BDO Private Bank

Building legacies

2018 ANNUAL REPORT

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Corporate Profile

Our Mission

Our purpose is to help clients meet their financial objectives.

Our goal is to be the best in what we do as individuals and as a firm.

Our ideas should be innovative yet appropriate for our clients' needs.

Our executions shall be seamless.

Our service should be par excellence.

Our integrity will not be compromised.

We are BDO Private Bank.

Our Philosophy

We seek to preserve and enhance the value of our clients' assets by achieving returns that outpace predefined market benchmarks.

We encourage diversification among asset classes and individual securities to mitigate price/market volatility. With these, we seek to grow and protect our clients' wealth for the enjoyment of their successors and their heirs.

We customize investment strategies to address each client's unique circumstances, as well as specific preferences for income, liquidity, and risk.

Where appropriate, we pursue cross-border investment opportunities to enhance returns and provide additional diversification.

Our Commitment

Our commitment to provide the best financial service to our clients requires us to be prudent in our design for financial solutions. We undertake to render proper due diligence, objective valuation, and full disclosure of material information. Through this process, we apply global standards in creating active markets for instruments we sponsor and offer to our clients.

Our product offerings are based on an open product architecture model, where clients are offered the best available products regardless of provider, an approach geared towards delivering the highest possible returns to each of our client groups.

In all these, we anchor our commitment on a solid base, a sound balance sheet, and a strong team of professionals.

To Clients

- Deliver high-value products and quality service
- Offer innovative solutions to specific needs
- Provide timely advice and investment/market information

To Shareholders

- Maximize return on investment
- Manage our business with the highest professional, ethical, and moral standards
- Pursue opportunities that improve shareholder value

To Associates

- Create a responsive environment that promotes teamwork
- Recognize individual worth and contribution
- Maintain and enhance the intellectual capital of our associates through rigorous and relevant training and education

Message from the Chairperson

Our drive to create long-term shareholder value is directly related to the value that we create for Filipino clients.

Dear Shareholders,

In 2018, the global financial markets experienced immense volatility as higher US interest rates, aggressive US trade renegotiations, and other geopolitical instability took their toll, causing various asset classes to perform negatively. We at BDO Private Bank still managed to maintain growth in 2018, reflecting continued solid execution of our mission to become the preferred full-service bank and financial services company in every market that we serve.

Our drive to create long-term shareholder value is directly related to the value that we create for Filipino clients. Differentiated service is central to our market leading position in Philippine private banking. With our “We Find Ways” culture and an emphasis on continual training, our private bankers are uniquely equipped with both the accountability and the skill sets to provide unmatched service tailored specifically to each client.

In alignment with the bespoke approach that our private bank truly embodies, we are carefully selecting an expanding, diverse array of services and products to balance the levels of diversification and risk appropriate for each client’s individualized investment goals and time horizons. BDO Private Bank’s relationship managers and wealth advisors integrate personalized, modern financial strategies with globally-sourced products and solutions to help our clients achieve their goals.

My fellow directors and I believe strongly in effective corporate governance and sustainable development programs because we recognize that the client-centric reputation that fuels our growth is a direct result of the culture fostered at the Board level. On behalf of the Board, I would like to thank our management team and each of our dedicated associates for their commitment to BDO Private Bank’s ideals and devotion to our clients. Together, we are building a legacy.

Yours truly,

Teresita T. Sy
Chairperson

Message from the President

Our industry-leading position is the result of a relentless drive to progressively add value to client relationships by structuring diverse portfolios bespoke to each client's unique circumstances.

Dear Clients and Shareholders,

BDO Private Bank is committed to adding more value to our client relationships by thoughtfully building our product and service offerings to achieve the unique objectives of each client. We take immense pride in the market leadership that our bespoke approach to private banking has created. To maintain our position at the very forefront of Philippine banking and to enhance future growth, we are prioritizing three initiatives as part of a multi-year strategy, and in 2018, we made excellent progress.

First, we are emphasizing trusteed accounts, which foster long-term relationships and provide a stable source of revenue to offset fluctuating trading profits. In 2018, trusteed accounts grew 37% to P63 billion, exceptional performance on top of growth of 47% in 2017. Dollar-based investment grew 16.5% to P123 billion.

Secondly, as the first Philippine banking institution to implement the open architecture approach, we uniquely offer a broad array of products and services to our clients in both domestic and offshore markets. We are focused on increasingly leveraging that open architecture to offer an industry-leading range of investment alternatives and expand client access to foreign asset managers and alternative investments. In 2018, we successfully added ten world-class fund families to our offering, including PIMCO, Fidelity, Goldman Sachs, BlackRock, and Invesco. We also extended our alternative investment offerings with unique precious metal solutions offered by J. Rotbart & Co. as well as US Consumer-Lending based investments firm FinEX Asia.

Finally, we are extending our family office function to engage with clients in more meaningful ways, provide specialized expertise, and responsive service. In 2018, our family office services began to offer an agency-like platform, enabling clients to diversify their portfolios with offshore opportunities and alternative investments.

These strategic directions supported our 2018 performance. However, overall profits were down due to the higher Philippine peso interest rates as a result of higher inflation and currency weakness. Going forward, we expect to be less dependent on higher Philippine peso funding costs. With respect to assets under management (AUM), we saw modest AUM growth in 2018, an increase of 5% to P315 billion, representing the new benchmark. Shareholder's equity was at P5.136 billion and net income was P301 million.

To further improve our service, we intend to leverage the digitalization of banking not only to increase the levels of client service that we can offer, but more importantly, to enable our team to spend more one-on-one time with clients. In 2018, we invested in infrastructure and operational software that will roll out gradually to streamline the accessibility of information, product offerings, and advanced accounting for our relationship managers and wealth advisors.

Our industry-leading position is the result of a relentless drive to progressively add value to client relationships by structuring diverse portfolios bespoke to each client's unique circumstances. As we seek to continually set the standards for the Philippines and sustain strong future growth, we remain committed to our values and founding principles of trust, integrity, privacy, expertise, and transparency.

We are grateful for your continued support.

Sincerely,

Albert S. Yeo
President

Summary Financial Review

(Amounts in Philippine Pesos)

	2018	2017
Profitability		
Total Net Interest Income	888,019,539	1,180,065,958
Total Non-interest Income	1,004,733,392	860,352,007
Total Non-interest Expenses	1,392,577,419	1,401,577,671
Pre-provision profit	501,733,675	637,012,919
Allowance (Reversal) for credit losses	(1,558,163)	1,827,375
Net Income	301,294,310	413,852,880
Selected Balance Sheet Data		
Liquid Assets	42,166,533,830	51,662,299,504
Gross Loans and Other Receivables	4,720,734,446	11,765,399,515
Total Assets	48,849,195,197	64,495,845,543
Deposits	40,513,687,343	56,811,889,972
Total Equity	5,136,365,729	5,348,616,350
Selected Ratios		
Return on average equity	5.8%	7.8%
Return on average resources	0.5%	0.7%
CET 1 capital ratio	18.36%	19.25%
Tier 1 capital ratio	18.36%	19.25%
Capital Adequacy Ratio	18.52%	19.51%
Per common share data		
Net Income per share:		
Basic	139.17	361.71
Diluted	139.17	361.71
Book Value	2,372	2,470
Others		
Cash Dividends declared	330,000,000	500,000,000
Headcount		
Officers	195	186
Staff	6	7

Our Story

A Distinct Approach to Private Banking

How BDO Private Bank endeavors to make your wealth work for you.

At BDO Private Bank, our vision for value creation is simple: We empower Filipinos to achieve their goals by preserving and enhancing our clients' wealth. Our principal task is to innately understand our clients and their family's needs and future life plans, then guide them in making the optimal decisions to achieve those goals. It takes commitment and resources to meet the sophisticated needs of our clients, and we remain steadfast in our commitment to a time-tested, bespoke approach to financial advice and wealth management.

