,353**	**₱1,176,061**	**₱1,291,281**	**₱1,248,571**	**₱11,611,871**
Real estate loans	**2,867,064**	**1,003,026**	**338,875**	**55,809**	**46,559**	**4,311,333**
Commercial loans	**140,750**	**16,268**	**15,540**	**–**	**7,606**	**180,164**
Personal loans	**124,835**	**29,533**	**19,024**	**45,412**	**325,870**	**544,674**
Other receivables						
Accrued interest receivable	**106,760**	**57,664**	**33,829**	**42,008**	**55,981**	**296,242**
Accounts receivable	**5,522**	**7,919**	**9,905**	**311,571**	**7,056**	**341,973**
Sales contract receivable	**3,083**	**4,180**	**–**	**2,719**	**9,236**	**19,218**
Total	**₱8,708,619**	**₱3,553,943**	**₱1,593,234**	**₱1,748,800**	**₱1,700,879**	**₱17,305,475**

*Shown gross of allowance for impairment and credit losses

	2016					
	Past Due but not Individually Impaired					
	Less than 30 days	31 to 60 days	61 to 90 days	91 to 180 days	Over 180 days	Total
Loans and receivables						
Receivables from customers						
Consumption loans	₱4,999,504	₱2,345,627	₱1,078,386	₱1,147,048	₱1,059,485	₱10,630,050
Real estate loans	2,880,797	984,062	304,272	156,228	50,496	4,375,855
Commercial loans	59,469	59,569	46,461	3,476	11,402	180,377
Personal loans	124,461	30,575	23,010	53,238	404,959	636,243
Other receivables						
Accrued interest receivable	97,288	54,234	30,435	37,565	50,299	269,821
Accounts receivable	8,863	4,472	6,910	247,637	44,675	312,557
Sales contract receivable	7,755	2,653	5,170	2,208	8,452	26,238
Total	₱8,178,137	₱3,481,192	₱1,494,644	₱1,647,400	₱1,629,768	₱16,431,141

*Shown gross of allowance for impairment and credit losses

b. *Market risk*

Market risk management covers the areas of trading and interest rate risks. The Bank utilizes various measurement and monitoring tools to ensure that risk-taking activities are managed within instituted market risk parameters. The Bank revalues its trading portfolios on a daily basis and checks the revenue or loss generated by each portfolio in relation to their level of market risk.

The Bank's risk policies and implementing guidelines are regularly reviewed by the Assets and Liabilities Committee (ALCO), ROC and BOD to ensure that these are up-to-date and in line with changes in the economy, environment and regulations. The ROC and the BOD set the comprehensive market risk limit structure and define the parameters of market activities that the Bank can engage in.

Market risk is the risk to earnings and capital arising from changes in the value of traded portfolios of financial instruments (trading market risk) and from movements in interest rates (interest rate risk). The Bank's market risk originates primarily from holding peso and dollar-denominated debt securities. The Bank utilizes Value-at-Risk (VaR) to measure and manage market risk exposure. VaR estimates the potential decline in the value of a portfolio, under normal market conditions, for a given confidence level over a specified holding period.

Trading activities
The Bank's trading portfolios are currently composed of peso and dollar-denominated fixed income securities that are marked-to-market daily. The Bank also uses VaR to measure the extent of market risk exposure arising from these portfolios.

VaR is a statistical measure that calculates the maximum potential loss from a portfolio over a holding period, within a given confidence level. The Bank's current VaR model uses historical simulation for Peso and USD HFT portfolios with confidence level at 99.00% and a 1 day holding period. It utilizes a 250 days rolling data most recently observed daily percentage changes in price for each asset class in its portfolio.

VaR reports are prepared on a daily basis and submitted to Treasury Group and RMO. VaR is also reported to the ROC and BOD on a monthly basis. The President, ROC and BOD are advised of potential losses that exceed prudent levels or limits.

When there is a breach in VaR limits, Treasury Group is expected to close or reduce their position and bring it down within the limit unless approval from the President is obtained to retain the same. All breaches are reported to the President for regularization. In addition to the regularization and approval of the President, breaches in VaR limits and special approvals are likewise reported to the ROC and BOD for their information and confirmation.

Back-testing is employed to verify the effectiveness of the VaR model. The Bank performs back-testing to validate the VaR model and stress testing to determine the impact of extreme market movements on the portfolios. Results of backtesting are reported to the ROC and BOD on a monthly basis. Stress testing is also conducted, based on historical maximum percentage daily movement and on an ad-hoc rate shock to estimate potential losses in a crisis situation.

The Bank has established limits, VaR, stop loss limits and loss triggers, for its trading portfolios. Daily profit or losses of the trading portfolios are closely monitored against loss triggers and stop-loss limits.

Responsibility for managing the Bank's trading market risk remains with the ROC. With the support of RMO, the ROC recommends to the BOD changes in market risk limits, approving authorities and other activities that need special consideration.

Discussed below are the limitations and assumptions applied by the Bank on its VaR methodology:

a. VaR is a statistical estimate and thus, does not give the precise amount of loss;
b. VaR is not designed to give the probability of bank failure, but only attempts to quantify losses that may arise from a bank's exposure to market risk;
c. Historical simulation does not involve any distributional assumptions, scenarios that are used in computing VaR are limited to those that occurred in the historical sample; and

d. VaR systems are backward-looking. It attempts to forecast likely future losses using past data. As such, this assumes that past relationships will continue to hold in the future. Major shifts therefore (i.e., an unexpected collapse of the market) are not captured and may inflict losses much bigger than anything the VaR model may have calculated.

The Bank's interest rate VaR follows (in thousands):

	December 31, 2017[1]		December 31, 2016	
	Peso	**USD**	Peso	USD
Year-end	**8,644**	**0**	4	9,817
Average	**9,328**	**9,108**	15,643	8,912
High	**30,309**	**39,341**	45,741	24,889
Low	**3**	**466**	3	–

[1]*Using METRISK Historical Simulation VaR*

Non-trading activities

Interest Rate Risk

The Bank follows a prudent policy on managing its assets and liabilities to ensure that fluctuations in interest rates are kept within acceptable limits.

One method by which the Bank measures the sensitivity of its assets and liabilities to interest rate fluctuations is by way of "gap" analysis. This analysis provides the Bank with a static view of the maturity and repricing characteristics of the positions in its statement of condition. An interest rate gap report is prepared by classifying all assets and liabilities into various time period categories according to contracted maturities or anticipated repricing dates, whichever is earlier. Non-maturing deposits are considered as rate sensitive liabilities; no loan pre-payments assumptions are used. The difference in the amount of assets and liabilities maturing or being repriced in any time period category would then give the Bank an indication of the extent to which it is exposed to the risk of potential changes in net interest income.

The interest rate sensitivity gap report measures interest rate risk by identifying gaps between the repricing dates of assets and liabilities. The Bank's sensitivity gap model calculates the effect of possible rate movements on its interest rate profile.

The Bank uses sensitivity gap model to estimate Earnings-at-Risk (EaR) should interest rates move against its interest rate profile. The Bank's EaR limits are based on a percentage of the Bank's projected earnings for the year or capital whichever is lower. The Bank also performs stress-testing to measure the impact of various scenarios based on interest rate volatility and shift in the yield curve. The EaR and stress testing reports are prepared on a monthly basis.

The ALCO is responsible for managing the Bank's structural interest rate exposure. The ALCO's goal is to achieve a desired overall interest rate profile while remaining flexible to interest rate movements and changes in economic conditions. The RMO and ROC review and oversee the Bank's interest rate risks.

The table below demonstrate the sensitivity equity. Equity sensitivity was computed by calculating mark-to-market changes of AFS debt instruments, assuming a parallel shift in the yield curve.

	2017		2016	
	Change in basis points	**Sensitivity of equity**	Change in basis points	Sensitivity of equity
Currency				
PHP	**+10**	**(53,429,706)**	+10	(33,918,897)
USD	**+10**	**(61,335,975)**	+10	(61,686,169)
Currency				
PHP	**-10**	**54,019,588**	-10	46,027,531
USD	**-10**	**62,192,804**	-10	62,421,587

The impact on the Bank's equity excludes the impact on transactions affecting the statement of income.

Foreign Currency Risk

Foreign currency risk is the risk of an investment's value changing due to an adverse movement in currency exchange rates. It arises due to a mismatch in the Bank's foreign currency assets and liabilities.

The Bank's policy is to maintain foreign currency exposure within the approved position, stop loss, loss trigger, VaR limits and to remain within existing regulatory guidelines. To compute for VaR, the Bank uses historical simulation model for USD/PHP FX position, with confidence level at 99.00% and a 1 day holding period. The Bank's VaR for its foreign exchange position for trading and non-trading activities are as follows (in thousands):

	2017[1]	2016[1]
As of year-end	**₱1,140**	₱176
Average	**883**	752
High	**1,302**	1,249
Low	**175**	18

[1] *Using METRISK Historical Simulation VaR*

The table below summarizes the Bank's exposure to foreign exchange risk as of December 31, 2017 and 2016. Included in the table are the Bank's assets and liabilities at carrying amounts (in thousands):

	2017	2016
Assets		
Cash	**$3**	$82
Due from other banks	**381**	1,728
FVPL investments	**–**	10
AFS investments	**–**	56,160
Total assets	**384**	57,980
Liabilities		
Deposit liabilities		
Savings	**56**	62
Time	**43**	52
Financial liabilities at FVPL	**–**	1,314
Other liabilities	**290**	11
Total liabilities	**389**	1,439
Net exposure	**($5)**	$56,541

c. Liquidity Risk

The Bank's policy on liquidity management emphasizes on three elements of liquidity, namely, cashflow management, ability to borrow in the interbank market, and maintenance of a stock of high quality liquid assets. These three approaches complement one another with greater weight being given to a particular approach, depending upon the circumstances. The Bank's objective in liquidity management is to ensure that the Bank has sufficient liquidity to meet obligations under normal and adverse circumstances and is able to take advantage of lending and investment opportunities as they arise.

The main tool that the Bank uses for monitoring its liquidity is the Maximum Cumulative Outflow (MCO) reports, which is also called liquidity gap or maturity matching gap reports. The MCO is a useful tool in measuring and analyzing the Bank's cash flow projections and monitoring liquidity risks. The liquidity gap report shows the projected cash flows of assets and liabilities representing estimated funding sources and requirements under normal conditions, which also forms the basis for the Bank's Liquidity Contingency Funding Plan (LCFP). The LCFP projects the Bank's funding position during stress to help evaluate the Bank's funding needs and strategies under various stress conditions.

The Bank discourages dependence on Large Funds Providers (LFPs) and monitors the deposit funding concentrations so that it will not be vulnerable to a substantial drop in deposit level should there be an outflow of large deposits. ALCO is responsible for managing the liquidity of the Bank while RMO and ROC review and oversee the Bank's overall liquidity risk management.

To mitigate potential liquidity problems caused by unexpected withdrawals of significant deposits, the Bank takes steps to cultivate good business relationships with clients and financial institutions, maintains high level of high quality liquid assets, monitors the deposit funding concentrations and regularly updates the Liquidity Contingency Funding Plan.

Financial assets
Analysis of equity and debt securities at FVPL and AFS investments into maturity groupings is based on the expected date on which these assets will be realized. For other assets, the analysis into maturity grouping is based on the remaining period from the end of the reporting period to the contractual maturity date or if earlier, the expected date the assets will be realized.

Financial liabilities
The maturity grouping is based on the remaining period from the end of the reporting period to the contractual maturity date and does not consider the behavioral pattern of the creditors. When the counterparty has a choice of when the amount is paid, the liability is allocated to the earliest period in which the Bank can be required to pay.

<u>Analysis of Financial Assets and Liabilities by Remaining Maturities</u>
The tables below show the maturity profile of the Bank's financial assets and liabilities based on contractual undiscounted repayment obligations (in millions):

	2017							
	On demand	**Up to 1 month**	**Over 1 to 3 months**	**Over 3 to 6 months**	**Over 6 to 12 months**	**Total within 1 year**	**Beyond 1 year**	**Total**
Financial Assets								
FVPL								
HFT - government securities	**₱306**	**₱–**	**₱–**	**₱–**	**₱–**	**₱306**	**₱–**	**₱306**
Derivatives	–	–	**73**	–	–	**73**	–	**73**
AFS investments								
Government securities	–	**110**	**192**	**147**	**422**	**871**	**21,782**	**22,653**
Quoted equity securities	–	–	–	–	–	–	**8**	**8**
Unquoted equity securities	–	–	–	–	–	–	**1**	**1**
HTM investments								
Government bonds	–	**227**	**347**	**196**	**766**	**1,536**	**39,290**	**40,826**
Loans and receivables								
Loans and advances to banks								
Due from BSP	**15,265**	–	–	–	–	**15,265**	–	**15,265**
Due from other banks	**1,508**	–	–	–	–	**1,508**	–	**1,508**
Interbank loans receivable and SPURA	–	**1,842**	–	–	–	**1,842**	–	**1,842**
Receivables from customers								
Consumption loans	**121**	**1,117**	**2,332**	**3,749**	**8,378**	**15,697**	**114,129**	**129,826**
Real estate loans	**111**	**385**	**945**	**1,582**	**3,434**	**6,457**	**75,848**	**82,305**
Commercial loans	**575**	**463**	**1,367**	**716**	**1,260**	**4,381**	**10,918**	**15,299**
Personal loans	**1,046**	**172**	**341**	**532**	**1,378**	**3,469**	**1,661**	**5,130**
Other receivables								
Accrued interest receivable	**₱36**	**₱20**	**₱19**	**₱33**	**₱75**	**₱183**	**₱1,729**	**₱1,912**
Accounts receivable	**4**	**721**	**5**	**9**	**490**	**1,229**	**21**	**1,250**
Sales contract receivable	**5**	**1**	**1**	**2**	**6**	**15**	**124**	**139**
Other assets								
Security deposits	–	–	–	–	–	–	–	–
RCOCI	**10**	–	–	–	–	**10**	–	**10**
Shortages	**179**	–	–	–	–	**179**	–	**179**
	₱19,166	**₱5,058**	**₱5,622**	**₱6,966**	**₱16,209**	**₱53,021**	**₱265,511**	**₱318,532**
Financial Liabilities								
Deposit liabilities								
Demand	**₱19,113**	**₱–**	**₱–**	**₱–**	**₱–**	**₱19,113**	**₱–**	**₱19,113**
Savings	**30,384**	–	–	–	–	**30,384**	–	**30,384**
Time	–	**13,556**	**50,086**	**20,331**	**31,039**	**115,012**	**24,674**	**139,686**
LTNCD	–	**30**	–	**30**	**58**	**118**	**3,759**	**3,877**
	49,497	**13,586**	**50,086**	**20,361**	**31,097**	**164,627**	**28,433**	**193,060**
Bills payable	–	**1,497**	–	–	–	**1,497**	–	**1,497**
Subordinated notes	–	–	**41**	**41**	**83**	**165**	**3,990**	**4,155**
Treasurer's, cashier's and manager's checks	**2,214**					**2,214**		**2,214**
Accrued interest payable	–	–	**518**	**22**	–	**540**	–	**540**
Accrued other expenses payable	**1,119**	–	–	–	–	**1,119**	–	**1,119**
Other liabilities								
Accounts payable	**2,080**	–	–	–	–	**2,080**	–	**2,080**
Other credits	–	–	–	–	–	–	**1,146**	**1,146**
Bills purchased - contra	**10**	–	–	–	–	**10**	–	**10**
Due to the Treasurer of the Philippines	–	–	–	–	–	–	**17**	**17**
Deposit for keys	**1**	–	–	–	–	**1**	–	**1**
Overages	**6**	–	–	–	–	**6**	–	**6**
	₱54,927	**₱15,083**	**₱50,645**	**₱20,424**	**₱31,180**	**₱172,259**	**₱33,586**	**₱205,845**