As the only stand-alone private bank in the Philippines that is not comingled with its main bank, BDO Private Bank maintains a highly differentiated approach to banking. We offer an open architecture platform, with a broad array of products and services in both domestic and offshore markets. Our team of Relationship Managers and Wealth Advisors is exceptionally well-trained, thus uniquely equipped to tailor investment accounts that most effectively address client risk profiles and investment horizons. While BDO Private Bank is certainly comparable with offshore banks in terms of products and services, we take pride in our superior understanding of client needs and our ability to adapt should those needs evolve.

Our Bespoke Approach

At BDO Private Bank, our wealth management advisory philosophy is fervently grounded in the power of personal communication. Our client-centric culture values face-to-face communication more than any other bank. A client's first meeting with one of our Relationship Managers is not about filling out forms. Rather, it is entirely about getting to know the client. Consequentially, we invest considerable resources to sustain what has become a distinct competitive advantage.

We recognize that each client's wealth is unique so our client interactions seek to fully appreciate the subtlety and complexity of our clients' lives and careers. A person's assets and finances are in many ways an expression of themselves, and thus deserve to reach their full potential. Our bankers bring this potential to life by striving to understand clients' unique objectives, immediate and long-term financial needs, and the legacy that they aspire to leave. We go well beyond simple financial planning to provide comprehensive strategies that will help our clients achieve their personal goals and best prepare for the future.

BDO Private Bank maintains a highly differentiated approach to banking. We offer an open architecture platform, with a broad array of products and services in both domestic and offshore markets.

To devote more time for face-to-face client interaction, we are embracing technology, continually upgrading the functionality of our systems. At the fingertips of our Relationship Managers and Wealth Advisors is a wealth of information about BDO Private Bank's product offerings, customer needs, and customer accounting, which increasingly enable our bankers to focus unequivocally on the personal client service that BDO Private Bank is recognized for.

We now have eight well-appointed customer lounges in the Philippines, designed to be warm and welcoming venues for our clients to meet face-to-face with their Relationship Manager or Wealth Advisor. There, meaningful client relationships are formed as wealth enhancement and preservation opportunities are explored.

To devote more time for face-to-face client interaction, we are embracing technology, continually upgrading the functionality of our systems.

Customized Wealth Management Plan

Once we have gotten to know a client, we will work together to create a life plan that prioritizes the client's financial and estate planning goals. The result is a tailored solution that reflects each client's unique tax, financial, and personal circumstances.

Financial Planning. Drawing on BDO Private Bank's resources and expertise, we will create an investment plan that is purpose-built to pursue and achieve future success as each client defines it. We aid clients in selecting an investment approach that befits their risk profile, crafting a customized menu of products and services.

Strategic Investment Advisory. Throughout the investment process, clients may choose to delegate the decision-making to us or to leverage our wealth of advisory services. We offer various approaches, including convenient managed accounts, which enable clients to maximize time dedicated to their work or passions; advisory accounts, which more actively involve clients that seek more responsibility in the process; and execution accounts, which fully support clients who prefer independent decision-making.

Investment Management. As a partner in managing the medium and long-term investments customized to achieve our clients' financial goals, our bankers value our clients' best interests above all else. Through intense and continuous training and insightful interactions with global asset managers, our Relationship Managers and Wealth Advisors are exceptionally well positioned to offer sound asset allocation, portfolio construction, and investment selection advice, continually identifying potential opportunities and risks around the globe. Balanced by your unique tolerance for risk, we are able to implement these insights across a diverse array of asset classes.

Wealth Protection and Distribution. We recognize that wealth management decisions have long-lasting implications. Our Wealth Advisors help clients choose from one or a combination of vehicles for wealth management and distribution, including trusts or foundations, corporate structures, and life insurance. To ensure that wealth plans are both compliant and sustainable, our advisors are also especially well-equipped to provide legal and regulatory expertise.

Diverse Investment Opportunities

To deliver the highest possible returns, we believe wholeheartedly in providing our clients with a highly diverse, continually upgraded suite of investment options. We work diligently to ensure our clients have access to not only the broadest assortment of products and services, but also the greatest opportunities.

Central to the pursuit of ideal investment opportunities is BDO Private Bank's open architecture platform. As the first financial institution to advocate an open architecture, our clients have unmatched access to an extensive and expanding selection of the best available equities, fixed income, currencies, commodities, precious metals, and alternative investments, regardless of provider.

Different generations have vastly different needs, risk tolerances, and expectations. Each has been influenced by different economic events that have shaped their financial attitudes and beliefs. With reasonable initial investment thresholds and competitively priced advisory fees, BDO Private Bank leads the industry in terms of providing diverse investment options and structures capable of meeting the unique needs of each generation.

Our clients want to leave purposeful legacies. We offer diverse financial and non-financial structures to manage wealth for the long term. Our Wealth Advisors can help clients strategically allocate assets to an operating company via the creation of a corporate structure. We also can serve as a trustee for our clients, via the host of trust services that we offer, including estate planning advisory for the creation of personal and management trusts, life insurance trusts, or employee benefit trusts.

Addressing Evolving Client Needs

At BDO Private Bank, we take immense pride in our ability to adapt skillfully not only to dynamic market environments, but also to evolving long-term client relationships and client wealth profiles. As an industry-leading, full-service asset manager across active and passive, multi-asset and alternative investments, we have a differentiated level of breadth and depth to serve all our clients' needs. Our Relationship Managers are passionate about serving clients, coordinating and communicating with departments across the BDO Group to efficiently and effectively execute their wealth planning and banking transactions.

For the bankers at the face of our organization, we consistently invest in education. We also utilize partnerships with global asset managers to upgrade our bankers' knowledge of and exposure to global products and services. Each is charged with understanding the relationship between global and local economies, the intricacies of stock markets, and the role that various investment instruments play in a balanced portfolio.

Over time, our clients' needs and financial priorities often change. As evolving personal and professional circumstances necessitate an adjustment in wealth management strategy, our team remains proactive and responsive. Through personal interaction with our customers, we work in partnership to adapt clients' wealth strategies to meet ever-changing needs and financial aspirations.

Our clients want to leave purposeful legacies. We offer diverse financial and non-financial structures to manage wealth for the long term.

Awards & Recognition

Best Private Wealth Management Bank in the Philippines

(2008–2018)
Alpha Southeast Asia
12th Financial Institution
Awards 2018

Best Private Bank — Philippines

(2015–2018)
Asian Private Banker
Awards for Distinction 2018

Best Private Bank in the Philippines

(2008–2018)
FinanceAsia 2018 Country Awards

Best Private Bank in the Philippines

(2015–2018)
Global Finance
Best Private Bank
Awards 2018

Best Private Bank in the Philippines

(2010–2018)
The Asset Triple A Private Banking, Wealth Management, Investment and ETF Awards 2018

Best Private Bank in the Philippines #1 Asset Management

(2015–2018)
Euromoney Private Banking Survey

Corporate Governance

Corporate governance in BDO Private Bank, similar to its Parent Bank, BDO Unibank, Inc. is about effective oversight, voluntary compliance and sustainable value creation to promote the best interest of its various stakeholders.

BDO Private Bank, Inc. (BDOPB) affirms its deep commitment to a high standard of corporate governance practice firmly anchored on the principles of accountability, fairness, integrity, transparency and performance consistently applied throughout the institution that support our corporate objective of delivering long-term value. BDOPB believes that incorporating ethical, social, economic and environmental considerations in its daily operations creates the best long-term value for its stakeholders. The Bank's good market reputation has been built on the solid foundation of an ethical corporate culture and responsible business conduct, underpinned by a well-structured and effective system of governance.

2018 was a year of positive change and continual improvement in BDOPB's corporate governance practice. It has incorporated the provisions of BSP Circular 969 on Enhanced Corporate Governance Guidelines for BSP-Supervised Financial Institutions and, where applicable, the recommendations of the SEC Code of Corporate Governance for Publicly-Listed Companies in its Corporate Governance Manual, which form part of its continuing commitment to comply with the latest rules and regulations. It has also continued to follow, the international best practices of corporate governance issued by globally recognized standards setting bodies such as the Organization for Economic Cooperation and Development (OECD) and the ASEAN Corporate Governance Scorecard which serve as essential points of reference.

This report describes the highlights of our corporate governance practices throughout the financial year ended December 31, 2018.

Governance Structure

Board of Directors

Functions

Responsibility for good governance resides with the Board. It is responsible for providing effective leadership and overall direction to foster the long-term success of the Bank. It oversees the business affairs of the Bank, reviews the strategic plans and performance targets, financial plans and budgets, key operational initiatives, capital expenditures, acquisitions and divestments, annual and interim financial statements, and corporate governance practices. It oversees management performance, enterprise risk management framework, internal control system, financial reporting and compliance, related party transactions, continuing director education, and succession plans for the Board and executive management. It considers sustainability issues related to the environment and social factors as part of its sustainable banking practices.

Composition

The Board is composed of 10 members and is aided by 3 advisors. The members of the Board are all professionals with expertise in banking, accounting and finance, merchandise marketing, strategy formulation, bank regulations and risk management. It is headed by a Non-Executive Chairperson with 4 Independent Directors, 4 Non-Executive Directors, and only one Executive Director who is the President. Independent Directors make up 40% of the members of the Board, which exceeds the requirement of the SEC and the BSP. Non-Executive Directors including Independent Directors now comprise 90% of board strength, which exceeds the requirement of the BSP that non-executive directors should comprise a majority of the Board. This provides independent and objective judgment on significant corporate matters and ensures that key issues and strategies are objectively reviewed, constructively challenged, thoroughly discussed and rigorously examined.

Each member of the Board owns one (1) qualifying share of the capital stock of the Bank. Collectively, the shares of stock held by the Board of Directors constitute 0% of the total shares of the Bank.

The Board is responsible for the selection of new directors through the Corporate Governance Committee. It leads the process of identifying and evaluating the nominees for

Board Snapshot

Director Diversity

3 Female

7 Male

Director Age

1 50-59

6 60-69

3 70+

Skills, Experience & Background

5 Banking & Finance

Business Executives

4 Private

1 Government

2018 Board Meetings

Director	Meetings Attended By Director	Total No. of Meetings	Percentage of Attendance
Teresita T. Sy	6	6	100%
Nestor V. Tan	6	6	100%
Albert S. Yeo	6	6	100%
Nicasio I. Alcantara	5	6	83.33%
Johnip G. Cua	6	6	100%
Gregory L. Domingo	6	6	100%
Violeta O. LuYm	6	6	100%
Pedro E.O. Roxas	4	6	66.67%
Elizabeth T. Sy	4	6	66.67%
Alfonso A. Uy	6	6	100%

directors. It evaluates the balance, skills, knowledge and experience of the existing Board and the requirements of the Bank. The result of the evaluation determines the role and key attributes that an incoming director should have. The Corporate Governance Committee receives recommendations of potential candidates and uses to the extent possible, external search firms or external databases in selecting the pool of candidates for the new members of the Board. The Corporate Governance Committee recommends the most suitable candidate to the Board for appointment or election as director.

For the reelection of incumbent directors, the Corporate Governance Committee also considers the results of the most recent self-assessments of the Board and peer evaluation, attendance record in meetings, participation in Board activities and overall contributions to the functioning of the Board.

In evaluating the suitability of an individual board member and promoting diversity in the composition of the Board, the Corporate Governance Committee takes into account the relevant qualifications of every candidate nominated for election such as, among others, physical/mental fitness, relevant educational and professional background, personal track record, experience/training, commitment to contribute, willingness to serve and interest to remain engaged and involved without regard to race, gender, ethnic origin, religion, age or sexual orientation.

The Board is also responsible for approving the selection and appointment of a competent executive management led by the President, including the heads of units who will exercise control functions i.e. Chief Compliance Officer, Chief Risk Officer and Chief Internal Auditor. Fit and proper standards are applied in the selection of key officers and utmost consideration is given to their integrity, technical expertise and banking industry experience.

Each year, the composition of the Board and board committees, including the skills and competencies of its members, is reviewed to ensure appropriate balance of skills and experience, and alignment with the new regulations. In 2018, the composition of the Risk Management, Trust, and Related Party Transactions Committees was revisited in order to align with the provisions of BSP Circular 969 on Enhanced Corporate Governance Guidelines for BSP-Supervised Financial Institutions, and with the Revised Corporate Governance Manual. Additionally, four out of seven Board committees, namely Risk Management, Audit, Corporate Governance and Related Party Transactions Committees, are chaired by Independent Directors.

Fit and proper standards are applied in the selection of key officers and utmost consideration is given to their integrity, technical expertise and banking industry experience.

Considering the changes made, the complexity and scope of the Bank's business, the Board believes that the current size and composition provides sufficient diversity among its directors that fosters critical discussion and promotes balanced decision-making by the Board. It views diversity at the Board level, which includes differences in skills, experience, gender, sexual orientation or preference, age, education, race, business and other related experience, as an essential element in maintaining an effective board for strong corporate governance.

During the year, the Board reviewed and approved the Bank's budget and business targets, declaration of dividends, and the hiring, resignation and promotions of senior officers. It approved the release of the 2017 audited financial statements within 60 days from year end. Its oversight functions include review of operational and financial performance of senior management and work of the various committees in accordance with their mandates.

Improving Board Effectiveness

Board Performance

A yearly self-assessment is conducted focusing on the performance of the Board Committee using an approved set of questionnaires. The performance evaluation process begins with sending out customized Board Evaluation Questionnaires to the directors and advisors. They are then required to complete the questionnaire and return the same to the Chief Compliance Officer within the specified submission date. A cover letter is attached to the questionnaire explaining the rationale and objectives of the performance evaluation. Based on the returns from each respondent, the ratings and responses are tabulated and consolidated. The Chief Compliance Officer prepares the overall report and presents this to the Corporate Governance Committee for discussion and endorsement to the Board, including the recommended actions and focus areas to improve effectiveness.

For 2018, the results of the self-assessment were presented to the Board including directors' recommendations to improve effectiveness in its governance functions. The overall assessment showed that the Board continues to operate on a very high standard of independence, committees function effectively and senior management has the relevant professional experience, necessary skills and ability to manage the Bank while the directors have rigorously maintained independence of views and the relationships between Board and committee members remain strong.

Director Continuing Education

The continuing education program for directors is an ongoing process geared towards the enhancement of their skills and knowledge, and encouraging best practice. Every year, all Directors and key officers are given updates and briefings on relevant policies and rules governing their respective roles, and are required to attend a corporate governance seminar on significant topics to ensure that they are continuously informed of the developments in the business and regulatory environments, including emerging opportunities and risks in the banking industry.

In 2018, all the members of our Board, including our senior officers, attended the requisite corporate governance seminars provided by its Parent Bank, BDO Unibank, Inc. and other SEC- and BSP-accredited institutions. The annual corporate governance seminar for directors and key officers conducted for the BDO Group centered on Financial Technology (FinTech) with the aim of updating the Board on the latest technological advances which are fast reshaping the global financial landscape.

Succession

Succession planning for the Board and senior management is an important part of the governance process. The Bank adopts the succession planning policy of its Parent Bank complete with the succession framework and leadership development plans for senior management and those directly reporting to the President, which are reviewed by BDO Unibank's Corporate Governance Committee and subsequently approved by its Board. As part of the periodic review, the succession framework is updated and training programs are conducted accordingly. The Bank has likewise adopted the policy on the Term Limit of Independent Directors of 9 consecutive years of service as a way to refresh the Board membership progressively and in an orderly manner.