	2016							
	On demand	Up to 1 month	Over 1 to 3 months	Over 3 to 6 months	Over 6 to 12 months	Total within 1 year	Beyond 1 year	Total
Financial Assets								
FVPL								
HFT - government securities	₱64	₱609	₱710	₱–	₱–	₱1,383	₱–	₱1,383
Derivatives	–	–	1	–	–	1	–	1
AFS investments								
Government securities	5	4	7	45	157	218	13,083	13,301
Private debt securities	–	–	26	28	93	147	5,798	5,945
Quoted equity securities	–	–	–	–	–	–	7	7
Unquoted equity securities	–	–	–	–	–	–	3	3
HTM investments								
Government bonds	–	30	24	85	400	539	24,998	25,537
Private bonds	–	1	6	39	395	441	2,965	3,406
Loans and receivables								
Loans and advances to banks								
Due from BSP	13,987	–	–	–	–	13,987	–	13,987
Due from other banks	1,839	–	–	–	–	1,839	–	1,839
Interbank loans receivable and SPURA	1	–	–	–	–	1	–	1
Receivables from customers								
Consumption loans	119	2,024	4,254	6,611	14,451	27,459	60,024	87,483
Real estate loans	136	647	1,539	2,379	5,317	10,018	55,570	65,588
Commercial loans	419	801	607	437	778	3,042	11,920	14,962
Personal loans	637	154	357	595	1,699	3,442	604	4,046
Other receivables								
Accrued interest receivable	1,422	–	187	47	46	1,702	71	1,773
Accounts receivable	801	–	–	–	–	801	–	801
Sales contract receivable	4	3	7	11	21	46	140	186
Other assets								
Security deposits	–	4	1	5	15	25	154	179
RCOCI	10	–	–	–	–	10	–	10
Shortages	1	–	–	–	–	1	–	1
	₱19,445	₱4,277	₱7,726	₱10,282	₱23,372	₱65,102	₱175,337	₱240,439

(Forward)

	2016							
	On demand	Up to 1 month	Over 1 to 3 months	Over 3 to 6 months	Over 6 to 12 months	Total within 1 year	Beyond 1 year	Total
Financial Liabilities								
Deposit liabilities								
Demand	₱15,339	₱–	₱–	₱–	₱–	₱15,339	₱–	₱15,339
Savings	27,236	–	–	–	–	27,236	–	27,236
Time	56	69,176	17,573	7,700	4,815	99,320	16,511	115,831
	₱42,631	₱69,176	₱17,573	₱7,700	₱4,815	₱141,895	₱16,511	₱158,406
Derivative Liability	–	33	32	–	–	65	–	65
Bills payable	–	4,698	1,401	–	–	6,099	–	6,099
Subordinated notes	–	3,066	–	41	82	3,189	4,114	7,303
Treasurer's, cashier's and manager's checks	1,761	–	–	–	–	1,761	–	1,761
Accrued interest payable	–	2	171	37	–	210	–	210
Accrued other expenses payable	–	851	–	–	–	851	–	851
Other liabilities								
Accounts payable	–	1,594	–	–	–	1,594	–	1,594
Other credits	–	–	–	–	–	–	592	592
Bills purchased - contra	–	64	–	–	–	64	–	64
Due to the Treasurer of the Philippines	12	–	–	–	–	12	–	12
Deposit for keys	1	–	–	–	–	1	–	1
Overages	5	–	–	–	–	5	–	5
	₱44,410	₱79,484	₱19,177	₱7,778	₱4,897	₱155,746	₱21,217	₱176,963

6. Segment Information

The Bank's operating segments 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 that offers different products and serves different markets. The Bank's reportable segments are as follows:

a. Consumer Banking - principally provides consumer-type loans generated by the Home Office;
b. Corporate Banking -principally handles loans and other credit facilities for small and medium enterprises, corporate and institutional customers acquired in the Home Office;
c. Branch Banking - serves as the Bank's main customer touch point which offers consumer and corporate banking products; and
d. Treasury - principally handles institutional deposit accounts, providing money market, trading and treasury services, as well as managing the Bank's funding operations by use of government securities and placements and acceptances with other banks.

These segments are the bases on which the Bank reports its primary segment information. The Bank evaluates performance on the basis of information about the components of the Bank that senior management uses to make decisions about operating matters. There are no other operating segments than those identified by the Bank as reportable segments. There were no inter-segment revenues and expenses included in the financial information. The Bank has no single customer with revenues from which is 10.00% or more of the Bank's total revenue.

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies. Primary segment information (by business segment) for the years ended December 31, 2017, 2016 and 2015 follows (in thousands):

	2017				
	Consumer Banking	Corporate Banking	Branch Banking	Treasury	Total
Operating income					
Interest income	₱4,811,338	₱321,494	₱6,777,057	₱2,633,888	₱14,543,777
Service fees and commission	561,436	40,482	868,284	–	1,470,202
Other operating income	898,009	15,705	529,289	(8,754)	1,434,249
Total operating income	6,270,783	377,681	8,174,630	2,625,134	17,448,228
Non-cash expenses					
Provision for (reversal of) credit and impairment losses	2,111,031	(36,167)	195,315	–	2,270,179
Depreciation	242,252	5,852	386,310	1,022	635,436
Amortization of other intangible assets	50,347	2,638	81,673	774	135,432
Total non-cash expenses	2,403,630	(27,677)	663,298	1,796	3,041,047
Interest expense	–	–	1,653,833	1,810,844	3,464,677
Service fees and commission expense	36,060	2,600	55,768	–	94,428
Subtotal	36,060	2,600	1,709,601	1,810,844	3,559,105
Compensation and fringe benefits	802,955	63,842	2,365,493	28,316	3,260,606
Taxes and licenses	410,454	31,874	438,575	388,005	1,268,908
Occupancy and equipment-related costs	68,023	1,022	670,795	211	740,051
Security, messengerial and janitorial services	115,856	4,649	355,784	1,244	477,533
Miscellaneous	709,485	37,715	1,336,751	167,383	2,251,334
Subtotal	2,106,773	139,102	5,167,398	585,159	7,998,432
Income before share in net income of a joint venture and income tax	₱1,724,320	₱263,656	₱634,333	₱227,335	₱2,849,644
Share in net income of a joint venture					71,837
Income before income tax					2,921,481
Provision for income tax					267,062
Net income					2,654,419
Segment assets	₱113,797,984	₱8,297,700	₱39,017,294	₱60,174,574	₱221,287,552
Investment in a joint venture					607,163
Deferred tax assets					1,429,327
Total assets					223,324,042
Segment liabilities	₱1,123,077	₱77,620	₱119,740,151	₱79,989,870	₱200,930,718

	2016				
	Consumer Banking	Corporate Banking	Branch Banking	Treasury	Total
Operating income					
Interest income	₱4,202,897	₱293,441	₱5,895,983	₱2,100,149	₱12,492,470
Service fees and commission	480,075	31,697	714,243	–	1,226,015
Other operating income	595,208	17,873	531,821	533,658	1,678,560
Total operating income	5,278,180	343,011	7,142,047	2,633,807	15,397,045
Non-cash expenses					
Provision for (reversal of) credit and impairment losses	3,209,361	(390,094)	(596,764)	–	2,222,503
Depreciation	185,943	5,839	365,680	187	557,649
Amortization of other intangible assets	40,057	2,327	68,521	255	111,160
Total non-cash expenses	3,435,361	(381,928)	(162,563)	442	2,891,312
Interest expense	–	–	1,606,743	1,221,805	2,828,548
Service fees and commission expense	35,112	2,318	52,238	–	89,668
Subtotal	35,112	2,318	1,658,981	1,221,805	2,918,216
Compensation and fringe benefits	721,231	56,789	2,127,091	17,790	2,922,901
Taxes and licenses	335,734	23,487	426,654	272,563	1,058,438
Occupancy and equipment-related costs	67,678	1,449	641,813	2	710,942
Security, messengerial and janitorial services	79,717	2,627	300,718	609	383,671
Miscellaneous	564,947	31,680	1,181,358	98,491	1,876,476
Subtotal	1,769,307	116,032	4,677,634	389,455	6,952,428

(Forward)

	2016				
	Consumer Banking	Corporate Banking	Branch Banking	Treasury	Total
Income before share in net income of a joint venture and income tax	₱38,400	₱606,589	₱967,995	₱1,022,105	2,635,089
Share in net income of a joint venture					35,467
Income before income tax					2,670,556
Provision for income tax					219,713
Net income					₱2,450,843
Segment assets	₱94,193,769	₱8,891,632	₱39,281,097	₱52,458,705	₱194,825,203
Investment in a joint venture					727,176
Deferred tax assets					1,300,724
Total assets					₱196,853,103
Segment liabilities	₱1,365,551	₱110,204	₱108,983,331	₱66,356,344	₱176,815,430

	2015				
	Consumer Banking	Corporate Banking	Branch Banking	Treasury	Total
Operating income					
Interest income	₱2,424,517	₱433,460	₱6,646,711	₱1,498,039	₱11,002,727
Service fees and commission	341,653	38,519	913,528	–	1,293,700
Other operating income	361,645	31,979	775,216	(44,746)	1,124,094
Total operating income	3,127,815	503,958	8,335,455	1,453,293	13,420,521
Non-cash expenses					
Provision for credit and impairment losses	534,730	34,988	1,015,294	3,286	1,588,298
Depreciation	94,839	6,189	400,103	180	501,311
Amortization of other intangible assets	23,423	2,784	73,779	239	100,225
Total non-cash expenses	652,992	43,961	1,489,176	3,705	2,189,834
Interest expense	–	–	1,476,307	1,044,474	2,520,781
Service fees and commission expense	25,936	2,924	69,348	–	98,208
Subtotal	25,936	2,924	1,545,655	1,044,474	2,618,989
Compensation and fringe benefits	434,632	53,123	2,111,648	14,465	2,613,868
Taxes and licenses	163,728	19,347	512,614	265,404	961,093
Occupancy and equipment-related costs	34,129	1,609	635,915	76	671,729
Security, messengerial and janitorial services	46,943	3,235	283,232	620	334,030
Miscellaneous	279,418	35,962	1,343,991	83,383	1,742,754
Subtotal	958,850	113,276	4,887,400	363,948	6,323,474
Income before share in net income of a joint venture and income tax	1,490,037	343,797	413,224	41,166	2,288,224
Share in net income of a joint venture					20,214
Income before income tax					2,308,438
Benefit from income tax					42,462
Net income					₱2,350,900
Segment assets	₱82,181,033	₱8,438,387	₱36,990,937	₱39,836,139	₱167,446,496
Investment in a joint venture					690,334
Deferred tax assets					1,194,417
Total assets					₱169,331,247
Segment liabilities	₱1,201,661	₱86,172	₱97,009,484	₱51,858,875	₱150,156,192

7. Interbank Loans Receivable and Securities Purchased Under Resale Agreements

This account consists of the following:

	2017	2016
Interbank loans receivable	**₱1,263,772,319**	₱–
SPURA	**578,250,730**	3,254,311,599
	₱1,842,023,049	₱3,254,311,599

Interbank loans receivable (IBCL) represents short-term lending with counterparty banks and other financial institutions. These are highly liquid instruments which mature within one to five days. As of December 31, 2017, outstanding balance of IBCL consists of both foreign currency-denominated and peso-denominated receivables amounting to ₱763.8 million and ₱500.0 million, respectively.

SPURA are lending to counterparties collateralized by government securities ranging from one to four days. As of December 31, 2017 and 2016, fair value of government securities held as collateral amounted to ₱577.9 million and ₱4.7 billion, respectively. The Bank is not permitted to sell or repledge the related collateral in the absence of default by the counterparty.

SPURA of the Bank bears annual interest rate of 3.00% in 2017 and ranges from 3.00% to 4.00% in 2016, while peso-denominated interbank loans of the Bank bear annual interest rate ranging from 2.50% to 3.30% in 2017 and 3.00% in 2016, respectively. Foreign currency-denominated interbank loans bear annual interest rates ranging from 1.00% to 1.25% in 2017. The Bank has no peso and foreign currency-denominated interbank loans as of December 31, 2016.

Interest income on SPURA and interbank loans receivable are as follows:

	2017	2016	2015
SPURA	**₱49,238,898**	₱56,735,116	₱162,099,556
Interbank loans receivable	**11,798,252**	4,795,139	28,714,798
	₱61,037,150	₱61,530,255	₱190,814,354

8. **Investment Securities**

Fair Value Through Profit or Loss Investments
FVPL consist of the following:

	2017	2016
HFT securities	**₱293,076,128**	₱1,360,292,936
Derivatives	**73,159,561**	499,211
	₱366,235,689	₱1,360,792,147

On August 19, 2009, the BSP approved the Bank's application for Type 3 Limited User Authority for plain vanilla foreign exchange (FX) forwards, which is limited to outright buying or selling of FX forwards at a specific price and date in the future and do not include non-deliverable forwards.

In 2017 and 2016, the Bank entered into foreign currency swaps and forwards. As of December 31, 2017 and 2016, foreign currency swaps had net positive and net negative fair value of ₱73.2 million and ₱64.8 million, respectively. As of December 31, 2017 and 2016, the aggregate notional amounts of the outstanding foreign currency swaps amounted to $53.1 million and $64.1 million, respectively.

Net movements in fair value changes of derivative instruments are as follows:

	2017	2016
Balance at beginning of year	**(₱64,817,467)**	₱–
Fair value changes during the year	**244,579,043**	(300,386,787)
Settled transactions	**(106,602,015)**	235,569,320
Balance at end of year	**₱73,159,561**	(₱64,817,467)

As of December 31, 2017 and 2016, the Bank has outstanding ROP paired warrants amounting to $1.9 million which give the Bank the option or right to exchange its holdings of ROP Global Bonds (Paired Bonds) into peso-denominated government securities upon occurrence of a pre-determined credit event. Paired Bonds shall be risk weighted at 0.00%, provided that the 0.00% risk weight shall be applied only to the Bank's holdings of Paired Bonds equivalent to not more than 50.00% of the total qualifying capital. Further, the Bank's holdings of said warrants, booked in the FVPL category, are likewise exempted from capital charge for market risk as long as said instruments are paired with ROP Global Bonds up to a maximum of 50.00% of the total qualifying capital. As a result of the sale of its paired bonds in 2013, the Bank is holding ROP warrants without paired instruments and with on active market. As of December 31, 2017 and 2016, the Bank determined the market value of its warrants to be zero.

Available-for-Sale Investments
AFS investments consist of the following:

	2017	2016
Debt securities		
Government (Notes 29 and 30)	**₱10,762,411,432**	₱8,462,431,246
Private	**6,153,071,645**	4,645,668,747
Equity securities		
Quoted	**8,922,987**	6,612,987
Unquoted	**3,268,542**	3,288,543
	16,927,674,606	13,118,001,523
Less allowance for impairment losses (Note 15)	**2,188,665**	2,188,665
	₱16,925,485,941	₱13,115,812,858

Movements in the net unrealized gain (loss) on AFS investments follow:

	2017	2016
Balance at beginning of year	**(₱842,908,364)**	₱179,775
Loss (gain) from sale of AFS investments realized in profit or loss	**49,756,366**	(456,628,139)
Changes in fair values of AFS investments	**381,641,780**	(386,460,000)
	431,398,146	(843,088,139)
Balance at end of year	**(₱411,510,218)**	(₱842,908,364)

As of December 31, 2017 and 2016, included in AFS investments are National Food Authority bonds pledged by the Bank to MBTC to secure its payroll account with MBTC with total carrying value of ₱50.2 million and ₱51.8 million, respectively (Note 29).

As of December 31, 2017 and 2016, the Bank deposited AFS investments in the form of government bonds with total carrying value of ₱64.5 million and ₱49.7 million in compliance with trust regulations, respectively (Note 30).

As of December 31, 2017, the carrying value of AFS investments in the form of government bonds pledged as collateral for its bills payable amounted to ₱751.8 million (Note 17).

Held-to-Maturity Investments
HTM investments consist of the following:

	2017	2016
Debt securities		
Government	**₱25,460,777,587**	₱20,046,354,933
Private	**4,012,946,797**	3,110,531,696
	₱29,473,724,384	₱23,156,886,629

As of December 31, 2017 and 2016, the carrying value of HTM Investments in the form of government bonds pledged by the Bank as collateral for bills payable amounted to ₱1.0 billion and ₱4.7 billion, respectively (Note 17).

Interest income on investment securities consists of:

	2017	2016	2015
HTM investments	**₱1,165,451,432**	₱776,516,116	₱375,698,086
AFS investments	**607,568,926**	486,761,874	266,464,510
FVPL investments	**50,570,958**	84,671,137	85,605,995
	₱1,823,591,316	₱1,347,949,127	₱727,768,591

Peso-denominated AFS investments bear nominal annual interest rates ranging from 2.13% to 9.50% in 2017, 2.13% to 8.13% in 2016 and 1.63% to 9.13% in 2015 while foreign currency-denominated AFS investments bear nominal annual interest rates ranging from 3.70% to 9.50% in 2017, 1.63% to 10.63% in 2016, and 2.50% to 10.63% in 2015.

Effective interest rates on AFS investments as of December 31, 2017, 2016, and 2015 range from 2.69% to 6.15%, 1.58% to 8.14% and 2.20% to 6.75%, respectively.

On the other hand, peso-denominated HTM investments bear effective interest rates ranging from 3.70% to 5.61% in 2017, 3.44% to 4.77% in 2016 and 2015, while foreign currency-denominated HTM investments bear effective interest rates ranging from 2.46% to 4.96%, 2.75% to 4.78%, 3.15% to 4.09% in 2017, 2016 and 2015, respectively.

Trading and securities gains (losses) - net on investment securities consist of:

	2017	2016	2015
FVPL investments (Note 29)			
Realized	**(₱27,662,614)**	₱43,228,664	(₱75,741,227)
Unrealized market valuation gain (loss)	**12,181,154**	9,808,773	(24,171,844)
	(15,481,460)	53,037,437	(99,913,071)
AFS investments (Note 29)	**(49,756,366)**	456,628,139	36,343,321
	(₱65,237,826)	₱509,665,576	(₱63,569,750)

9. Loans and Receivables

This account consists of:

	2017	2016
Receivables from customers		
Consumption loans	**₱84,276,599,224**	₱70,110,905,877
Real estate loans	**46,594,075,046**	43,899,559,143
Commercial loans	**11,975,704,903**	11,605,784,470
Personal loans (Note 29)	**3,486,068,122**	3,589,638,459
	146,332,447,295	129,205,887,949
Less unearned discounts	**145,142**	11,479,526
	146,332,302,153	129,194,408,423
Other receivables		
Accrued interest receivable	**1,911,372,461**	1,773,467,620
Accounts receivable (Note 29)	**1,250,586,507**	801,280,736
Sales contract receivables	**106,727,770**	151,649,979
Bills purchased (Note 19)	**10,482,445**	63,773,615
	149,611,471,336	131,984,580,373
Less allowance for credit losses (Note 15)	**4,646,958,115**	4,762,733,222
	₱144,964,513,221	₱127,221,847,151

Personal loans comprise deposit collateral loans, employee salary and consumer loan products such as money card, multi-purpose loan and flexi-loan.

As of December 31, 2017, 2016 and 2015, 40.02%, 42.95% and 45.02%, respectively, of the total receivables from customers are subject to periodic interest repricing with average effective interest rates of 14.06%, 13.78% and 13.39% in 2017, 2016 and 2015. Remaining receivables earn average annual fixed interest rates of 14.81%, 15.06% and 15.10% in 2017, 2016 and 2015, respectively.

Receivables from customers earned interest income at an effective interest rate ranging from 8.94% to 9.17%, 8.55% to 9.70%, and 8.56% to 10.16% for the periods ending December 31, 2017, 2016 and 2015, respectively.

Interest income on loans and receivables consists of:

	2017	2016	2015
Receivables from customers			
Consumption loans	**₱7,624,465,526**	₱6,326,845,090	₱5,273,970,259
Real estate loans	**3,273,928,199**	3,149,014,794	2,889,904,587
Personal loans (Note 29)	**820,957,546**	838,015,354	881,020,749
Commercial loans	**749,518,594**	741,347,084	868,764,738
Other receivables			
Sales contract receivables	**8,263,372**	11,640,532	15,998,131
	₱12,477,133,237	₱11,066,862,854	₱9,929,658,464

Interest income accreted on impaired loans and receivables classified under real estate loans and commercial loans amounted to ₱58.1 million, ₱71.7 million and ₱92.1 million in 2017, 2016 and 2015, respectively.

Interest income from restructured loans amounted to ₱11.0 million, ₱34.4 million and ₱54.7 million in 2017, 2016 and 2015, respectively.

BSP Reporting
The breakdown of loans and receivables from customers (gross of unearned discounts and allowance for credit losses, excluding Bills Purchased) as to secured and unsecured and as to type of security follows:

	2017	**%**	2016	%
Secured by:				
Chattel	**₱84,276,599,224**	**57.59**	₱70,110,905,877	54.26
Real estate	**31,276,232,123**	**21.37**	29,237,515,082	22.63
Deposit hold-out	**599,229,388**	**0.41**	412,128,144	0.32
Others	**–**	**0.00**	9,526	0.00
	116,152,060,735	**79.37**	99,760,558,629	77.21
Unsecured	**30,180,386,560**	**20.63**	29,445,329,320	22.79
	₱146,332,447,295	**100.00**	₱129,205,887,949	100.00

Details of NPLs follow:

	2017	2016
Secured	**₱3,357,179,140**	₱3,367,352,853
Unsecured	**1,413,353,220**	1,163,757,704
	₱4,770,532,360	₱4,531,110,557

Generally, NPLs refer to loans and receivables whose principal and/or interest is unpaid for thirty (30) days or more after due date if payable in lumpsum or after they have become past due in accordance with the following schedule, in which case, the total outstanding balance thereof shall be considered non-performing:

Mode of Payment	Number of Installments in arrears
Monthly	Three (3)
Quarterly	One (1)
Semestral	One (1)
Annual	One (1)

Provided, however, that when the total amount of arrearages reaches twenty percent (20.00%) of the total outstanding balance of the loans and receivables, the total outstanding balance of the loans and receivables shall be considered as past due, regardless of the number of installments in arrears.

In the case of loans and receivables 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, i.e., when the total amount of arrearages reaches ten percent (10.00%) of the total receivable balance, in which case, the entire outstanding balance of the receivable shall be considered as past due.

Restructured loans and receivables, which do not meet the requirements to be treated as performing receivables, shall also be considered as NPLs.

All items in litigation shall be considered non-performing.

The NPLs of the Bank not fully covered by allowance for credit losses follow:

	2017	2016
Total NPLs	**₱4,770,532,360**	₱4,531,110,557
NPLs fully covered by allowance for credit losses	**967,848,231**	1,011,362,190
	₱3,802,684,129	₱3,519,748,367

Restructured loans as of December 31, 2017 and 2016 amounted to ₱157.7 million and ₱186.8 million, respectively. The Bank's loan portfolio includes non-risk loans as defined under BSP regulations totaling ₱1.2 billion and ₱3.7 billion as of December 31, 2017 and 2016, respectively.

Loan concentration as to economic activity follows (gross of unearned discounts and allowance for credit losses, excluding Bills Purchased):

	2017	%	2016	%
Activities of households as employers and undifferentiated goods-and-services producing activities of households for own use	**₱89,619,513,953**	**61.24**	₱75,920,078,811	58.76
Real estate activities	**41,988,414,397**	**28.69**	39,133,764,415	30.29
Wholesale and retail trade, repair of motor vehicles and motorcycles	**2,406,750,036**	**1.64**	2,008,807,243	1.55
Financial and insurance activities	**2,076,032,590**	**1.42**	2,241,354,851	1.73
Electricity, gas, steam and air-conditioning supply	**1,729,067,501**	**1.18**	1,555,364,752	1.20
Administrative and support service activities	**988,927,513**	**0.68**	1,168,225,729	0.90
Transportation and storage	**955,988,018**	**0.65**	706,406,196	0.55
Construction	**794,540,357**	**0.54**	419,201,856	0.32
Manufacturing	**641,017,094**	**0.44**	544,063,882	0.42
Information and communication	**591,624,626**	**0.40**	1,510,721,131	1.17
Accommodation and food service activities	**369,461,368**	**0.25**	320,287,158	0.25
Human health and social work activities	**321,458,626**	**0.22**	351,327,898	0.27
Water supply, sewerage, waste management and remediation activities	**233,548,432**	**0.16**	285,743,840	0.22
Education	**196,750,868**	**0.13**	201,105,384	0.16
Professional, scientific and technical activities	**137,424,796**	**0.09**	81,018,814	0.06
Arts, entertainment and recreation	**84,598,346**	**0.06**	36,956,995	0.03
Agriculture, forestry and fishing	**24,481,568**	**0.04**	19,554,970	0.02
Mining and quarrying	**7,206,617**	**0.01**	4,513,747	0.00
Others	**3,165,640,589**	**2.16**	2,697,390,277	2.10
	₱146,332,447,295	**100.00**	₱129,205,887,949	100.00

Others relate to other service activities including the activities of membership organizations, repair of computers, personal and household goods and a variety of personal service activities not covered elsewhere in the classification above.

10. Investment in a Joint Venture

On August 9, 2017, the Bank signed a Sale and Purchase Agreement ("SPA") to sell 2.0 million shares or 10.00% ownership in SMFC to GT Capital Holdings, Inc. (GT Capital), a related party, for ₱190.0 million or ₱95.0 per share. The price of the transaction was based on an independent valuation report which was subjected to a third party fairness opinion.

As a result of the sale, the Bank's ownership interest in SMFC was reduced from 40.00% to 30.00%. Management has assessed that the Bank continues to have joint control over SMFC together with GT Capital, Sumitomo Japan and Sumitomo Corporation of the Philippines (Sumitomo Group), as all investors are bound by all the terms and conditions of the original Joint Venture Agreement between the Bank and Sumitomo Group, where unanimous consent is required from all the parties for SMFC's relevant activities.

SMFC is engaged in the business of lending or leasing to retail customers for their purchase of motorcycles. As of December 31, 2017 and 2016, the Bank's Investment in a Joint Venture amounted to ₱607.2 million and ₱727.2 million, respectively.

The following table illustrates the summarized financial information of SMFC (in thousands):

	2017	2016
Current assets	**₱3,415,192**	₱2,481,689
Non-current assets	**118,675**	125,057
Current liabilities	**(1,485,946)**	(179,881)
Non-current liabilities	**(24,045)**	(608,924)
Net assets	**₱2,023,876**	₱1,817,941

	2017	2016	2015
Revenues	**₱818,915**	₱661,242	₱449,887
Costs and expenses	**524,426**	539,530	379,678
	294,489	121,712	70,209
Provision for income tax	**89,062**	35,687	19,674
Net income	**205,427**	86,025	50,535
Other comprehensive income	**541**	3,440	3,783
Total comprehensive income	**₱205,968**	₱89,465	₱54,318

Movement in this account follows (in thousands):

	2017	2016
Balance at beginning of year	**₱727,176**	₱690,334
Carrying value of investment sold	**(192,012)**	–
Share in net income (Note 29)	**71,837**	35,466
Share in unrealized gain on remeasurement of retirement liability	**162**	1,376
Ending balance	**₱607,163**	₱727,176

Cost of the investment as of December 31, 2017 and 2016 amounted to ₱600.0 million and ₱800.0 million, respectively.

SMFC is a private company and there is no quoted market price available for its shares. The net assets of SMFC consist mainly of financial assets and financial liabilities.

The Bank has no share in any contingent liabilities or capital commitments of SMFC as of December 31, 2017 and 2016. There are also no agreements entered into by SMFC that may restrict dividends and other capital contributions to be paid, loans and advances to be made or repaid to or from the Bank as of the said dates.

Movement in Equity in Remeasurement Gains on Retirement Plan of a Joint Venture is as follows:

Share in unrealized gain on remeasurement of retirement liability	₱162,445
Reclassification of OCI to profit or loss due to sale of shares in joint venture	(360,900)
Total	(₱198,455)

11. Property and Equipment

The composition of and movements in this account follow:

	2017				
	Land	**Building**	**Furniture, Fixtures and Equipment**	**Leasehold Improvements**	**Total**
Cost					
Balance at beginning of year	**₱976,443,676**	**₱1,125,080,642**	**₱2,599,237,687**	**₱910,425,844**	**₱5,611,187,849**
Acquisitions	**–**	**1,512,727**	**159,892,831**	**65,714,426**	**227,119,984**
Disposals	**–**	**–**	**(37,676,241)**	**–**	**(37,676,241)**
Balance at end of year	**976,443,676**	**1,126,593,369**	**2,721,454,277**	**976,140,270**	**5,800,631,592**
Accumulated Depreciation					
Balance at beginning of year	**–**	**380,990,516**	**1,937,538,765**	**625,488,113**	**2,944,017,394**
Depreciation	**–**	**35,479,744**	**263,138,807**	**93,270,131**	**391,888,682**
Disposals	**–**	**–**	**(33,766,144)**	**–**	**(33,766,144)**
Reclassifications/transfer	**–**	**–**	**18,479,470**	**(164)**	**18,479,306**
Balance at end of year	**–**	**416,470,260**	**2,185,390,898**	**718,758,080**	**3,320,619,238**
Net Book Value	**₱976,443,676**	**₱710,123,109**	**₱536,063,379**	**₱257,382,190**	**₱2,480,012,354**

	2016				
	Land	Building	Furniture, Fixtures and Equipment	Leasehold Improvements	Total
Cost					
Balance at beginning of year	₱976,443,676	₱1,090,198,998	₱2,392,877,414	₱877,422,384	₱5,336,942,472
Acquisitions	–	35,590,621	247,293,337	36,146,475	319,030,433
Disposals	–	(708,977)	(40,933,064)	(3,143,015)	(44,785,056)
Balance at end of year	976,443,676	1,125,080,642	2,599,237,687	910,425,844	5,611,187,849
Accumulated Depreciation					
Balance at beginning of year	–	346,201,515	1,695,505,804	549,160,782	2,590,868,101
Depreciation	–	34,789,001	256,555,570	77,100,086	368,444,657
Disposals	–	–	(29,168,860)	(772,755)	(29,941,615)
Reclassifications/transfer	–	–	14,646,251	–	14,646,251
Balance at end of year	–	380,990,516	1,937,538,765	625,488,113	2,944,017,394
Net Book Value	₱976,443,676	₱744,090,126	₱661,698,922	₱284,937,731	₱2,667,170,455

Gain on sale of property and equipment amounted to ₱1.7 million, ₱2.6 million and ₱17.7 million in 2017, 2016 and 2015, respectively.

The details of depreciation under the statements of income follow:

	2017	2016	2015
Property and equipment	**₱391,888,682**	₱368,444,657	₱340,827,746
Investment properties (Note 12)	**93,249,037**	85,649,120	73,873,201
Chattel mortgage properties (Note 14)	**150,298,384**	103,554,973	86,610,199
	₱635,436,103	₱557,648,750	₱501,311,146

As of December 31, 2017 and 2016, property and equipment of the Bank with gross carrying amounts of ₱1.5 billion and ₱1.4 billion, respectively, are fully depreciated but are still being used.