Remuneration

The Bank also adopts the Remuneration policy of its Parent Bank which is geared towards attracting, retaining and motivating employees and members of the Board. The remuneration framework for senior management includes fixed pay, bonuses and the Employee Stock Option Plan as a long term incentive program. It is linked to corporate and individual performance, based on an annual appraisal of senior management officers.

For the Non-Executive Directors (NEDs), they receive per diems for attending board and committee meetings. There is no distinction on the fee for a committee chairman or member. In addition, the Bank grants director fees other than per diems in accordance with law to ensure that the remuneration is commensurate with the effort, time spent and responsibilities of NEDs.

Dividends

On the dividend policy, which is adopted from its Parent Bank's, BDOPB likewise recognizes the importance of providing a stable and sustainable dividend stream consistent with its commitment to its shareholder. The Bank has been paying a regular cash dividend and will endeavor to do so while maintaining financial flexibility. The procedures in paying dividends entail prior board approval of the record and payment dates as recommended by Management based on BSP and SEC rules on declaration of cash dividends, and amount to be paid to eligible common shareholders. Upon Board approval, necessary disclosures are made in compliance with regulatory requirements. The full dividend policy statement is published in the BDO corporate website.

Chairperson of the Board

The Chairperson is primarily responsible for leading the Board and ensuring its effectiveness. She provides independent leadership to the Board, fosters constructive relationship between Directors, promotes an open environment for critical discussions and constructive debate on key issues and strategic matters, and ensures that the Board of Directors exercises strong oversight over the Bank's business to performance of senior management. She takes a lead role in ensuring that the Board provides effective governance of the Bank and continues to operate at a very high standard of independence with the full support of the directors.

Board of Directors

Teresita T. Sy

Chairperson

Filipino
68 years old

Teresita T. Sy, the Chairperson of BDO Unibank, Inc., was elected to the Board of Directors of BDO Private Bank, Inc. on August 6, 2007. Concurrently, she serves as the Chairperson and/or Director of various subsidiaries and affiliates of BDO: BDO Leasing & Finance, Inc., BDO Capital & Investment Corporation, BDO Foundation, Inc., and BDO Life Assurance Company, Inc. Ms. Sy also serves as Advisor to the Board of One Network Bank, Inc. (A Rural Bank of BDO).

Ms. Sy is the Vice Chairperson of SM Investments Corporation and Advisor to the Board of SM Prime Holdings, Inc. She also sits as Chairperson of the Board of SM Retail, Inc. A graduate of Assumption College with a degree in Bachelor of Arts and Science in Commerce, major in Management, she brings to the board her diverse expertise in banking and finance, retail merchandising, mall and real estate development.

Nestor V. Tan

Vice Chairman

Filipino
60 years old

Nestor V. Tan, the President and CEO of BDO Unibank, Inc., was elected to the Board of Directors and named Vice Chairman of BDO Private Bank, Inc. on December 3, 2003. He concurrently holds the Chairmanship of the following BDO Unibank Subsidiaries: BDO Strategic Holdings, Inc. and One Network Bank, Inc. (A Rural Bank of BDO). He also concurrently holds vice chairmanships and/or directorships in the following subsidiaries of BDO Unibank, Inc.: BDO Leasing and Finance, Inc., BDO Capital and Investment Corporation, BDO Insurance Brokers, Inc., BDO Life Assurance Company, Inc., BDO Remit (USA), Inc., and SM Keppel Land, Inc. He is also a Trustee of BDO Foundation, Inc., Chairman of the De La Salle University Board of Trustees, and a Director of the Asian School of Business and Technology. He currently serves as President and Director of the Bankers Association of the Philippines and the BAP Credit Bureau. He is also the Chairman of the Philippine Dealing System Holdings Corporation, Bancnet and the RBB Microfinance Foundation Board of Trustees.

Prior to joining BDO, Mr. Tan was Chief Operating Officer of the Financial Institutions Services Group of BZW, the investment banking subsidiary of the Barclays Group. His banking career spans nearly four decades and includes posts at global financial institutions, among them Mellon Bank (now BNY Mellon) in Pittsburgh, PA; Bankers Trust Company (now Deutsche Bank) in New York, NY; and the Barclays Group in New York and London. He holds a bachelor's degree in Commerce from De La Salle University and an MBA from the Wharton School, University of Pennsylvania.

Albert S. Yeo

President and Director

Filipino
59 years old

Albert S. Yeo is the President and a Director of BDO Private Bank, Inc. He was elected to the Board on April 17, 2017. Prior to joining BDO, he was a senior financial advisor in Merrill Lynch & Co., USA. His 33-year career in finance and investments included other global institutions namely UBS Financial Service, Prudential Securities, Inc., IBJ Schroder Bank & Trust and with the Rizal Commercial Banking Corp. Mr. Yeo holds a Master of Business Administration from Wharton School, University of Pennsylvania and a Bachelor of Science degree in Management Engineering, magna cum laude, from the Ateneo de Manila University.

Nicasio I. Alcantara

Independent Director

Filipino
76 years old

Nicasio I. Alcantara was elected to the Board of Directors of BDO Private Bank, Inc. on September 14, 2009. He serves as Chairman of both the Corporate Governance Committee and Related Party Transactions Committee of the Bank, and is a member of the Board Audit Committee. Mr. Alcantara is also the Chairman of the Board of Conal Corporation, Chairman and President of Fial, Niacor and Punta Properties, Inc., and Vice Chairman of Aviana Development Corporation. He is currently a Director of Alsons Corporation, Alsons Development and Investment Corporation, Alsons/AWS Information System, Inc., Alsons Security Company, Inc., Conal Holdings Corporation, Aquasur Resources Corporation, Alsons Aquaculture Corporation, Alsons Land Corporation, Finfish Hatcheries, Inc., Indophil Resources NL, Site Group International Ltd., Sarangani Agricultural Co., Inc., Sarangani Energy Corporation, Seafront Resources Corporation, Seawood Holdings, Inc., Alsing Power Holdings, Inc., Southern Philippines Power Corporation, Alsons Power Holdings Corporation, Western Mindanao Power Corporation, San Ramon Power, Inc., Sarangani Energy Corporation, and recently, Enderun Colleges, Inc. Prior to this, Mr. Alcantara held the position of Chairman and CEO of Petron Corporation, Chairman/President of various corporations, namely Alsons Insurance Brokers Corp., Alsons Aquaculture Corp., Alsons Consolidated Resources, Inc., Davao Industrial Plantation, Inc., Iligan Cement Corporation, Alsons Cement Corporation, Northern Mindanao Power Corporation, Southern Philippines Power Corporation and Refractories Corporation of the Philippines, and Chairman of the Board of ACR Mining Corp. He was also the Chairman of Alsons Prime Investments Corporation until 2015, and served as Director of Bank One Savings, Bancasia Capital Corporation, and C. Alcantara & Sons, Inc. He also served as member of the Board of Trustees of WWF-Philippines from 2008-2013. Mr. Alcantara holds a Master's degree in Business Administration from Sta. Clara University, California, and a Bachelor of Science in Business Administration from the Ateneo de Manila University.

Johnip G. Cua

Independent Director

Johnip G. Cua was elected to the Board of Directors of BDO Private Bank, Inc. on March 10, 2008. Director Cua is Chairman of the Risk Management Committee and a member of the Trust Committee of the Bank. He was formerly the President of Procter & Gamble Philippines, Inc., and is presently the Chairman of the Board of Xavier School, Inc. and P&Gers Fund, Inc., and Chairman and President of Taibrews Corporation. He is a member of the Board of Trustees of Xavier School Educational & Trust Fund and of MGCC Foundation; a Director of Interbake Marketing Corporation, Teambake Marketing Corporation, Bakerson Corporation, and Lartizan Corporation. Additionally, Mr. Cua serves as Independent Director of Philippine Airlines, Inc., PAL Holdings, Inc., Century Pacific Food, Inc., LT Group, Inc., PhilPlans First, Inc., Eton Properties Philippines, Inc., ALI-Eton Property Development Corporation, MacroAsia Corporation, MacroAsia Catering Services, Inc., MacroAsia Airport Services Corporation, MacroAsia Properties Development, Corp., and Allied Botanical Corporation. Mr. Cua holds a Bachelor of Science degree in Chemical Engineering from the University of the Philippines, Diliman.

Filipino
62 years old

Gregory L. Domingo

Non-Executive Director

Filipino
64 years old

Gregory L. Domingo was elected to the Board of Directors of BDO Private Bank, Inc. on April 18, 2016, and he serves as Chairman of the Trust Committee and Advisor to the Risk Management Committee of the Bank. Previous to his election as Director, he was the Secretary of the Department of Trade and Industry from July 2010 to December 2015. His government service includes posts as Undersecretary of DTI–Industry and Investments Group (IIG), Managing Head of the Board of Investments, Vice Chairman of the National Development Council (NDC), and membership in the respective boards of the Philippine Economic Zone Authority (PEZA), the Philippine Export-Import Credit Agency (PHILEXIM), and the National Power Corporation (NAPOCOR). Mr. Domingo was formerly the Vice Chairman of Belle Corporation. Additionally, he served as Director of several private companies, among them SM Investments Corporation, BDO Private Bank, Inc. (from June 2006 to June 2010), Pampanga Sugar Development Company (PASUDECO), and Manila Electric Company (MERALCO). He also served as Managing Director of Chase Manhattan Bank/Chemical Bank (New York); President of Carmelray-JTCI Corporation; and Vice President of Seamen's Bank for Savings (New York). Mr. Domingo has worked for other financial institutions in New York and Pennsylvania, including First Boston, Drexel Burnham Lambert, and Mellon Bank/Girard Bank. Mr. Domingo holds a Bachelor of Science degree in Management Engineering from the Ateneo de Manila University, a master's degree in Business Administration from the Asian Institute of Management where he graduated with distinction, and a Masters in Science Operations Research from the Wharton School of the University of Pennsylvania.

Violeta O. LuYm

Non-Executive Director

Filipino
72 years old

Violeta O. LuYm was elected to the Board of Directors of BDO Private Bank, Inc. on March 10, 2008. Ms. LuYm is a member of the Audit Committee, Corporate Governance Committee, and Related Party Transactions Committee of the Bank. She is the Chairperson of the Board of Directors of BDO Securities Corporation, and the Director and Treasurer of BDO Capital & Investment Corporation. She also sits on the boards of directors of Tangiers Resources Corporation, Venture Vision Realty Development Corporation, and Philippine Equity Corporation, and is a Director and Treasurer of various mutual fund companies under the Philequity Group of Funds. Ms. LuYm is the Corporate Secretary of Homeworld Shopping Corporation. She functioned as a Director of Equitable Savings Bank Inc. from 2007 to 2008; BDO Financial Services from 1997 to 2007; Banco De Oro-EPCI, Inc. from 1998 to 2007; and Vantage Equities, Inc. in 2011. In the past, she has held senior officer positions in the following financial institutions: Security Bank & Trust Co., Bancom Development Corp., International Corporate Bank, Bancom Finance Corp., BDO Commercial Bank, and BDO Universal Bank. She graduated from Assumption College and received her MBA from UCLA.

Pedro Emilio O. Roxas

Independent Director

Filipino
62 years old

Pedro Emilio O. Roxas was elected to the Board of Directors of BDO Private Bank, Inc. on February 16, 2001. He is the Chairman of the Board Audit Committee, and also serves as member of the Corporate Governance Committee and Related Party Transactions Committee of BDO Private Bank, Inc. Additionally, he is the Chairman of Roxas Holdings, Inc., Roxas & Company, Inc., Roxaco Land Corporation, Club Punta Fuego, and Hawaiian-Phil. Co. and is a Director of Brightnote Assets Corporation. He is also an Independent Director of Philippine Long Distance Telephone Company (PLDT), MERALCO, Mapfre Insular Insurance Corporation and Cemex Holdings, Inc. Mr. Roxas holds a bachelor’s degree in Business Administration from the University of Notre Dame.

Elizabeth T. Sy

Non-Executive Director

Filipino
66 years old

Elizabeth T. Sy was elected to the Board of Directors of BDO Private Bank, Inc. on August 6, 2007. She is a member of the Executive Committee and the Trust Committee of BDO Private Bank, Inc. She is also the Chairperson and President of SM Hotels and Conventions Corporation where she steers SM's continuous growth in the tourism, leisure, and hospitality industry. She is also the Chairman of Nazareth School of National University. Ms. Sy likewise serves as Advisor to the Boards of SM Investments Corporation and SM Prime Holdings, Inc., and as Co-Chairperson of Pico De Loro Beach and Country Club. She holds a degree in Business Administration from Maryknoll College.

Alfonso A. Uy

Independent Director

Filipino
79 years old

Alfonso A. Uy was elected to the Board of Directors of BDO Private Bank, Inc. on August 6, 2007. He is a member of the Risk Management Committee and Trust Committee of BDO Private Bank, Inc. He is also the Lead Independent Director of the Bank. Director Uy is Chairman of various corporations, namely La Filipina Uygongco Corporation, Capiz Sugar Central, Inc., Philippine Foremost Milling Corp., Excel Farm Corporation, Amigo Agro-Industrial Development Corporation, and Mindanao Grain Processing Corporation. He is also the Chairman Emeritus of the Iloilo Economic Development Foundation, and President of Uygongco Foundation Inc. Additionally, he sits on the boards of directors of Steag State Power Inc. and Global Business Power Corporation. He was formerly the Vice Chairman of Panay Power Holding Corporation. Mr. Uy holds a Bachelor of Science degree in Chemical Engineering, magna cum laude, from the Central Philippine University.

Edmundo L. Tan

Corporate Secretary

Filipino
73 years old

Edmundo L. Tan was appointed as Corporate Secretary of BDO Private Bank, Inc. on February 13, 2012 and has been serving in that position up to the present. He also serves as Corporate Secretary of BDO Unibank, Inc. from July 27, 2007 up to the present. He was formerly a Director of BDO Leasing and Finance, Inc. and now serves as Advisor of the Board. Atty. Tan is a Director and the Corporate Secretary of APC Group, Inc. from 2000 until his resignation as Corporate Secretary on May 31, 2017. He serves as Director and Corporate Secretary of Philippine Global Communications, Inc. from 2000 until his resignation as Corporate Secretary in 2010, and Aragorn Power and Energy Corporation from 2005 until his resignation as Corporate Secretary in 2012. He is currently Director of PRC MAGMA Resources (2010 to the present). He is a Director of OCP Holdings, Inc. from July 2012 up to the present. He was elected as Director of Sagittarius Mines, Inc. in March 2016 up to the present. Atty. Tan was a charter member and elected as Trustee of the Philippine Dispute Resolution Center, Inc. on August 13, 2016 and became President in July 2017 to the present.

Atty. Tan is the Managing Partner of Tan Acut Lopez & Pison Law Offices (1993 up to present). He was formerly Senior Partner in Ponce Enrile Cayetano Reyes & Manalastas Law Offices, a Partner in Angara Abello Concepcion, Regala & Cruz Law Offices, and an Associate in Cruz Villarin Ongkiko Academia & Durian Law Offices. Atty. Tan holds a Bachelor of Arts degree from De La Salle College, Bacolod and Bachelor's degree in Law from the University of the Philippines.