12. Investment Properties

The composition of and movements in this account follow:

	2017		
	Land	**Building Improvements**	**Total**
Cost			
Balance at beginning of year	**₱1,738,547,376**	**₱2,742,910,089**	**₱4,481,457,465**
Additions (Note 32)	**263,873,034**	**604,407,391**	**868,280,425**
Disposals	**(375,578,758)**	**(416,696,304)**	**(792,275,062)**
Balance at end of year	**1,626,841,652**	**2,930,621,176**	**4,557,462,828**
Accumulated Depreciation			
Balance at beginning of year	**–**	**366,374,975**	**366,374,975**
Depreciation (Note 11)	**–**	**93,249,037**	**93,249,037**
Disposals		**(61,998,295)**	**(61,998,295)**
Balance at end of year	**–**	**397,625,717**	**397,625,717**
Allowance for Impairment Losses			
Balance at beginning of year	**181,407,122**	**71,967,060**	**253,374,182**
Provisions (reversals) for the year (Note 15)	**–**	**(1,201,346)**	**(1,201,346)**
Disposals	**(14,589,743)**	**(8,063,461)**	**(22,653,204)**
Balance at end of year	**166,817,379**	**62,702,253**	**229,519,632**
Net Book Value	**₱1,460,024,273**	**₱2,470,293,206**	**₱3,930,317,479**

	2016		
	Land	Building Improvements	Total
Cost			
Balance at beginning of year	₱1,572,972,787	₱2,327,005,675	₱3,899,978,462
Additions (Note 32)	409,768,437	715,620,863	1,125,389,300
Disposals	(244,193,848)	(299,716,449)	(543,910,297)
Balance at end of year	1,738,547,376	2,742,910,089	4,481,457,465
Accumulated Depreciation			
Balance at beginning of year	–	318,449,867	318,449,867
Depreciation (Note 11)	–	85,649,120	85,649,120
Disposals	–	(37,724,012)	(37,724,012)
Balance at end of year	–	366,374,975	366,374,975
Allowance for Impairment Losses			
Balance at beginning of year	181,407,122	55,967,060	237,374,182
Provisions for the year (Note 15)	–	16,000,000	16,000,000
Balance at end of year	181,407,122	71,967,060	253,374,182
Net Book Value	₱1,557,140,254	₱2,304,568,054	₱3,861,708,308

The details of the net book value of investment properties follow:

	2017	2016
Real estate properties acquired in settlement of loans and receivables	**₱3,832,340,181**	₱3,759,902,584
Bank premises leased to third parties and held for capital appreciation	**97,977,298**	101,805,724
	₱3,930,317,479	₱3,861,708,308

As of December 31, 2017 and 2016, the aggregate fair value of investment properties amounted to ₱4.9 billion and ₱4.7 billion, respectively. Fair value of the properties was determined using Sales Comparison Approach. Fair values are based on valuations performed by accredited external and in-house appraisers.

Gain on foreclosure of investment properties amounted to ₱271.9 million, ₱350.4 million and ₱258.7 million in 2017, 2016 and 2015, respectively. The Bank realized gain on sale of investment properties amounting to ₱76.9 million and ₱14.0 million in 2017 and 2016, respectively, and a loss on sale amounting to ₱0.7 million in 2015.

Rental income on investment properties included in miscellaneous income amounted to ₱48.7 million, ₱53.8 million and ₱53.0 million in 2017, 2016 and 2015, respectively (Notes 23 and 25).

Operating expenses incurred in maintaining investment properties (included under miscellaneous expense) amounted to ₱20.5 million, ₱18.8 million and ₱15.7 million in 2017, 2016 and 2015, respectively (Note 26).

13. Goodwill and Intangible Assets

This account consists of:

	2017	2016
Goodwill	**₱53,558,338**	₱53,558,338
Intangible assets		
Software costs	**624,241,981**	414,483,793
Branch licenses	**37,123,737**	37,123,737
	661,365,718	451,607,530
	₱714,924,056	₱505,165,868

The movements in intangible assets follow:

	2017		
	Software Costs	**Branch Licenses**	**Total**
Balance at beginning of year	**₱414,483,793**	**₱37,123,737**	**₱451,607,530**
Additions	**345,190,531**	**–**	**345,190,531**
Amortization	**(135,432,343)**	**–**	**(135,432,343)**
Balance at end of year	**₱624,241,981**	**₱37,123,737**	**₱661,365,718**

	2016		
	Software Costs	Branch Licenses	Total
Balance at beginning of year	₱355,178,046	₱35,723,737	₱390,901,783
Additions	170,466,198	1,400,000	171,866,198
Amortization	(111,160,451)	–	(111,160,451)
Balance at end of year	₱414,483,793	₱37,123,737	₱451,607,530

14. Other Assets

This account consists of:

	2017	2016
Chattel mortgage properties - net	**₱712,848,255**	₱607,096,135
Security deposits (Note 29)	**179,996,425**	178,330,923
Prepayments	**139,556,053**	186,996,554
Documentary stamps on hand	**103,123,771**	42,298,499
Stationeries and supplies on hand	**41,788,037**	25,762,082
Sundry debits	**23,766,185**	21,699,387
RCOCI	**10,349,423**	10,315,608
Creditable withholding tax	**6,675,985**	1,130,340
Others	**1,462,245**	4,453,528
	₱1,219,566,379	₱1,078,083,056

Prepayments represent prepaid insurance, rent, taxes and other prepaid expenses. Creditable withholding tax (CWT) pertains to the excess credits after applying CWT against income tax payable.

The movements in chattel mortgage properties - net follow:

	2017	2016
Cost		
Balance at beginning of year	**₱683,799,123**	₱526,167,582
Additions (Note 32)	**2,577,163,081**	1,925,310,853
Disposals	**(2,454,636,558)**	(1,767,679,312)
Balance at the end of year	**806,325,646**	683,799,123
Accumulated Depreciation		
Balance at beginning of year	**76,086,898**	69,266,942
Depreciation (Note 11)	**150,298,384**	103,554,973
Disposals	**(133,167,936)**	(96,735,017)
Balance at the end of year	**93,217,346**	76,086,898
Allowance for Impairment Losses		
Balance at beginning of year (Note 15)	**616,090**	616,090
Disposals	**(356,045)**	–
Balance at end of year	**260,045**	616,090
Net Book Value	**₱712,848,255**	₱607,096,135

Gain on foreclosure of chattel mortgage properties amounted to ₱759.1 million, ₱458.4 million and ₱432.6 million in 2017, 2016 and 2015, respectively. The Bank realized loss on sale of chattel mortgage properties amounting to ₱174.2 million, ₱106.7 million, and ₱54.9 million in 2017, 2016 and 2015, respectively.

15. Allowance for Credit and Impairment Losses

	2017					
	AFS Investments – Equity Securities (Note 8)		**Loans and Receivables** (Note 9)	**Investment Properties** (Note 12)	**Other Assets** (Note 14)	
	Quoted	**Unquoted**				**Total**
Balance at beginning of year	**₱1,220,000**	**₱968,665**	**₱4,762,733,222**	**₱253,374,182**	**₱616,090**	**₱5,018,912,159**
Provision (reversal) for credit a and impairment losses	**–**	**–**	**2,271,380,151**	**(1,201,346)**	**–**	**2,270,178,805**
Reversal of allowance on assets sold/settled	**–**	**–**	**(1,413,816,082)**	**(22,653,204)**	**(356,045)**	**(1,436,825,331)**
Accounts written off	**–**	**–**	**(973,339,176)**	**–**	**–**	**(973,339,176)**
Balance at end of year	**₱1,220,000**	**₱968,665**	**₱4,646,958,115**	**₱229,519,632**	**₱260,045**	**₱4,878,926,457**

	2016					
	AFS Investments – Equity Securities (Note 8)		Loans and Receivables (Note 9)	Investment Properties (Note 12)	Other Assets (Note 14)	
	Quoted	Unquoted				Total
Balance at beginning of year	₱1,220,000	₱968,665	₱4,625,202,276	₱237,374,182	₱616,090	₱4,865,381,213
Provision for credit and impairment losses	–	–	2,206,503,257	16,000,000	–	2,222,503,257
Reversal of allowance on assets sold/settled	–	–	(1,231,826,987)	–	–	(1,231,826,987)
Accounts written off	–	–	(837,145,324)	–	–	(837,145,324)
Balance at end of year	₱1,220,000	₱968,665	₱4,762,733,222	₱253,374,182	₱616,090	₱5,018,912,159

A reconciliation of the allowance for credit losses by class of loans and receivables is as follows (in thousands):

2017

	Receivables from Customers				Other Receivables				
	Consumption	**Real Estate**	**Commercial**	**Personal**	**Accrued Interest Receivable**	**Accounts Receivable**	**Sales Contract Receivable**	**Bills Purchased**	**Total**
Balance at beginning of year	**₱2,049,703**	**₱505,499**	**₱881,296**	**₱666,010**	**₱158,626**	**₱466,460**	**₱33,836**	**₱1,303**	**₱4,762,733**
Provisions for the year charged against profit or loss	**1,950,817**	**126,603**	**(91,369)**	**227,854**	**57,398**	**77**	**–**	**–**	**2,271,380**
Reversal of allowance	**(1,413,816)**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(1,413,816)**
Amounts written off	**(629,341)**	**–**	**–**	**(297,756)**	**(46,168)**	**(74)**	**–**	**–**	**(973,339)**
Balance at end of year	**₱1,957,363**	**₱632,102**	**₱789,927**	**₱596,108**	**₱169,856**	**₱466,463**	**₱33,836**	**₱1,303**	**4,646,958**
Individual impairment	**₱–**	**₱487,884**	**₱103,431**	**₱–**	**₱48,199**	**₱185,139**	**₱–**	**₱–**	**₱824,653**
Collective impairment	**1,957,363**	**144,218**	**686,496**	**596,108**	**121,657**	**281,324**	**33,836**	**1,303**	**3,822,305**
	₱1,957,363	**₱632,102**	**₱789,927**	**₱596,108**	**169,856**	**₱466,463**	**₱33,836**	**₱1,303**	**4,646,958**
Gross amount of loans individually impaired, before deducting any individual impairment allowance	**₱–**	**₱1,031,117**	**₱145,606**	**₱–**	**₱48,199**	**₱185,139**	**₱–**	**₱–**	**₱1,410,061**

2016

	Receivables from Customers				Other Receivables				
	Consumption	Real Estate	Commercial	Personal	Accrued Interest Receivable	Accounts Receivable	Sales Contract Receivable	Bills Purchased	Total
Balance at beginning of year	₱779,300	₱571,894	₱1,784,455	₱606,227	₱381,765	₱466,422	₱33,836	₱1,303	₱4,625,202
Provisions for the year charged against profit or loss	3,140,534	(66,395)	(903,159)	226,828	(191,391)	86	–	–	2,206,503
Reversal of allowance	(1,231,827)	–	–	–	–	–	–	–	(1,231,827)
Amounts written off	(638,304)	–	–	(167,045)	(31,748)	(48)	–	–	(837,145)
Balance at end of year	₱2,049,703	₱505,499	₱881,296	₱666,010	₱158,626	₱466,460	₱33,836	₱1,303	₱4,762,733
Individual impairment	₱–	₱459,093	₱105,041	₱–	₱100,007	₱184,652	₱–	₱–	₱848,793
Collective impairment	2,049,703	46,406	776,255	666,010	58,619	281,808	33,836	1,303	3,913,940
	₱2,049,703	₱505,499	₱881,296	₱666,010	₱158,626	₱466,460	₱33,836	₱1,303	₱4,762,733
Gross amount of loans individually impaired, before deducting any individual impairment allowance	₱–	₱1,047,721	₱172,246	₱–	₱100,007	₱184,652	₱–	₱–	₱1,504,626

16. **Deposit Liabilities**

Interest expense on deposit liabilities consists of:

	2017	2016	2015
Time (Note 29)	**₱2,792,840,772**	₱2,158,092,448	₱1,964,893,142
Demand (Note 29)	**167,111,638**	131,686,232	107,321,034
Savings	**138,804,756**	120,200,524	98,527,236
LTNCD	**115,908,554**	–	–
	₱3,214,665,720	₱2,409,979,204	₱2,170,741,412

Peso-denominated deposit liabilities earn annual fixed interest rates ranging from 0.25% to 6.00% in 2017 and 0.25% to 9.00% in 2016 and 0.25% to 10.50% in 2015, while foreign currency-denominated deposit liabilities earn annual fixed interest rates ranging from 0.50% to 2.00% in 2017, 0.01% to 2.13% in 2016 and 0.13% to 6.00% in 2015. Effective interest rates on deposit liabilities range from 0.25% to 1.75% as of December 31, 2017 and 2016, and from 1.50% to 2.00% as of December 31, 2015.

Under existing BSP regulations, non-FCDU deposit liabilities of the Bank are subject to reserves equivalent to 8.00%. As of December 31, 2017 and 2016, the Bank is in compliance with such regulations. As of December 31, 2017 and 2016, Due from BSP amounting to ₱13.9 billion and ₱12.0 billion, respectively, was set aside as reserves for deposit liabilities, as reported to the BSP.

On December 8, 2016, the BSP authorized the Bank to issue LTNCDs up to ₱10.0 billion through one or multiple tranches over a period of one year. On January 30, 2017, the Bank issued the first tranche of LTNCDs amounting to ₱3.4 billion with a tenor of five (5) years and due April 30, 2022 with interest rate of 3.50% per annum payable quarterly. The minimum investment size for the LTNCDs is ₱50,000 with increments of ₱50,000 thereafter. Subject to BSP Rules, the Bank has the option to pre-terminate the LTNCDs as a whole but not in part, prior to maturity and on any interest payment date at face value plus accrued interest covering the accrued and unpaid interest.

For the period ended December 31, 2017, the interest expense related to the LTNCDs is ₱115.9 million.

17. **Bills Payable and Subordinated Notes**

Bills Payable

This account consists of the following:

	2017	2016
Securities sold under repurchase agreements (SSURA)	**₱1,492,418,518**	₱3,856,396,533
Interbank borrowings	–	2,237,400,000
	₱1,492,418,518	₱6,093,796,533

Bills payable – SSURA are borrowings from counterparties secured by pledge of government securities with maturities ranging from 5 to 33 days. Details of securities pledged under Bills payable – SSURA as of December 31, 2017 and 2016 are as follows:

	December 31, 2017		
Collateral Pledge	**Face Value**	**Carrying Value**	**Fair Value**
HTM Investments (Note 8)	**₱748,950,000**	**₱1,010,100,200**	**₱1,009,137,727**
AFS Investments (Note 8)	**439,300,000**	**751,808,493**	**751,808,493**

	December 31, 2016		
Collateral Pledge	Face Value	Carrying Value	Fair Value
HTM Investments (Note 8)	₱3,247,163,480	₱4,740,757,004	₱4,686,900,717

Peso-denominated interbank borrowings of the Bank bear annual interest is 2.50% in 2017, and ranging from 2.50% to 2.56% in 2016 and 2015. Foreign currency-denominated interbank borrowings bear annual interest ranging from 1.00% to 1.55%, 0.88% to 1.94%, and 0.55% to 1.25% in 2017, 2016, and 2015, respectively. Annual interest rate on dollar-denominated SSURA ranges from 1.05% to 1.75%, 0.25% to 1.65%, and 0.50% to 1.25% in 2017, 2016, and 2015, respectively.

Interest expense on bills payable in 2017, 2016 and 2015 amounted to ₱59.0 million, ₱56.8 million and ₱7.4 million, respectively.

Subordinated Notes

This account consists of the following Peso Notes:

		Carrying Value	
Maturity Date	Face Value	**2017**	2016
February 20, 2022	3,000,000,000	**₱–**	₱2,999,264,700
August 23, 2024	3,000,000,000	**2,978,997,695**	2,976,467,410
	6,000,000,000	**₱2,978,997,695**	₱5,975,732,110

Unamortized debt issuance costs on these notes amounted to ₱21.0 million and ₱24.3 million as of December 31, 2017 and 2016, respectively.

5.75%, ₱3.0 Billion Unsecured Subordinated Notes

On December 29, 2011, the Bank obtained approval from the BSP to issue and sell ₱3.0 billion in Unsecured Subordinated Notes due 2022 (the Notes) and issued them on February 20, 2012 with an interest rate of 5.75%.