Harley T. Sy

Advisor to the Board

Raissa Hechanova-Posadas

Advisor to the Board

Josefina N. Tan

Advisor to the Board

Board Committees

The Board is supported by seven (7) committees with their respective mandates and composition as follows:

Executive Committee

Functions:

The Executive Committee acts as the main approving body for Bank exposures and credit proposals involving DOSRI or related party accounts, subject to such limitations as may be imposed by the Board of Directors. The Board has also empowered the Executive Committee to act on its behalf to approve board items which may be referred to it by Management in between regular quarterly board meetings. These items include the approval of actions pertaining to Anti-Money Laundering, Compliance, Bank Signatories, approval of manuals, policies or procedures and other matters of an urgent nature arising between regular board meetings, where action or inaction may result in loss, injury, liability, damage or prejudice to the Bank.

Chairperson:

Teresita T. Sy

Members:

Elizabeth T. Sy
Nestor V. Tan
Albert S. Yeo

Meetings:

The Committee had 10 meetings in 2018.

Teresita T. Sy 10/10
Elizabeth T. Sy 10/10
Nestor V. Tan 10/10
Albert S. Yeo 10/10

Audit Committee

Functions:

The Board Audit Committee (BAC) is empowered to assist the Board of Directors in fulfilling its oversight function over the Bank's financial reporting process, system of internal control, overall management of risks and governance processes, Internal and External Audit functions and compliance with applicable rules and regulations, as set forth in its Terms of Reference.

Guided by its Board-approved Terms of Reference, the Board Audit Committee (BAC) discharged its oversight functions independently over the Bank's financial reporting process, system of internal control, overall management of risks and governance processes, Internal and External Audit functions and compliance with applicable rules and regulations. The BAC, composed of three board members (two of whom are independent directors) had five meetings in 2018.

Chairperson:

Pedro Emilio O. Roxas
(Independent Director)

Members:

Nicasio I. Alcantara
(Independent Director)
Violeta O. LuYm
(Non-Executive Director)

Meetings:

The Committee had five (5) meetings during the year with all the members in attendance.

Pedro Emilio O. Roxas 5/5
Nicasio I. Alcantara 5/5
Violeta O. LuYm 5/5

In 2018, the BAC accomplished the following:

1. On financial reporting process:

   - Extensively reviewed and discussed with Management and External Auditor the annual audited financial statements for the year ended December 31, 2018 before endorsing the same to the Board of Directors. The related internal controls on the financial reporting process, compliance with accounting standards and tax regulations, as well as the impact of new accounting standards and regulations more specifically the adoption of Philippine Financial Reporting Standards (PFRS) 9 were likewise reviewed.
   - Reviewed and discussed with Management the quarterly unaudited financial statements and results of operations prior to endorsement to the Board of Directors for approval.

2. On its oversight function over Internal Audit

   - Deliberated with Internal Audit and approved the risk-based audit plan covering the scope, audit methodology, risk assessment and rating processes, financial budget, manpower resources, as well as changes to the plan during the year.
   - In accordance with regulation, reviewed the revised Internal Audit Charter.
   - Periodically received audit reports and constantly deliberated high and moderate risk findings relating to operational, financial and compliance controls including risk management systems and information security.
   - Regularly tracked the timely resolution of findings and asked for Management's action plans on items that needed more time to be addressed.
   - The Committee, likewise continued to keep track of updates from Information Technology (IT) in further strengthening IT risk management.
   - Ensured Internal Audit's independence and free access to all records, properties and information to be able to fully carry out its functions.
   - Assessed the performance of the Chief Internal Auditor and key Audit Officers.

3. On its oversight function over External Audit

   - Ensured the independence, qualification and objectivity of the appointed BSP-accredited External Auditor.

- Reviewed and discussed with the External Auditor the content of the engagement letter, audit plan, scope of work, focus areas, engagement team among others, prior to commencement of audit work.
- Discussed comprehensively the external audit reports, focusing on internal controls, risk management, governance and matters with financial impact particularly on the changes in accounting and reporting standards.
- Reviewed the Management Letter as well as Management's response and action taken on the external auditor's findings and recommendations.

4. On its oversight over the Compliance function:

- Reviewed and approved the annual plans and compliance roadmaps.
- Endorsed for approval of the Board the revised manuals for the Compliance and Anti-Money Laundering (AML) Units incorporating new and amended regulations.
- Monitored the progress of the Independent Compliance and AML Testing.
- Ensured timely submission of regulatory requirements, compliance with mandatory ratios as well as continuous improvement of the Bank's Compliance and AML system.
- Discussed in detail the BSP Report of Examination (ROE) including the results of regulatory examinations of the Bank's business units and reviewed Management's reply to the findings, ensuring implementation of corrective actions.
- Assessed the performance of the Chief Compliance Officer.

Reports on cases in operations, whistleblower accounts as well as non-loan related cases with impact to financials, internal controls, information systems and reputation were deliberated focusing on risk assessment, legal handling, and fraud prevention.

In 2018, the members of the BAC attended a FinTech Corporate Governance Seminar, a Corporate Governance Enhancement Session on Sustainability Strategy in a Disruptive Business Environment and an Ethical Decision-Making Workshop conducted by the CFA Society of the Philippines.

As part of its commitment to excellent corporate governance, the Committee conducted a self-assessment for its 2018 performance based on its Terms of Reference. The BAC likewise evaluated the performance of Internal Audit, Compliance and Anti-Money Laundering Units and External Audit to ensure their effectiveness and achievement of objectives.

The Board Audit Committee reports its evaluation of the effectiveness of the internal controls, financial reporting process, risk management systems and governance processes of the Bank based on the report and unqualified opinion obtained from the External Auditor, the overall assurance provided by the Chief Internal Auditor and additional reports and information requested from Senior Management, and found that these are generally adequate across BDOPB.

Corporate Governance Committee

Functions:

- Primarily tasked to assist the Board in formulating the governance policies and overseeing the implementation of the governance practices across the Bank.
- Ensures compliance of the Bank with corporate governance principles and practices; monitoring corporate governance new regulations and recommending appropriate changes; reviewing and reporting to the Board on corporate governance regulatory or compliance issues; reviewing and recommending to the Board on best practices to be adopted as applicable; and, reviewing periodically the disclosure of corporate governance policies and information in the Bank's website.
- Annually conducts the performance evaluation of the Board of Directors, its committees, executive management, peer evaluation of directors, and conducts a self-evaluation of its performance. It provides an assessment of the outcome of the survey and reports to the Board the final results of the evaluation including recommendations for improvement and areas to focus on to enhance effectiveness.
- Oversees the continuing education program for directors and key officers and proposes relevant trainings for them.

Chairperson:

Nicasio I. Alcantara
(Independent Director)

Members:

Violeta O. LuYm
(Non-Executive Director)

Pedro Emilio O. Roxas
(Independent Director)

Meetings:

The Committee had five (5) meetings during the year with all the members in attendance.

Nicasio I. Alcantara 5/5
Violeta O. LuYm 5/5
Pedro Emilio O. Roxas 5/5

For 2018, the Committee reviewed the Corporate Governance Charter and amended its Corporate Governance Manual and Terms of Reference to align with the Parent Bank and to comply with the specific regulatory requirements of the BSP and SEC. It also recommended the reconstitution of certain Board committees to conform with the requirements of BSP Circular 969. The committee conducted the annual evaluation of the Board, committees, executive management and directors including the self-evaluation of its performance.

The continuing education of directors is a vital part of the governance initiatives. The members of the Corporate Governance Committee separately attended a FinTech Corporate Governance Seminar, a Corporate Governance Enhancement Session on Sustainability Strategy in a Disruptive Business Environment and an Ethical Decision-Making Workshop conducted by the CFA Society of the Philippines.