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

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

b. The Notes bear interest at the rate of 5.75% per annum from and including February 20, 2012 but excluding February 20, 2022. The interest shall be payable quarterly in arrears at the end of each interest period on every 20th of May, August, November and February of each year, commencing on February 20, 2012 until the maturity date;

c. The Notes will constitute direct, unconditional and unsecured obligations of the Bank. The Notes will be subordinated in right of payment of principal and interest to all depositors and other creditors of the Issuer and will rank pari passu and without any preference among themselves, but in priority to the rights and claims of holders of all classes of equity securities of the Bank, including holders of preferred shares, if any;

d. Subject to satisfaction of certain regulatory approval requirements, the Bank may redeem the Notes in whole and not only in part at a redemption price equal to 100.00% of the principal amount together with the accrued and unpaid interest upon at least thirty (30) days notice prior to call option date, which is the Banking Day immediately following the fifth anniversary of the issue date of the Notes or February 21, 2017.

e. The Bank may, but is not obliged to, redeem the Notes, in whole but not in part, at the Call Option Amount, on the Call Option Date, subject to the prior approval of the BSP and the compliance by the Bank with the Regulations and prevailing requirements for the granting by the BSP of its consent therefore, including (i) the capital adequacy ratio of the Bank is well above the required minimum ratio after redemption; or (ii) the Note is simultaneously replaced, on or prior to the Call Option Date, with issues of new capital which is of the same or of better quality and is done under conditions which are sustainable for the income capacity of the Bank; and (iii) a 30 Banking Day prior written notice to the then Holder on record. Any tax due on interest income already earned by the Holders on the Notes shall be for the account of the Bank. Call Option Amount shall be based on the Issue Price of the Note plus accrued but unpaid interest thereon up to but excluding the Call Option Date.

   On July 22, 2016, the Board of Directors approved the Bank's option to call the Tier 2 Notes issued in 2012 on its fifth year anniversary or on February 21, 2017. The request of the Bank to exercise the same was approved by the BSP on September 13, 2016. The redemption falls under the call provisions of the Tier 2 Notes worth ₱3.0 Billion, which had an original maturity of ten years or until 2022.

   The Bank sent a notice on the call option to its public trustee, Development Bank of the Philippines, with a copy to its registrar and paying agent Standard Chartered Bank on January 12, 2017. Each of the noteholders also received individual notices no less than 30 business days nor more than 45 days prior to the Call Option date. The Bank has likewise published the notice of Call Option in two newspapers of general circulation within Metro Manila for two consecutive weeks prior to February 21, 2017. The notice included the Call Option Date, Call Option Amount and the manner in which the call will be effected.

<u>5.50%, ₱3.0 Billion Unsecured Subordinated Notes</u>
On April 14, 2014, the Bank obtained approval from the BSP to issue and sell ₱3.0 billion in Unsecured Subordinated Notes due August 23, 2024 (the Notes) and issued them on May 23, 2014 with an interest rate of 5.50%.

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

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

b. The Notes bear interest at the rate of 5.50% per annum from and including May 23, 2014 to but excluding August 23, 2024. Unless the Notes are earlier redeemed upon at least 30 days prior notice to August 23, 2019, the Call Option Date. Interest shall be payable quarterly in arrears at the end of each Interest Period on August 23, November 23, February 23 and May 23 of each year, commencing on August 23, 2014 until the Maturity Date;

c. The Notes will constitute direct, unconditional and unsecured obligations of the Bank. The Notes will be subordinated in right of payment of principal and interest to all depositors and other creditors of the Bank and will rank pari passu and without any preference among themselves, but in priority to the rights and claims of holders of all classes of equity securities of the Bank, including holders of preferred shares, if any;

d. The Notes have a loss absorption feature, which means the Notes are subject to a Non-Viability Write-Down in case of the occurrence of a Non-Viability Event, subject to certain conditions set out in the "Terms and Conditions of the Notes - Loss Absorption Due to Non-Viability Event; Non-Viability Write-Down", when the Bank or its parent company is considered non-viable as determined by the BSP. Non-viability is defined as a deviation from a certain level of Common Equity Tier 1 (CET1) Ratio or the inability of the Bank or its parent company to continue business or any other event as determined by the BSP, whichever comes earlier. A Non-Viability Trigger Event shall be deemed to have occurred if the BSP notifies the Bank in writing that it has determined that a: i) Write-Down of the Notes and other capital instruments of the Bank is necessary because, without such write-down, the Bank would become non-viable, ii) public sector injection of capital, or equivalent support, is necessary because, without such injection or support, the Bank would become non-viable, or iii) write-down of the Notes and other capital instruments of the Bank is necessary, because, as a result of the closure of the Bank, the latter has become non-viable;

e. Unless previously converted, and provided a Non-Viability Trigger Event has not occurred and subject to regulations, the Bank shall have the option but not the obligation, upon securing all required regulatory approvals, to redeem the Notes as a whole, but not in part, in the following circumstances: i) at the Call Option Amount, on the Call Option Date, subject to the prior approval of the BSP and the compliance by the Issuer with Regulations and prevailing requirements for the granting by the BSP of its consent, ii) prior to the stated maturity and on any Interest Payment Date at par plus accrued but unpaid interest thereon if or when payments or principal or interest due on the Notes become subject to additional or increased taxes, other than any taxes and rates of such taxes prevailing as of the Issue Date, as a result of certain changes in law, rule, or regulation, or in the interpretation thereof, and such additional or increased rate of such tax cannot be avoided by use of reasonable measures available to the Bank or iii) the non-qualification of the Notes as Tier 2 capital as determined by the BSP. Incremental tax, if any, that may be due on the interest income already earned under the Notes as a result of the exercise by the Bank of its option for early redemption, shall be for its own account. Call Option Amount shall be based on the principal amount of the Note plus accrued interest covering the accrued and unpaid interest as of but excluding the Call Option Date.

As of December 31, 2017 and 2016, the Bank is in compliance with the terms and conditions upon which the subordinated notes have been issued.

Interest expense incurred on these notes amounted to ₱191.1 million, ₱361.8 million and ₱342.7 million in 2017, 2016 and 2015, respectively, net of amortization of deferred financing cost amounting to ₱3.3 million, ₱23.7 million and ₱5.2 million, respectively.

18. Accrued Taxes, Interest and Other Expenses

This account consists of:

	2017	2016
Accrued interest payable	**₱539,659,048**	₱209,657,954
Accrued other taxes and licenses payable	**121,804,006**	132,890,355
Accrued other expenses payable (Note 29)	**996,960,250**	851,268,063
	₱1,658,423,304	₱1,193,816,372

Accrued other expenses payable consist of:

	2017	2016
Litigation	**₱209,942,489**	₱145,925,051
Insurance (Note 29)	**193,075,730**	153,566,866
Lease payable	**188,338,698**	177,998,246
Compensation and fringe benefits	**141,725,665**	121,462,104
Security, messengerial and janitorial	**76,800,392**	54,428,863
Advertising	**68,640,771**	82,806,040
Information technology (Note 29)	**37,731,731**	57,590,058
ATM maintenance	**15,568,755**	11,967,068
Telephone	**7,562,631**	5,700,133
Membership, fees & dues	**4,993,929**	3,817,488
Professional and consultancy fees	**2,830,174**	5,422,558
Miscellaneous	**49,749,285**	30,583,588
	₱996,960,250	₱851,268,063

Compensation and fringe benefits include salaries and wages as well as medical, dental and hospitalization benefits.

Miscellaneous include accruals for ATM rentals, utilities and maintenance and other expenses.

19. Other Liabilities

This account consists of:

	2017	2016
Accounts payable (Note 29)	**₱2,080,276,358**	₱1,594,254,450
Other credits	**698,347,392**	592,403,220
Net retirement liability (Note 24)	**515,852,989**	748,843,368
Sundry credits	**207,190,555**	191,460,186
Withholding taxes payable	**94,051,921**	73,091,847
Due to the Treasurer of the Philippines	**16,959,070**	12,229,687
Bills purchased - contra (Note 9)	**10,482,445**	63,773,615
SSS, Medicare, ECP and HDMF premium payable	**9,122,722**	8,757,223
Miscellaneous (Note 29)	**40,948,901**	53,663,903
	₱3,673,232,353	₱3,338,477,499

Accounts payable includes payable to suppliers and service providers, and loan payments and other charges received from customers in advance.

Other credits represent long-outstanding unclaimed balances from inactive and dormant accounts.

Miscellaneous liabilities include incentives for housing loan customers that are compliant with the payment terms amounting to ₱18.2 million and ₱27.3 million as of December 31, 2017 and 2016, respectively.

20. Maturity Analysis of Assets and Liabilities

The following table shows an analysis of assets and liabilities analyzed according to whether they are expected to be recovered or settled within one year and beyond one year from the statement of condition dates (in thousands):

	December 31					
	2017			2016		
	Within One Year	Beyond One Year	Total	Within One Year	Beyond One Year	Total
Financial Assets						
Cash and other cash items	**₱2,596,873**	**₱–**	**₱2,596,873**	₱2,778,009	₱–	₱2,778,009
Due from BSP (Note 16)	**15,265,388**	**–**	**15,265,388**	13,986,785	–	13,986,785
Due from other banks (Note 16)	**1,508,489**	**–**	**1,508,489**	1,838,630	–	1,838,630
Interbank loans receivable and SPURA (Note 7)	**1,842,023**	**–**	**1,842,023**	3,254,312	–	3,254,312
FVPL investments (Note 8)	**366,236**		**366,236**	1,360,792	–	1,360,792
AFS investments - gross (Note 8)	**565,979**	**16,361,696**	**16,927,675**	39,805	13,078,197	13,118,002
HTM investments (Note 8)	**–**	**29,473,724**	**29,473,724**	329,768	22,827,119	23,156,887
Loans and receivables - gross (Note 9)	**14,576,182**	**135,035,434**	**149,611,616**	12,821,739	119,174,321	131,996,060
Other assets - gross* (Note 14)	**–**	**191,358**	**191,358**	36,475	153,479	189,954
	36,721,170	**181,062,212**	**217,783,382**	36,446,315	155,233,116	191,679,431
Nonfinancial Assets						
Investment in a joint venture	**–**	**607,163**	**607,163**	–	727,176	727,176
Property and equipment - gross (Note 11)	**–**	**5,800,632**	**5,800,632**	–	5,611,188	5,611,188
Investment properties - gross (Note 12)	**–**	**4,557,463**	**4,557,463**	–	4,481,457	4,481,457
Deferred tax assets	**–**	**1,429,327**	**1,429,327**	–	1,300,724	1,300,724
Goodwill and intangible assets	**–**	**714,924**	**714,924**	–	505,166	505,166
Other assets - gross**	**315,324**	**806,362**	**1,121,686**	281,033	683,799	964,832
	315,324	**13,915,871**	**14,231,195**	281,033	13,309,510	13,590,543
Less: Allowance for credit and impairment losses (Note 15)			**4,878,926**			5,018,912
Accumulated depreciation (Notes 11, 12 and 14)			**3,811,463**			3,386,479
Unearned discounts (Note 9)			**145**			11,480
			8,690,534			8,416,871
	₱37,036,494	**₱194,978,083**	**₱223,324,043**	₱36,727,348	₱168,542,626	₱196,853,103

* Others assets under financial assets comprise petty cash fund, shortages, RCOCI and security deposits.

** Other assets under nonfinancial assets comprise inter-office float items, prepaid expenses, stationery and supplies on hand, sundry debits, documentary stamps on hand, deferred charges, postages stamps and chattel mortgage properties.

	December 31					
	2017			2016		
	Within One Year	**Beyond One Year**	**Total**	Within One Year	Beyond One Year	Total
Financial Liabilities						
Deposit liabilities	**₱170,432,096**	**₱18,481,306**	**₱188,913,402**	₱141,892,398	₱16,494,921	₱158,387,319
Bills payable	**1,492,419**	**–**	**1,492,419**	6,093,797	–	6,093,797
Subordinated notes	**–**	**2,978,998**	**2,978,998**	2,999,265	2,976,467	5,975,732
Derivatives at negative fair value	**–**	**–**	**–**	65,317	–	65,317
Treasurer's, cashier's and manager's checks	**2,213,870**	**–**	**2,213,870**	1,760,506	–	1,760,506
Accrued other expenses payable (Note 18)	**996,960**	**–**	**996,960**	851,268	–	851,268
Accrued interest payable (Note 18)	**539,659**	**–**	**539,659**	209,658	–	209,658
Other liabilities (Note 19)						
Accounts payable	**2,080,276**	**–**	**2,080,276**	1,594,254	–	1,594,254
Other credits	**698,347**	**–**	**698,347**	592,403	–	592,403
Bills purchased - contra	**10,482**	**–**	**10,482**	63,774	–	63,774
Due to the treasurer of the Philippines	**16,959**	**–**	**16,959**	12,230	–	12,230
Deposits for keys – SDB	**806**	**–**	**806**	₱823	₱–	₱823
Others*	**5,585**	**–**	**5,585**	4,702	–	4,702
	₱178,487,459	**₱21,460,304**	**₱199,947,763**	156,140,395	19,471,388	175,611,783
Nonfinancial Liabilities						
Accrued other taxes and licenses payable (Note 18)	**₱121,804**	**₱–**	**₱121,804**	₱132,890	₱–	₱132,890
Income tax payable	**375**	**–**	**375**	467	–	467
Withholding taxes payable (Note 19)	**94,052**	**–**	**94,052**	73,092	–	73,092
Other liabilities (Note 19)**	**250,871**	**515,853**	**766,724**	248,354	748,844	997,198
	467,102	**515,853**	**982,955**	454,803	748,844	1,203,647
	₱178,954,561	**₱21,976,157**	**₱200,930,718**	₱156,595,198	₱20,220,232	₱176,815,430

* Others under financial liabilities comprise payment orders payable and overages.

** Other liabilities under nonfinancial liabilities comprise advance rentals on bank premises, sundry credits, SSS, Medicare, ECP & HDMF premium payable, net retirement liability, and miscellaneous liabilities.

21. Equity

Issued Capital

The Bank's capital stock consists of:

	2017		2016	
	Shares	**Amount**	Shares	Amount
Authorized common stock - ₱10 par value	**425,000,000**	**₱4,250,000,000**	425,000,000	₱4,250,000,000
Issued and outstanding				
Balance at beginning and end of year (Note 28)	**240,252,491**	**₱2,402,524,910**	240,252,491	₱2,402,524,910

The Bank became listed in the Philippine Stock Exchange (PSE) on October 10, 1994. 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	Authorized Shares	Par Value
August 16, 1995	Common	300,000,000	₱10
October 8, 1997	Common	425,000,000	₱10

As of December 31, 2017 and 2016, the total number of stockholders is 1,483 and 1,507, respectively.

Dividends Paid and Proposed

Details of the Bank's dividend distributions as approved by the Bank's BOD and the BSP follow:

	Cash Dividends				
Date of declaration	Per share	Total amount	Date of BSP approval	Record date	Payment date
January 22, 2015	0.75	180,189,368.3	March 3, 2015	March 30, 2015	April 17, 2015
April 28, 2015	0.75	180,189,368.3	June 5, 2015	July 14, 2015	July 28, 2015
July 28, 2015	0.75	180,189,368.3	September 23, 2015	October 26, 2015	November 11, 2015
October 29, 2015	0.75	180,189,368.3	–	November 16, 2015	November 27, 2015
January 19, 2016	0.75	180,189,368.3	–	February 1, 2016	February 19, 2016
April 26, 2016	0.75	180,189,368.3	–	May 11, 2016	May 26, 2016
July 22, 2016	0.75	180,189,368.3	–	August 8, 2016	August 22, 2016
October 21, 2016	0.75	180,189,368.3	–	November 9, 2016	November 21, 2016
January 24, 2017	0.75	180,189,368.3	–	February 10, 2017	February 24, 2017
April 24, 2017	0.75	180,189,368.3	–	May 10, 2017	May 24, 2017
July 27, 2017	0.75	180,189,368.3	–	August 11, 2017	August 29, 2017
October 26, 2017	0.75	180,189,368.3	–	November 14, 2017	November 24, 2017
January 18, 2018	0.75	180,189,368.3	–	February 02, 2018	February 19, 2018

On October 9, 2015, the Bangko Sentral ng Pilipinas (BSP) issued Circular No. 888, *Amendments to Regulations on Dividend Declaration and Interest Payments on Tier 1 Capital Instruments*, which liberalized said rules in the sense that prior BSP verification and approval is no longer required except for banks with major supervisory concerns. However, banks are bound to comply with the provisions of Section X136 of the Manual of Regulations for Banks (MORB) and its subsections, including the submission of documentary requirements under Subsection X136.4 of the MORB, otherwise, banks, subsequently found to have violated the provisions on dividend declaration or have falsely certified/submitted misleading statements shall be reverted to the prior BSP verification wherein the bank can only make an announcement or communication on the declaration of the dividends or payment of dividends thereon upon receipt of BSP advice thereof. The Bank is compliant with the said circular.

The computation of surplus available for dividend declaration in accordance with SEC Memorandum Circular No. 11 issued in December 2008 differs to a certain extent from the computation following BSP guidelines.

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.

A portion of the surplus corresponding to the accumulated net earnings of a joint venture is not available for dividend declaration (Note 10) until receipt of cash dividends from the investee.

Capital Management

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements, as mandated by the BSP, and that the Bank maintains healthy capital ratios in order to support its business and maximize returns for its shareholders. The Bank considers its paid in capital and surplus as its capital.

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 payments to shareholders or issue capital securities. The major activities in this area include the following:

- The Bank issued additional common shares for its qualified stockholders in 2008 and 2006 through stock rights offerings that raised ₱2.0 billion and ₱750.0 million in capital, respectively.

- On March 2, 2005, the Bank's BOD approved an amendment to the Bank's Dividend Policy which provides for an annual regular cash dividend of 6.00% of the par value of the total capital stock payable quarterly at the rate of 1.50% or ₱0.15 per share payable not later than March 31, June 30, September 30 and December 31 of each year.

- On February 29, 2012, the Bank's BOD approved a further amendment to the Bank's Dividend Policy to provide for an annual regular cash dividend of 30.00% of the par value of the total capital stock, payable quarterly at the rate of 7.50% or ₱0.75 per share payable not later than March 31, June 30, September 30 and December 31 of each year.

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 unimpaired capital (regulatory capital) as reported to the BSP. This is determined on the basis of regulatory accounting policies which differ from PFRS in some respects.

In addition, the risk-based capital ratio of a bank, expressed as a percentage of qualifying capital to risk-weighted assets, should not be less than 10.00% for both solo basis and consolidated basis. Qualifying capital and risk-weighted assets are computed based on BSP regulations. Risk-weighted assets consist of total assets less cash on hand, due from BSP, loans covered by hold-out on or assignment of deposits, loans or acceptances under letters of credit to the extent covered by margin deposits and other non-risk items determined by the Monetary Board of the BSP.

On January 15, 2013, the BSP issued Circular No. 781, *Basel III Implementing Guidelines on Minimum Capital Requirements,* which states 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 took effect on January 1, 2014.

The Circular sets out a minimum Common Equity Tier 1 (CET1) ratio of 6.00% and Tier 1 capital ratio of 7.50%. It also introduces a capital conservation buffer of 2.50% comprised of CET1 capital. The BSP's existing requirement for Total CAR remains unchanged at 10.00% and these ratios shall be maintained at all times.

The CAR of the Bank as of December 31, as reported to the BSP, based on BSP Circular No. 781 and BSP Circular No. 538, respectively, are shown in the table below (amounts in millions).

	2017	2016
Tier 1 capital	**₱20,898**	₱18,768
Tier 2 capital	**4,346**	4,168
Gross qualifying capital	**25,244**	22,936
Less required deductions	**3,583**	3,281
Total qualifying capital	**21,661**	19,655
Risk weighted assets	**₱156,140**	₱139,738
Tier 1 capital adequacy ratio	**11.09%**	11.08%
Capital adequacy ratio	**13.87%**	14.07%

Regulatory qualifying capital consists of Tier 1 (going concern) capital, which comprises capital stock, surplus, surplus reserves, net unrealized gains on AFS securities, and cumulative translation adjustment. Certain adjustments are made to PFRS-based results and reserves, as prescribed by the BSP. The other component of regulatory capital is Tier 2 (gone-concern) capital, which is comprised of the Bank's general loan loss provision and unsecured subordinated debt (refer to Note 17). Certain items are deducted from the regulatory Gross Qualifying Capital, such as but not limited to, outstanding unsecured credit accommodations both direct and indirect, to DOSRI, and unsecured loans, other credit accommodations and guarantees granted to subsidiaries and affiliates (net of specific provisions), deferred income tax (net of allowance for impairment, if any) and goodwill. In 2013, deductions to Tier 2 Capital are capped at its total gross amount and any excess shall be deducted from Tier 1 Capital in accordance with Basel II standards.

Risk-weighted assets are determined by assigning defined risk weights to amounts of on-balance sheet exposures and to the credit equivalent amounts of off-balance sheet exposures.

As of December 31, 2017 and 2016, the Bank has complied with the requirements of BSP Circular No. 781 and BSP Circular No. 538, respectively.

The issuance of BSP Circular No. 639 covering the Internal Capital Adequacy Assessment Process (ICAAP) in 2009 supplements the BSP's risk-based capital adequacy framework under Circular No. 538. In compliance with this new circular, the Metrobank Group has adopted and developed its ICAAP framework to ensure that appropriate level and quality of capital are maintained by the Group. Under this framework, the assessment of risks extends beyond the Pillar 1 set of credit, market and operational risks and onto other risks deemed material by the Group. The level and structure of capital are assessed and determined in light of the Group's business environment, plans, performance, risks and budget, as well as regulatory directives. The Bank follows the Group's ICAAP framework and submits the result of its assessment to the parent company. Per BSP Circular 869, effective January 31, 2015, submission of an ICAAP document is required by BSP every March 31 of each year. The Bank has complied with this requirement.

The Bank has taken into consideration the impact of the foregoing requirements to ensure that the appropriate level and quality of capital are maintained on an ongoing basis.

Financial Performance

The following basic ratios measure the financial performance of the Bank:

	2017	2016	2015
Return on average equity	**12.51%**	12.50%	12.74%
Return on average assets	**1.26%**	1.34%	1.49%
Net interest margin on average earning assets	**6.10%**	6.17%	6.37%
Liquidity ratio	**20.70%**	23.46%	28.72%
Debt-to-equity ratio	**8.97:1**	8.82:1	7.83:1
Asset-to-equity ratio	**9.97:1**	9.82:1	8.83:1
Interest rate coverage ratio	**1.84:1**	1.94:1	1.92:1

22. Net Service Fees and Commission Income

This account consists of:

	2017	2016	2015
Service Fees and Commission Income			
Credit-related fees and commissions	**₱1,002,687,070**	₱731,435,587	₱757,297,871
Deposit-related and other fees received	**441,197,668**	473,979,270	521,122,916
Trust fees	**26,317,702**	20,600,300	15,278,974
	1,470,202,440	1,226,015,157	1,293,699,761
Service Fees and Commission Expense			
Commissions	**₱83,211,656**	83,156,492	89,801,141
Brokerage	**11,216,635**	6,511,459	8,406,570
	94,428,291	89,667,951	98,207,711
Net Service Fees and Commission Income	**₱1,375,774,149**	₱1,136,347,206	₱1,195,492,050

23. Miscellaneous Income

This account consists of:

	2017	2016	2015
Recovery of charged-off assets	**₱325,476,107**	₱296,241,762	₱284,561,719
Insurance commission income	**113,868,238**	63,948,168	42,103,916
Rental income (Notes 12 and 25)	**50,137,646**	55,505,274	54,876,077
Others	**18,028,368**	10,452,674	133,871,739
	₱507,510,359	₱426,147,878	₱515,413,451

Rental income arises from the lease of properties and safety deposit boxes of the Bank.

Others include income from renewal fees, checkbook charges, dividend income and other miscellaneous income.

24. Retirement Benefits

The Bank has a funded, noncontributory defined benefit plan covering substantially all of its employees. The benefits are based on years of service and final compensation.

The plan administered by the Retirement Committee is composed of five (5) members appointed by the Board of Directors of the Bank. The Retirement Committee have all the powers necessary or useful in the discharge of its duties of administration including, but not limited to determining the rights of Members under the Plan. The Retirement Committee may adopt such rules and regulations as it deems necessary and desirable, including those governing the establishment of procedures, the use of necessary forms, and the setting up of minimum periods where notice is required. The Retirement Committee may seek advice of counsel, and may appoint an independent accountant to audit the Plan and actuary to value the plan periodically, whose professional fees and expenses may be charged to the Fund.

Under the existing regulatory framework, Republic Act 7641 requires a provision for retirement pay to qualified private sector employees in the absence of any retirement plan in the entity, provided however that the employee's retirement benefits under any collective bargaining and other agreements shall not be less than those provided under the law. The law does not require minimum funding of the plan.

The date of the latest actuarial valuation is December 31, 2017.

The amounts of pension expense included in 'Compensation and fringe benefits' in the statements of income follow:

	2017	2016
Current service cost	**₱217,415,312**	₱194,358,002
Net interest cost	**30,210,252**	40,071,574
	₱247,625,564	₱234,429,576

The net retirement liability shown under 'Other liabilities' recognized in the Bank's statements of condition follows (in thousands):

		2017										
		Net benefit cost				Remeasurements in other comprehensive income						
	January 1, 2017	Current service cost	Net Interest	Subtotal	Benefits paid	Return on plan assets (excluding amount included in net interest)	Actuarial changes arising from experience adjustments	Actuarial changes arising from changes in demographic assumptions	Actuarial changes arising from changes in financial assumptions	Subtotal	Contribution by employer	December 31, 2017
Present value of defined benefit obligation	**₱2,222,652**	**₱217,415**	**₱114,127**	**₱331,542**	**(₱88,676)**	**₱–**	**₱87,389**	**(₱48,863)**	**(₱88,493)**	**(₱49,967)**	**₱–**	**₱2,415,551**
Fair value of plan assets	**(1,473,809)**	**–**	**(83,917)**	**(83,917)**	**88,676**	**55,241**	**–**	**–**	**–**	**55,241**	**(485,889)**	**(1,899,698)**
Net defined benefit liability	**₱748,843**	**₱217,415**	**₱30,210**	**₱247,625**	**₱–**	**₱55,241**	**₱87,389**	**(₱48,863)**	**(₱88,493)**	**₱5,274**	**(485,889)**	**₱515,853**

		2016										
		Net benefit cost				Remeasurements in other comprehensive income						
	January 1, 2016	Current service cost	Net Interest	Subtotal	Benefits paid	Return on plan assets (excluding amount included in net interest)	Actuarial changes arising from experience adjustments	Actuarial changes arising from changes in demographic assumptions	Actuarial changes arising from changes in financial assumptions	Subtotal	Contribution by employer	December 31, 2016
Present value of defined benefit obligation	₱1,990,815	₱194,358	₱97,314	₱291,672	(₱65,706)	₱–	₱69,380	₱–	(₱63,509)	₱5,871	₱–	₱2,222,652
Fair value of plan assets	(1,190,983)	–	(57,242)	(57,242)	65,706	94,601	–	–	–	94,601	(385,891)	(1,473,809)
Net defined benefit liability	₱799,832	₱194,358	₱40,072	₱234,430	₱–	₱94,601	₱69,380	₱–	(₱63,509)	₱100,472	(₱385,891)	₱748,843

The maximum economic benefit available is a combination of expected refunds from the plan and reductions in future contributions.

The Bank expects to contribute ₱413.5 million to its noncontributory defined benefit plan in 2018.

The fair values of plan assets by each class as at the statements of condition date are as follows:

	2017	2016
Cash and cash equivalents		
Special deposit account	**₱554,889,479**	₱582,003,365
Certificate of time deposit (Note 29)	–	92,000,000
Investment in other debt securities	**1,240,305,685**	531,057,496
Investment in equity securities	**26,368,915**	223,986,236
Unit Investment Trust Fund	**66,781,376**	58,850,839
Other assets	**12,961,335**	5,833,021
	1,901,306,790	1,493,730,957
Other liabilities	**1,608,492**	19,922,568
	₱1,899,698,298	₱1,473,808,389

The person exercising voting right for the foregoing equity instruments is currently a senior officer of the Bank.

The principal actuarial assumptions used in determining retirement liability as of December 31, 2017 and 2016 are shown below:

	2017	2016
Discount rate	**5.73%**	5.31%
Turnover rate	**5.00%**	6.00%
Future salary increases	**5.00%**	5.00%

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

	December 31, 2017		December 31, 2016	
	Possible Fluctuations	**Increase (decrease)**	Possible Fluctuations	Increase (decrease)
Discount rate	**+1.00%**	**(193,153,254)**	+1.00%	(190,815,355)
	-1.00%	**223,084,719**	-1.00%	221,306,014
Turnover rate	**+1.00%**	**(10,645,594)**	+1.00%	(20,387,630)
	-1.00%	**10,953,731**	-1.00%	20,980,032
Future salary increase rate	**+1.00%**	**238,335,111**	+1.00%	238,629,209
	-1.00%	**(209,707,814)**	-1.00%	(208,964,328)

The Retirement Committee ensures that there will be sufficient assets to pay pension benefits as they fall due and maintains the plan on an actuarially sound basis considering the benefits to members.

Shown below is the maturity analysis of the undiscounted benefit payments:

	2017	2016
Less than one year	**₱260,863,815**	₱146,739,063
More than one year to five years	**728,232,134**	660,937,425
More than five years to 10 years	**1,673,064,174**	1,364,613,210
More than 10 years to 15 years	**1,991,238,250**	2,014,243,913
More than 15 years to 20 years	**2,001,828,082**	1,954,212,513
More than 20 years	**4,280,297,426**	4,095,907,866

The average duration of the expected benefit payments at the statement of condition date is 16.1 years.

25. Leases

The Bank leases the premises occupied by its branches for periods ranging from 1 to 20 years renewable under certain terms and conditions. Various lease contracts include escalation clauses, most of which bear an annual rent increase of 10.00%. Rentals charged against profit or loss under these lease contracts amounting to ₱579.9 million, ₱559.9 million and ₱521.8 million in 2017, 2016 and 2015, respectively, are shown under 'Occupancy and equipment-related costs' in the statements of income.

Future minimum rentals payable under non-cancelable operating leases are as follows:

	2017	2016
Within one year	**₱361,756,475**	₱370,406,271
After one year but not more than five years	**1,078,413,962**	1,152,216,591
More than five years	**461,169,886**	607,663,809
	₱1,901,340,323	₱2,130,286,671

The Bank has also entered into commercial property leases on its surplus office space. These non-cancelable leases have remaining non-cancelable lease terms between 1 and 5 years. As of December 31, 2017 and 2016, there is no contingent rental income. Rental income of the Bank related to these property leases amounting to ₱48.7 million, ₱53.8 million, and ₱53.0 million in 2017, 2016 and 2015, respectively are shown under 'Miscellaneous income' in the statements of income.

Future minimum rentals receivable under non-cancelable operating leases are as follows:

	2017	2016
Within one year	**₱54,489,372**	₱48,424,870
After one year but not more than five years	**64,053,882**	40,876,011
	₱118,543,254	₱89,300,881

26. Miscellaneous Expenses

This account consists of:

	2017	2016	2015
Insurance	**₱646,175,766**	₱531,430,943	₱477,751,230
Litigation	**311,326,367**	231,158,922	275,455,140
Information technology	**300,919,189**	342,296,763	272,182,604
Fines, penalties and other charges	**193,083,359**	18,411,698	14,432,007
Communications	**171,980,030**	154,193,467	159,129,969
Repairs and maintenance	**145,685,402**	139,952,788	159,398,625
Advertising	**134,701,913**	102,412,588	64,934,029
Transportation and traveling	**108,019,662**	115,592,190	107,011,983
Stationery and supplies	**61,923,426**	58,283,090	63,978,794
Supervision and examination fees	**59,666,717**	49,247,092	52,911,508

(Forward)

	2017	2016	2015
Management and professional fees	**₱29,477,993**	₱23,062,585	₱25,993,577
Training and seminars	**19,158,180**	18,007,677	9,332,858
Donations and charitable contributions	**11,391,445**	10,920,000	3,912,468
Banking activities expenses	**9,032,636**	8,004,469	9,472,020
Meeting allowance	**6,731,295**	4,074,588	4,675,555
Rewards and incentives	**6,595,774**	3,181,297	4,522,624
Membership fees and dues	**3,508,422**	5,816,084	5,046,531
Entertainment, amusement and recreation (EAR) (Note 27)	**3,492,739**	3,407,845	3,563,703
Others	**28,463,191**	57,022,178	29,049,206
	₱2,251,333,506	₱1,876,476,264	₱1,742,754,431

Insurance expense includes premiums paid to the Philippine Deposit Insurance Corporation (PDIC) amounting to ₱368.2 million, ₱289.5 million, and ₱245.2 million in 2017, 2016 and 2015, respectively.