Trust Committee

Functions:

- Primarily responsible for overseeing the fiduciary activities of the Bank.
- Ensures that fiduciary activities are done in accordance with applicable laws, rules and regulations and prudent practices; effective risk management framework and internal controls in place and continue to be relevant, comprehensive and effective.
- Reviews and approves the opening and closing of trust, investment management and other fiduciary accounts of the Bank's Wealth Advisory and Trust Group as well as account related transactions including investment activities and investment outlets, new products and services offering, establishment and renewal of lines and limits with financial institutions and counterparties.
- Reviews trust and other fiduciary accounts and the overall performance and accountabilities under its management, the industry position of the business, the compliance and risk management of the group.
- Oversees and evaluates the performance of the Trust Officer.

Chairperson:

Gregory L. Domingo
(Non-Executive Director)

Members:

Johnip G. Cua
(Independent Director)

Juan Sabino P. Lizares
(Trust Officer)

Elizabeth T. Sy

Alfonso A. Uy
(Independent Director)

Albert S. Yeo
(President)

Meetings:

The Trust Committee met six (6) times in 2018.

Gregory L. Domingo 6/6
Johnip G. Cua 5/6
Juan Sabino P. Lizares 6/6
Elizabeth T. Sy 4/6
Alfonso A. Uy 4/6
Albert S. Yeo 6/6

Risk Management Committee

Functions:

- Responsible for the oversight of the Bank's Risk Management system to ensure its effectiveness.
- Develops the Bank's risk plan and policies, designs and implements the appropriate risk management strategies for identifying, quantifying, managing and controlling risk exposures including preventing and/or minimizing the impact of losses when they occur.
- Supports the Board in performing its risk oversight functions and reviews the overall risk management philosophy, risk appetite levels and tolerance limits, oversees the implementation and review of the risk management plan on an integrated enterprise-wide basis, system of limits of management of discretionary authority delegated by the Board and takes immediate corrective actions when breached and Management's activities in managing credit, liquidity, market, operational, legal and other risk exposures.
- Responsible for the continuing assessment of the relevance, comprehensiveness and effectiveness of the risk management plan, and revises it when needed including how the business and operating units are addressing and managing these risks.
- Reviews risk reports that control and monitor risk exposures and limits.

In 2018, the Committee conducted regular discussions of the Bank's exposures (including the Trust Unit) to credit risks (including country risks), market and liquidity risks, and operational risks, including risk mitigation strategies, where necessary and applicable; large exposures and concentration, asset quality, results of credit stress tests and its impact on capital adequacy; approved the liquidity gaps and results of liquidity stress tests; Value-at-Risk (VAR), Earnings-at-Risk (EAR), results of market risk stress tests and its impact on capital adequacy; operational risk profile of the Bank, significant operational losses and impact on capital adequacy, results of Business Continuity Plan (BCP) testing and any information security incidents; approved the results of the annual review of the Bank's risk management policies and limits; the newly developed or redeveloped risk management models and conducted a discussion on the performance of all implemented models; conducted a discussion on the results of the BSP-mandated stress tests (i.e. BSP Uniform Stress Test and Real Estate Stress Test) for banks; and the profile of client complaints/requests and a general description of the resolution/actions taken, in compliance with BSP Circular 857 on Consumer Protection.

Chairperson:

Johnip G. Cua
(Independent Director)

Members:

Alfonso A. Uy
(Independent Director)
Albert S. Yeo

Advisors:

Nestor V. Tan
Gregory L. Domingo

Meetings:

The Committee met 11 times in 2018.

Johnip G. Cua 10/11
Gregory L. Domingo 8/11
Nestor V. Tan 8/11
Alfonso A. Uy 8/11
Albert S. Yeo 11/11

Credit Committee

Functions:

- Acts as the main approving body for Bank exposures, loans and investments as well as other credit-related issues.
- Approves credit and investment proposals, except those involving DOSRI or related party accounts, and subject to such limitations that may be imposed by the Board of Directors.
- Approves, reviews and revises credit related policies, procedures, and other credit risk standards.

Chairperson:

Teresita T. Sy

Members:

Nestor V. Tan
Albert S. Yeo

Meetings:

The Committee had 85 meetings during the year.

Related Party Transactions Committee

Functions:

- Assists the Board in its oversight of the conduct of all Related Party Transactions (RPTs) to protect the interest of the Bank and its stakeholders.
- Ensures proper disclosure of all approved RPTs in accordance with applicable legal and regulatory requirements and confirmation by majority vote at the Annual Stockholders' meeting of the Bank's significant transactions with related parties.

During the year, the Committee reviewed and updated its Related Party Transactions Policy, which included the addition of a new provision to the procedure on reporting by servicing bank units to BDOPB Compliance of identified related parties and corresponding RP classification, in order to facilitate account tagging/inclusion in the RPT database. The revised policy encapsulates the entire process which spans from identification of related parties, processing, vetting and approval or confirmation by the Board of transactions, and its reporting to the BSP.

Chairperson:

Nicasio I. Alcantara
(Independent Director)

Members:

Violeta O. LuYm
(Non-Executive Director)
Pedro Emilio O. Roxas
(Independent Director)

Meetings:

The Committee had five (5) meetings during the year with all the members in attendance.

Nicasio I. Alcantara 5/5
Violeta O. LuYm 5/5
Pedro Emilio O. Roxas 5/5

Independent Control Functions

Compliance

BDOPB's Compliance Office oversees the Bank's Compliance System, the overall compliance framework of the Bank executed through a Compliance Program, and promotes its effective implementation. The Compliance System forms the processes, people, policies and other components that, as an integral unit, ultimately drive the Bank's initiatives to conform to industry laws, regulations and standards. In line with the Bank's initiatives is its commitment to ensure that activities of the Bank and its personnel are conducted in accordance with all applicable banking laws and regulations and industry standards, and this commitment to compliance serves to protect the Bank and its stakeholders.

The BDOPB Compliance Office is headed by a Chief Compliance Officer (CCO) who functionally reports to the Board Audit Committee. The Compliance Office is responsible for overseeing, coordinating, monitoring and ensuring compliance of the Bank with existing laws, rules and regulations through the implementation of the overall compliance system and program in accordance with the requirements of the BSP and other regulatory agencies, including but not limited to the identification and control of compliance risks, prudential reporting obligations as well as compliance training.

The Anti-Money Laundering Unit (AMLU) under the Compliance Office, together with the Bank's Anti-Money Laundering Committee (AMLC), focuses on the enforcement of the Anti-Money Laundering Act and its implementing rules and regulations, as well as the Terrorism Financing Prevention and Suppression Act of 2012; the monitoring and reporting of covered and suspicious transactions, and conduct of AML training, aimed towards mitigating the risk of the Bank being used for money-laundering and terrorist financing activities.

The Bank seeks to prevent money laundering, combat terrorist financing and stop the flow of funds by detecting and reporting money laundering and terrorist financing red flags, establishing policies and guidelines as articulated in a Board-approved Money Laundering and Terrorist Financing Prevention Program Manual (MLPP) aligned with AML laws and BSP regulations, with which frontliners and responsible bank officers comply. The Bank's MLPP supports the conduct of proactive and targeted monitoring initiatives to identify suspected money launderers and terrorists, as well as terrorist-related transactional activities.

The Bank is also part of a BDO Group-wide program of providing e-Learning training courses. The Bank's AMLU also conducts an annual live face-to-face training on AML and other legal and regulatory updates to all Bank units including the Client Lounges.

BDOPB Compliance Office oversees adherence to the Corporate Governance Manual, Code of Conduct and other regulatory requirements. It engages regulators on their annual examinations and reports to senior management and the Board Audit Committee significant compliance issues and regulatory findings.

Internal Audit

The Internal Audit function of the Bank is part of the scope of BDO Unibank's Internal Audit which covers the entire Group including foreign and local subsidiaries and offices. It adheres to the principles required by the ISPPIA (International Standard for the Professional Practice of Internal Auditing), COSO Internal Control - Integrated Framework, COBITS (Control Objectives for Information and Related Technology), the Internal Audit Definition and Code of Ethics.