Other expenses include sponsorship expenses, home free loan expenses, appraisal fees and notarial fees. It also include payments to union members amounting to ₱10.8 million, ₱10.6 million and ₱10.5 million in 2017, 2016 and 2015, respectively, for the successful completion of the collective bargaining agreement.

27. Income and Other Taxes

Under Philippine tax laws, the Bank is subject to percentage and other taxes (presented as 'Taxes and licenses' in the statements of income) as well as income taxes. Percentage and other taxes paid consist principally of gross receipts tax (GRT) and documentary stamp tax (DST).

Income taxes include corporate income tax, further discussed below, and final taxes paid at the rate of 20.00%, which is a final withholding tax on gross interest income from government securities and other deposit substitutes.

The NIRC of 1997 also provides for rules on the imposition of a 2.00% MCIT on the gross income as of the end of the taxable year beginning on the fourth (4th) taxable year immediately following the taxable year in which the company commenced its business operations. Any excess MCIT over the RCIT can be carried forward on an annual basis and credited against the RCIT for the three (3) immediately succeeding taxable years.

Starting July 1, 2008, the Optional Standard Deduction (OSD) equivalent to 40.00% of gross income may be claimed as an alternative deduction in computing for the RCIT. The Bank elected to claim itemized expense deductions instead of the OSD in computing for the RCIT in 2017 and 2016.

On March 15, 2011, the BIR issued RR No. 4-2011 which prescribes the attribution and allocation of expenses between FCDUs/EFCDUs or OBU and RBU, and further allocation within RBU based on different income earning activities. 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 provide for the ceiling on the amount of EAR expense that can be claimed as a deduction against taxable income. Under the regulations, EAR expense allowed as a deductible expense for a service company is limited to the actual EAR paid or incurred but not to exceed 1.00% of net revenue.

FCDU 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 (OBUs) is taxed at 7.50%.

Under current tax regulations, the income derived by the FCDU from foreign currency transactions with non-residents, OBUs, local commercial banks, including branches of foreign banks, is tax-exempt while interest income on foreign currency loans from residents other than OBUs or other depository banks under the expanded system is subject to 10.00% income tax.

Provision for (benefit from) income tax consists of:

	2017	2016	2015
Current:			
Final tax	**₱259,181,580**	₱148,514,787	₱158,241,185
RCIT	**134,901,056**	147,364,626	193,630,281
	394,082,636	295,879,413	351,871,466
Deferred	**(127,021,129)**	(76,166,179)	(394,333,106)
	₱267,061,507	₱219,713,234	(₱42,461,640)

Net deferred tax assets consist of the following tax effects:

	2017	2016
Deferred tax assets on:		
Allowance for credit and impairment losses	**₱1,414,817,274**	₱1,317,650,642
Net pension liability	**154,755,897**	224,653,010
Difference between book base and tax base of investment property	**104,430,509**	96,203,815
Accrued rent	**57,352,453**	53,399,474
Unamortized pension cost contribution	**122,630,722**	65,821,218
	1,853,986,855	1,757,728,159
Deferred tax liabilities on:		
Net unrealized gain on investment properties	**(353,705,501)**	(353,141,383)
Accretion of interest on impaired loans	**(12,349,848)**	(30,002,072)
Unrealized foreign exchange gains	**(58,604,137)**	(73,860,470)
	(424,659,486)	(457,003,925)
	₱1,429,327,369	₱1,300,724,234

As of December 31, 2017 and 2016, the Bank did not recognize deferred tax assets on allowance for credit losses amounting to ₱48.9 million and ₱188.0 million, respectively. Income tax effect recognized in OCI amounted to ₱1.6 million, ₱30.1 million and ₱68.1 million in 2017, 2016 and 2015, respectively.

The reconciliation between the statutory income tax and effective income tax follows (in thousands):

	2017	2016	2015
Statutory income tax	**₱876,444**	₱801,167	₱692,532
Tax effect of:			
Tax-paid and tax-exempt income	**(688,672)**	(677,956)	(540,388)
Nondeductible expenses	**365,298**	336,301	272,409
FCDU income	**(97,955)**	(206,632)	(19,132)
Others	**(188,053)**	(33,167)	(447,882)
Effective income tax	**₱267,062**	₱219,713	(₱42,461)

28. **Earnings Per Share**

The following table presents information used to calculate basic EPS:

	2017	2016	2015
a. Net income	**₱2,654,419,128**	₱2,450,843,310	₱2,350,900,100
b. Weighted average number of common shares for basic earnings per share	**240,252,491**	240,252,491	240,252,491
c. Basic/Diluted EPS (a/b)	**11.05**	10.20	9.79

As of December 31, 2017, 2016 and 2015, there were no potential common shares with dilutive effect on the basic EPS of the Bank.

29. **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 are as follows:

- Bank's Directors, Officers, Stockholders and their Related Interests (DOSRI) as defined per BSP's existing DOSRI rules and regulations;
- Close Family Members (i.e. 2nd degree relatives) of the Bank's Directors, Officers with rank of SVP and up and Individual Substantial Stockholders;
- Bank's Subsidiaries and Affiliates as defined per BSP's existing rules and regulations on lending to subsidiaries and affiliates;
- Any party that the Bank exerts direct or indirect control over or that exerts direct or indirect control over the Bank;
- Subsidiaries, Affiliates and Special Purpose Entities (SPEs) of any party that the Bank exerts direct or indirect control over or that exerts direct or indirect control over the Bank;
- Corresponding Persons in Affiliated Companies as defined in the Bank's Related Party Transaction (RPT) Policy; and
- Any natural person or juridical entity whose interest may pose potential conflict with the Bank's interest.

The Bank has several business relationships with related parties. The terms of the transactions with such parties are listed below on substantially the same terms, including interest and collateral, as those prevailing at the time for comparable transactions with other parties.

Transactions with the Retirement Plan

On December 20, 2012, the SEC issued Memorandum Circular No. 12 providing for guidelines on the disclosure of transactions with retirement benefit funds. Under said circular, a reporting entity shall disclose information about any transaction with a related party (retirement fund, in this case) and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements.

Under PFRS, certain post-employment benefit plans are considered as related parties. The Bank has business relationships with its retirement plan pursuant to which it provides trust and management services to the said plan. The retirement plan of the employees of the Bank is being managed and maintained by the Trust Division of the Bank. The total fair value of the retirement fund as of December 31, 2017 and 2016 amounted to ₱1.9 billion and ₱1.5 billion, respectively. The details of the assets of the fund as of December 31, 2017 and 2016 are disclosed in Note 24.

The following table shows the amount of outstanding balances of related party transactions of the Bank and SMFC with the retirement plan of the employees of the Bank as of December 31, 2017 and 2016:

		2017	
		Elements of Transaction	
Related Party	**Nature of Transaction**	**Statement of Condition**	**Statement of Income**
Philippine Savings Bank	Savings Deposit	**₱684**	
	Investment in Money Market Fund*	**66,781,376**	
	Loss on sale of equity securities		**₱10,040,000**
	Income from Unit Investment Trust Fund (UITF)		**880,008**
	Interest income		**7,867**
First Metro ETF	Equity investment	**9,349,047**	

*Includes fair value gains of ₱0.2 million

		2016	
		Elements of Transaction	
Related Party	Nature of Transaction	Statement of Condition	Statement of Income
Philippine Savings Bank	Investment in Money Market Fund*	₱58,850,839	
	Deposits in Bank	3,365	
	Gain on sale of equity securities		₱246,455,484
	Dividends earned		6,901,211
	Interest income		7,309
	Income from Unit Investment Trust Fund (UITF)		1,179,402
Sumisho Motor Finance Corporation	Equity investment	200,000,000	

*Includes fair value gains of ₱0.2 million

Transactions relating to the Bank's retirement plan are approved by its Retirement Committee. The voting right over the investments in the Bank's capital stocks is exercised by a member of the Retirement Committee as approved by all members of the Retirement Committee, whom are senior officers of the Bank.

Remunerations of Directors and Other 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 Management Committee to constitute key management personnel for purposes of PAS 24, *Related Party Disclosures.*

Total remunerations of key management personnel (covering assistant vice presidents and up) included under 'Compensation and fringe benefits' in the statements of income are as follows:

	2017	2016
Short-term employee benefits	**₱253,953,306**	₱250,805,503
Post-employment pension benefits	**7,858,066**	6,356,856
	₱261,811,372	₱257,162,359

Short-term employee benefits include salaries and other non-monetary benefits.

Remunerations given to directors, as approved by the Board Remuneration Committee, amounted to ₱19.3 million, ₱16.7 million, and ₱16.9 million in 2017, 2016 and 2015, respectively.

The Bank also provides banking services to Directors and other key management personnel and persons connected to them.

Other Related Party Transactions

Other related party transactions of the Bank by category of related party are presented below. The following tables show the amount and outstanding balances included in the financial statements (in thousands):

	December 31, 2017		
Category	**Amount/ Volume**	**Outstanding Balance**	**Nature, Terms and Conditions**
Significant Investor			
Interbank loans receivable			Peso-denominated lending with 2.50% fixed interest rates and maturities ranging from 1 to 3 days
Placements	**₱19,970,000**	**₱–**	
Maturities	**19,970,000**	–	
Due from other banks	**(540,032)**	**912,745**	Peso-denominated lending with 2.50% fixed interest rates and maturities ranging from 360 days
Accounts receivable	**10,802**	**17,651**	Outstanding ATM service fees, rental and utility receivables, non interest bearing; no impairment
Miscellaneous assets	–	**781**	Security deposits on lease contracts
Bills payable		–	Peso-denominated borrowing with fixed interest rate of 2.50% and maturities ranging from 1 to 3 days
Deposits/placements	**1,285,000**	–	
Withdrawals/maturities	**1,285,000**	–	
Miscellaneous liabilities	–	**6,242**	Advance payments of security deposits
Accrued other expense payable	–	**37,732**	Outstanding information technology expense payable, charges on current and savings accounts processing
Interest income	**2,494**	–	Income on deposits and interbank loans receivables
Rental income	**18,384**	–	Income from leasing agreements with various lease terms ranging from 2 to 5 years
Miscellaneous income	**7,502**	–	Income received from ATM service fees, rental and utilities
Information technology expense	**95,662**	–	Payment of information technology expenses
Trading and security loss	**(3,898)**	–	Loss from securities transactions
Interest expense	**256**	–	Interest expense on bills payable

(Forward)

Category	Amount/ Volume	Outstanding Balance	Nature, Terms and Conditions
			December 31, 2017
Securities transactions			
Outright purchases	**₱8,493,345**	–	Outright purchase of FVPL, AFS and HTM investments
Outright sales	**4,920,695**	–	Outright sale of FVPL and AFS investments
Joint Venture			
Investment in a joint venture	–	**₱607,163**	Capital investment in SMFC after sale of 10% ownership to GT Capital Inc.
Accounts receivable	**1,466**	**1,980**	Outstanding rental and utility receivables, non-interest bearing
Deposit liabilities	**934**	**13,321**	Demand and short term peso time-deposits with annual fixed rates of 1.25%
Miscelleneous liabilities	**(2,975)**	–	Payment of security deposits
Rental income	**11,619**	–	Income from leasing agreements
Share in net income of a joint venture	**71,837**	–	40.00% (January to July) and 30% (August to December) share in net income of SMFC
Interest expense	**75**	–	Interest on deposit liabilities
Other Related Parties			
Interbank loans receivable	–	**500,000**	Peso-denominated lending which earn 2.50% fixed daily interest rate with maturity terms from 1 to 5 days.
Placements	**59,900,000**	–	
Maturities	**59,400,000**	–	
Receivable from customers		**10,241**	Loans granted bear interest ranging from 6.00% to 10.50% with maturities ranging from 1 to 5 years; Secured - ₱10,241
Placements	**3,723**	–	
Maturities	**2,817**		
Miscellaneous assets	–	**1,390**	Three months advance security deposits
Accounts receivable	**16**	**2,470**	Outstanding ATM service fees, rental and utility receivables, non interest bearing
Prepaid expense		**4,125**	Payment for various policy renewals
Deposit liabilities	**5,073,694**	**1,612,687**	Demand, savings and short term peso and foreign currency time deposits with fixed rates ranging from 0.00% to 2.00%
Bills payable			Peso-denominated borrowing with fixed interest rate of 2.50% and maturities ranging from 1 to 4 days
Deposits/placements	**4,750,000**	–	
Withdrawals/maturities	**4,750,000**	–	
Accounts payable	–	**2,617**	Various personal and car insurance payable
Miscellaneous liabilities	–	**3,169**	Advance payment of security deposits from various tenants
Interest income	**3,445**	–	Income on receivables from customers and interbank loans receivables
Trading and securities loss	**2,836**	–	Loss from securities transactions
Rental income	**13,690**	–	Income from leasing agreements with various lease terms
Bank commission	**1,396**	–	Commission income on ATM service fees
Miscellaneous income	**13,107**	–	Service income from referral fees on approved credit card issuances and bank insurance with rates ranging from 2.00% to 10.00%
Insurance expense	**79,790**	–	Payment of insurance premium
Interest expense	**35,350**	–	Interest on deposit liabilities and bills payable
Rent expense	**1,025**	–	Payment of rent expense to various lessors
Securities transactions			
Outright purchases	**2,065,340**	–	Outright purchase of FVPL and AFS investments
Outright sales	**1,000,000**	–	Outright sale of FVPL and AFS investments
Key Personnel			
Receivables from customers	–	**₱13,069**	Unsecured, no impairment, with annual fixed interest rates of 6.00% and maturities ranging from 2 to 10 years
Placements	**₱2,815**	–	
Maturities	**3,554**	–	
Interest income	**973**	–	Interest income from loans

			December 31, 2016
Category	Amount/ Volume	Outstanding Balance	Nature, Terms and Conditions
Significant Investor			
Interbank loans receivable			Peso-denominated lending with 2.50% fixed interest rates and maturities ranging from 1 to 3 days
Placements	₱26,450,000	₱–	
Maturities	26,450,000	–	
Due from other banks	418,071	1,452,777	Short-term peso and foreign currency-denominated deposits with fixed rates ranging from 0.00% to 5.00% secured by government securities amounting to ₱788,154
Accounts receivable	216	6,849	Outstanding ATM service fees, rental and utility receivables, non interest bearing; no impairment
Miscellaneous assets	–	781	Security deposits on lease contracts
Bills payable		–	Peso-denominated borrowing with fixed interest rate of 2.50% and maturities ranging from 1 to 4 days
Deposits/placements	14,526,000		
Withdrawals/maturities	14,526,000		
Miscellaneous liabilities	–	6,242	Advance payments of security deposits
Accrued other expense payable	–	57,590	Outstanding information technology expense payable, charges on current and savings accounts processing
Interest income	4,077	–	Income on deposits and interbank loans receivables
Rental income	24,775	–	Income from leasing agreements with various lease terms ranging from 2 to 5 years
Miscellaneous income	6,022	–	Income received from ATM service fees, rental and utilities
Information technology expense	263,263	–	Payment of information technology expenses
Trading and security loss	6,937	–	Loss from securities transactions
Interest expense	2,144	–	Interest expense on bills payable
Securities transactions		–	
Outright purchases	6,374,152		Outright purchase of FVPL, AFS and HTM investments
Outright sales	2,611,040		Outright sale of FVPL and AFS investments
Joint Venture			
Investment in a joint venture		727,176	Capital investment in SMFC
Accounts receivable	(38)	514	Outstanding rental and utility receivables, non-interest bearing
Deposit liabilities	7,318	12,387	Demand and short term peso time-deposits with annual fixed rates of 1.25%
Miscellaneous liabilities	–	2,975	Advance payment of security deposits
Rental income	11,460	–	Income from leasing agreements
Share in net income of a joint venture	35,467	–	40.00% share in net income of SMFC
Interest expense	47	–	Interest on deposit liabilities
Other Related Parties			
Interbank loans receivable		–	Peso-denominated lending which earn 2.50% fixed daily interest rate with maturity terms from 1 to 5 days.
Placements	11,800,000		
Maturities	11,800,000		
Receivable from customers		12,252	Loans granted bear interest ranging from 7.00% to 19.14% with maturities ranging from 1 to 2 years; Secured - ₱12,252
Placements	14,715		
Maturities	383,987		
Miscellaneous assets		1,390	Three months advance security deposits
Accounts receivable	621	2,454	Outstanding ATM service fees, rental and utility receivables, non interest bearing
Prepaid expense		8,600	Payment for various policy renewals
Deposit liabilities	2,494,936	6,686,381	Demand, savings and short term peso and foreign currency time deposits with fixed rates ranging from 0.00% to 2.00%
Bills payable		900,000	Peso-denominated borrowing with fixed interest rate of 2.50% and maturities ranging from 1 to 4 days
Deposits/placements	10,630,000		
Withdrawals/maturities	9,730,000		
Accrued other expense payable		3,231	Outstanding group life insurance payable
Accounts payable		174	Various personal and car insurance payable
Miscellaneous liabilities		3,169	Advance payment of security deposits from various tenants
Interest income	1,251	–	Income on receivables from customers and interbank loans receivables
Trading and securities gain	2,590	–	Gain from securities transactions
Rental income	12,967	–	Income from leasing agreements with various lease terms
Bank commission	4,629	–	Commission income on ATM service fees
Miscellaneous income	1,020	–	Service income from referral fees on approved credit card issuances and bank insurance with rates ranging from 2.00% to 10.00%

(Forward)

December 31, 2016			
Category	Amount/ Volume	Outstanding Balance	Nature, Terms and Conditions
Insurance expense	₱53,946	₱–	Payment of insurance premium
Interest expense	179,408	–	Interest on deposit liabilities and bills payable
Rent expense	3,410	–	Payment of rent expense to various lessors
Securities transactions		–	
Outright purchases	650,000		Outright purchase of FVPL and AFS investments
Outright sales	650,000		Outright sale of FVPL and AFS investments
Key Personnel			
Receivables from customers		₱13,808	Unsecured, no impairment, with annual fixed interest rates of 6.00% and maturities ranging from 2 to 10 years
Placements	₱2,528		
Maturities	559		
Interest income	814		Interest income from loans

Regulatory Reporting

As required under existing BSP rules and regulations, the Bank discloses loans and other credit accommodations granted to its Directors, Officers, Stockholders and Related Interests (DOSRI). These loans and other credit accommodations were made substantially on the same terms as with other individuals and businesses of comparable risks and were subject of prior Board approval and entailing BSP reportorial requirements.

Existing banking regulations also limit the total amount of credit exposure to each of the Bank's DOSRIs, at least 70.00% of which must be secured, to the total of their respective deposits and book value of their respective unencumbered deposits and, if any, book value of their respective paid-in capital contribution in the Bank. In the aggregate, the Bank's total credit exposure to all its DOSRIs should not exceed its net worth or 15.00% of its total loan portfolio, whichever is lower, with any unsecured portion thereof not exceeding the lower between 30.00% of the aggregate limit or of the total actual exposure. However, loans and other credit accommodations to DOSRIs that are secured by assets considered by the BSP as non-risk are exempt from these ceilings. As of December 31, 2017 and 2016, the Bank's credit exposures to DOSRI are within the said regulatory limits.

BSP Circular No. 423 dated March 15, 2004, as amended by BSP Circular No. 914 dated June 23, 2016, provide the rules and regulations governing credit exposures to DOSRI. The following table shows information relating to the loans, other credit accommodations and guarantees classified as DOSRI accounts under regulations existing prior to BSP Circular No. 423 and new DOSRI loans and other credit accommodations granted under said circular as of December 31, 2017 and 2016:

	2017	2016
Total outstanding DOSRI accounts	**₱1,201,916,069**	₱1,734,454,266
Percent of DOSRI accounts granted under regulations existing prior to BSP Circular No. 423 to total loans	**0.82%**	1.34%
Percent of new DOSRI accounts granted under BSP Circular No. 423 to total loans	**–**	–
Percent of unsecured DOSRI accounts to total DOSRI accounts	**19.94%**	12.63%
Percent of past due DOSRI accounts to total DOSRI accounts	**0.00%**	0.00%
Percent of nonperforming DOSRI accounts to total DOSRI accounts	**0.00%**	0.00%

Total interest income from DOSRI loans amounted to ₱5.8 million, ₱26.6 million, ₱44.7 million in 2017, 2016 and 2015, respectively.

30. Trust Operations

Securities and other resources held by the Bank in fiduciary or agency capacity for its customers are not included in the accompanying statements of condition since these are not assets of the Bank.

As of December 31, 2017 and 2016, the Bank deposited government securities with carrying value of ₱64.5 million and ₱49.7 million in compliance with trust regulations, respectively (Note 8).

In 2017, the Bank transferred from surplus to surplus reserve the amount of ₱0.1 million, which corresponds to 10.00% of the net income realized from the Bank's Trust Department in compliance with existing banking regulations.

During 2016, the Bank did not appropriate any surplus reserve resulting from the operations of the Bank's Trust Department since it is still in a net loss position. No part of such surplus reserve shall at any time be paid out in dividends, but losses accruing in the course of its trust business may be charged against surplus.

31. Commitments and Contingent Liabilities

In the normal course of the Bank's operations, there are various outstanding commitments and contingent liabilities such as guarantees and commitments to extend credit, which are not reflected in the accompanying financial statements. The Bank, however, does not anticipate significant 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:

	2017	2016
Trust department accounts (Note 30)	**₱5,596,171,367**	₱3,991,172,047
Swap forward exchange - sold	**2,653,256,032**	3,185,627,487
Stand-by credit lines	**81,664,196**	83,660,385
Late deposits/payments received	**5,625,757**	62,929,377
Items held for safekeeping	**1,298,438**	695,408
Spot foreign exchange contracts - sold	–	49,720,000
Others	**519,297**	472,843

Also, several suits and claims, in behalf or against the Bank in relation to its banking operations and labor-related cases are pending before the courts and quasi-judicial bodies. The Bank and its legal counsel believe that any losses arising from suits and claims which are not specifically provided for will not have a material adverse effect on the financial statements.

32. Notes to Statements of Cash flows

The following is a summary of principal non-cash activities that relate to the analysis of the statements of cash flows:

	2017	2016	2015
Additions to chattel mortgage in settlement of loans (Note 14)	**₱2,577,163,081**	₱1,925,310,853	₱1,598,334,363
Additions to investment properties in settlement of loans (Note 12)	**868,280,425**	1,125,389,300	923,843,570
Change in net unrealized gain/ loss on AFS investments (Note 8)	**381,641,780**	(386,460,000)	9,922,633
Cumulative translation adjustment	**(5,292,411)**	(42,860,727)	1,401,659

The table below provides for the changes in liabilities arising from financing activities (in millions):

	Subordinated Notes	**Bills Payable**	**Total Liabilities from Financing Activities**
January 1, 2017	**₱5,976**	**₱6,094**	**₱12,070**
Cash flows from settlement	**(3,000)**	**(4,602)**	**(7,602)**
Foreign exchange movement	**–**	**–**	**–**
Others	**3**	**–**	**3**
December 31, 2017	**₱2,979**	**₱1,492**	**₱4,471**

Others include amortization of subordinated notes and declaration of dividends.

33. Offsetting of Financial Assets and Liabilities

PFRS 7 requires 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 tables.

Financial assets

December 31, 2017						
				Effect of remaining rights of set-off (including rights to set-off financial collateral) that do not meet PAS 32 offsetting criteria		
Financial assets recognized at the end of reporting period by type	**Gross carrying amounts (before offsetting) [a]**	**Gross amounts offset in accordance with the offsetting criteria [b]**	**Net amount presented in statement of condition [a-b] [c]**	**Financial instruments [d]**	**Fair value of financial collateral [d]**	**Net exposure [c-d] [e]**
Derivative Assets (Note 8)	**₱2,723,211,637**	**₱2,650,052,076**	**₱73,159,561**	**₱–**	**₱–**	**₱73,159,561**
Securities Purchased Under Resale Agreements (SPURA) (Note 7)	**578,250,730**	**–**	**578,250,730**	**–**	**577,931,536**	**319,194**

Financial assets recognized at the end of reporting period by type	Gross carrying amounts (before offsetting) [a]	Gross amounts offset in accordance with the offsetting criteria [b]	Net amount presented in statement of condition [a-b] [c]	Effect of remaining rights of set-off (including rights to set-off financial collateral) that do not meet PAS 32 offsetting criteria [d]: Financial instruments	Fair value of financial collateral	Net exposure [c-d] [e]
			December 31, 2016			
Derivative Assets (Note 8)	₱499,211	₱–	₱499,211	₱65,316,678	₱–	₱–
Securities Purchased Under Resale Agreements (SPURA) (Note 7)	3,254,311,599	–	3,254,311,599	–	4,686,900,717	–

Financial liabilities

Financial liabilities recognized at end of reporting period by type	**Gross carrying amounts (before offsetting) [a]**	**Gross amounts offset in accordance with the offsetting criteria [b]**	**Net amount presented in statement of condition [a-b] [c]**	**Effect of remaining rights of set-off (including rights to set-off financial collateral) that do not meet PAS 32 offsetting criteria [d]: Financial instruments**	**Fair value of financial collateral**	**Net exposure [c-d] [e]**
			December 31, 2017			
Securities Sold Under Repurchase Agreements* (SSURA) (Note 17)	**₱1,492,418,518**	**₱–**	**₱1,492,418,518**	**₱–**	**₱1,205,795,357**	**₱286,623,160**

* *Included in 'Bills Payable' in the Statement of Condition*

Financial liabilities recognized at end of reporting period by type	Gross carrying amounts (before offsetting) [a]	Gross amounts offset in accordance with the offsetting criteria [b]	Net amount presented in statement of condition [a-b] [c]	Effect of remaining rights of set-off (including rights to set-off financial collateral) that do not meet PAS 32 offsetting criteria [d]: Financial instruments	Fair value of financial collateral	Net exposure [c-d] [e]
			December 31, 2016			
Derivative Liabilities	₱65,316,678	₱–	₱65,316,678	₱499,211	₱–	₱64,817,467
Securities Sold Under Repurchase Agreements* (SSURA) (Note 17)	3,856,396,533	–	3,856,396,533	–	4,686,900,717	–

34. **Subsequent Events**

Cash Dividend Declaration

On January 18, 2018, the BOD of the Bank declared a 7.50% regular cash dividend for the fourth quarter of 2017 amounting to ₱180.19 million or ₱0.75 per share (Note 21).

35. Approval for the Release of the Financial Statements

The accompanying comparative financial statements were reviewed by the Audit Committee on January 25, 2018 and approved by the BOD in its meeting on February 22, 2018.

36. Report on the Supplementary Information Required Under Revenue Regulations (RR) No. 15-2010

On November 25, 2010, the BIR issued RR No. 15-2010 to amend certain provisions of RR No. 21-2002. The regulations provide that starting 2010, the notes to financial statements shall include information on taxes, duties and license fees paid or accrued during the taxable year.

The Bank reported and/or paid the following types of taxes for the year:

Taxes and Licenses
For the taxable year ended December 31, 2017, taxes and licenses of the Bank consist of:

Gross receipts tax	₱655,407,895
Documentary stamps tax	534,245,710
Local taxes	72,187,567
Fringe benefit tax	7,044,313
Others	22,494
	₱1,268,907,979

Withholding Taxes
Details of total remittances of withholding taxes in 2017 are as follows:

Withholding taxes on compensation and benefits	₱554,116,959
Final withholding taxes	489,445,015
Expanded withholding taxes	99,945,753
	₱1,143,507,727

The Bank has no ongoing tax assessment as of December 31, 2017.

Corporate Information

Philippine Savings Bank
PSBank Center
777 Paseo de Roxas corner Sedeño Street
Makati City 1226 Philippines
Tel: (+632) 845-8888
Website: www.psbank.com.ph

Annual Shareholders' Meeting
Monday, 23 April 2018, 3:00 p.m.
PSBank Hall, 19th Floor PSBank Center
777 Paseo de Roxas corner Sedeño Street
Makati City 1226 Philippines

Stock Listing
Philippine Savings Bank (PSBank) common shares are listed and traded at the Philippine Stock Exchange under the ticker symbol "PSB."

Shareholders
The number of common shareholders of record as of 02 March 2018 was 1,475.

Major Shareholder
Metropolitan Bank & Trust Company
Percentage of Stockholdings: 82.675%
Nationality: Filipino

Market Information
Following are the high and low closing prices of the PSB shares as reported in the PSE for each quarter of the years ending in 2016 and 2017:

Years	Quarters	Highest	Lowest
2016	1st	104.00	95.00
	2nd	107.00	98.10
	3rd	106.00	95.75
	4th	101.00	90.00
2017	1st	91.00	87.00
	2nd	90.50	86.50
	3rd	92.00	87.65
	4th	90.00	87.00

Annual Report in SEC Form 17-A
The financial report included in this report follows the information contained in the Bank's SEC Form 17-A as required by and submitted to the Securities and Exchange Commission. Copies of this report may be obtained free of charge upon written request to the Office of the Finance Group Head.

Shareholder Assistance and Services

Investor Relations
Corporate Affairs Division
9th Floor PSBank Center
777 Paseo de Roxas corner Sedeño Street
Makati City 1226 Philippines
Tel: (+632) 845-8888
Fax: (+632) 885-8352
Email: *investor@psbank.com.ph*

Media
PR & Corporate Communications Division
8th Floor PSBank Center
777 Paseo de Roxas corner Sedeño Street
Makati City 1226 Philippines
Tel: (+632) 845-8888
Fax: (+632) 845-0025

For inquiries or concerns:
Customer Experience Group
6th Floor PSBank Center
777 Paseo de Roxas corner Sedeño Street
Makati City 1226 Philippines
Tel: (+632) 845-8888
Fax: (+632) 845-0048
SMS: (+63) 998-8458888
Email: *customerexperience@psbank.com.ph*
Chat: *www.psbank.com.ph*

Stockholder Services
For inquiries regarding dividend payments, change of address or account status:
Metrobank Trust Banking - Stock Transfer Department
17th Floor GT Tower International
6813 Ayala Avenue corner H.V. Dela Costa Street
Makati City 1227 Philippines
Tel: (+632) 857-5695
Fax: (+632) 858-8010

CREDITS

Publisher

Philippine Savings Bank

Editor in Chief

Noel Tuazon

Editorial

Sheila Pesayco

Katt Pascual

Layout & Design

Jer Macasero

Photography

Albert Labrador

Revoli Cortez

Kai Huang

Project Managers

Jean Salvador

Kae Tamase

Agency

Writers Edge

PSBank Center, 777 Paseo de Roxas corner Sedeño Sts.
Makati City 1226 Philippines

www.psbank.com.ph

Customer Experience Hotline: (02) 845-8888

customerexperience@psbank.com.ph

PSBank LiveChat via *www.psbank.com.ph*

View the annual report online
by scanning this QR code.

PSBankOfficial