It provides assurance and a systematic, disciplined approach to evaluate and improve effectiveness of risk management, internal control, and governance processes. Upholding a commitment to integrity and accountability, Internal Audit provides value to senior management and governing bodies as objective source of independent advice.

Internal Audit reports directly to the Board Audit Committee through the Chief Internal Auditor (parent bank and respective subsidiaries), seeking approval for the annual audit plan, providing updates on accomplishments, reporting results of audit conducted and tracking resolution of audit findings.

Risk Management

The Risk Management Unit (RMU) is responsible for developing guidelines and policies for effective risk management. It is also responsible for identifying the key risk exposures, assessing and measuring the extent of risk exposures of the Bank in the conduct of its business. It performs independent monitoring and objective assessment of decisions to accept particular risks whether these are consistent with board approved policies on risk tolerance and the effectiveness of the corresponding risk mitigation measures. On a regular basis, it reports to the Risk Management Committee, a board committee, the results of the RMU's assessment and monitoring. RMU is staffed by competent personnel with sufficient experience, qualifications, knowledge of the banking business as well as risk disciplines. It is headed by a Chief Risk Officer (CRO) who is independent from executive functions, business line responsibilities, operations and revenue-generating functions. The CRO reports directly to the Risk Management Committee and can only be appointed and replaced with prior approval from the Board.

The Bank's RMU is part of an integrated risk management framework covering the BDO Universal Bank Group to address the material risks it faces in its banking activities.

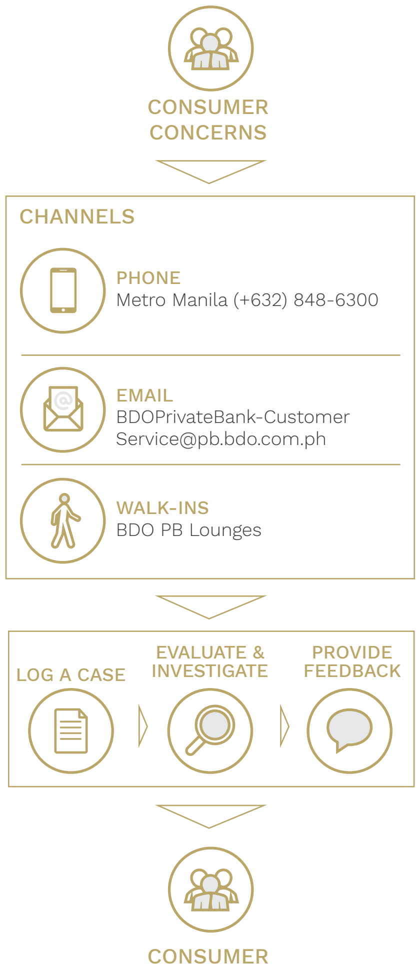
Consumer Protection Practices

BDOPB adopts the BDO Group's Guiding Principles on Consumer Protection, which was approved by the Board of Directors of Parent Bank on 29 August 2015 and serves as the Group's framework for defining its Consumer Protection Risk Management System (CPRMS). As specified in the CPRMS, consumer protection practices are embedded in the banking operations, and considered in the development and implementation of products and services. BDO's Code of Conduct reflects the Bank's commitment to ensuring that its customers are always treated fairly and professionally.

A Consumer Assistance Management System (CAMS) was established by Parent Bank in November 2015 to address consumer concerns for the entire conglomerate. To ensure its effective implementation, the Customer Contact Center (CCC) of Parent Bank was designated to receive customer requests, inquiries, complaints/problems or other feedback, applying standard handling procedures and service levels groupwide. It then assigns these to the responsible units for their appropriate handling, monitors resolution, and reports the summary to Senior Management and to the Board's Risk Management Committee (RMC) on a periodic basis. The adjacent chart is the illustration of the CAMS.

Effective recourse is one of the five (5) areas of BSP's Consumer Protection Framework, and BDOPB has been devoting resources to ensure that customer issues are resolved in a timely manner. For the year 2018, a total of 42 customer complaints were received by BDO Private Bank. Of this number, 30 were valid complaints (those caused by issues encountered /recognized by the Bank, such as system error, lapses in process, or fraud) while 12 were considered invalid, i.e., the complaints could not be linked to the potential issues involving the bank or product/service.

Consumer Assistance Management System



The Bank continues to focus on building responsible customer relationships through its engagement and compliance practices, as well as efforts to counter financial crime and fraudulent activities relative to consumer protection.

Data Privacy

The Board of Directors approved the appointment of the Data Protection Officer (DPO) in July 2017 and subsequent registration with the National Privacy Commission (NPC), in accordance with the requirements of Republic Act No. 10173, also known as the Data Privacy Act (DPA).

The Bank adopts the BDO Enterprise Privacy Policy approved by Parent Bank Board in January 2018, which incorporates the provisions of the DPA. The BDO Enterprise Privacy Policy contains the general data privacy policies on corporate governance, data collection, processing and retention of personal data, risk assessment, data privacy education, handling and reporting of customer concerns, data sharing, and management of third party personal information processors.

Related Party Transactions

To maintain transparency of related party transactions between and among the Bank and its affiliated companies, directors, officers, stockholders, related interests (DOSRI), the Bank complies fully with the legal and regulatory requirements pertaining to the proper approval and disclosure of such transactions.

Policies and procedures have been put in place to manage potential conflicts of interest arising from related party transactions such as credit accommodations, products or services extended by the Bank to directors or officers in their personal capacity or to their company. The Executive Committee reviews and approves material related party transactions and endorses these to the RPT Committee and to the full Board for independent review and approval. All directors except the interested parties can scrutinize the transactions to ensure that these are done on an arms-length basis and in accordance with regulations. Approved related party transactions are properly tagged for monitoring and reporting.

Compliance with the SEC Code of Corporate Governance

As of December 31, 2018, BDO Private Bank, Inc., hand in hand with its Parent Bank, has substantially complied with the recommendations of the SEC Code of Corporate Governance except for the following reservations made by Parent Bank: 1) Policy on retirement age of directors; and 2) Disclosure of board and executive remuneration on an individual basis.

On the retirement age of directors, we adopt the policy statement laid down by BDO Unibank Board recognizing the fact that chronological age is not the main factor in determining effectiveness of the director in discharging his/her duties and responsibilities. The wisdom of senior directors is a valuable asset. The Board derives much benefit from their counsel and will continue to utilize them for the benefit of all its Stakeholders. Age discrimination is discouraged by law, as once a director has been elected, removal due solely to age is prohibited. In this regard, Parent Bank Board decided to hold in abeyance the implementation of a retirement age policy for directors and instead reviews the individual director's potential contribution to the Bank and its Stakeholders, and decides on that basis.

On the disclosure of the remuneration on an individual basis for Board members and Executive Officers, the Board has serious reservations given the possible adverse security issues and poaching of talents by competitors in the industry. Hence, it has decided it will not be to the best interest of the Bank to do so at this time. It will disclose the remuneration figures on a consolidated basis only.

As a wholly-owned subsidiary of a leading practitioner of good corporate governance in the Philippines, BDOPB also aims to apply the essential principles, and comply with the provisions of the SEC Code of Corporate Governance to the extent possible and appropriate to the business. We are confident that it will be beneficial for our business and that it will open opportunities for the Bank to achieve greater heights in pursuing its objectives with integrity and transparency, and in bringing the most benefit to its clients and stakeholders.

Corporate Social Responsibility Initiatives

The employees and clients of BDO Private Bank support the initiatives of BDO Foundation, the corporate social responsibility arm of BDO Unibank, especially on its disaster response initiatives.

Looking Ahead

Following the lead of its Parent Bank, BDOPB is now in the era of digital transformation and sustainability, thus, we are looking at ways to optimize the use of the new technologies to further strengthen our corporate governance practices while remaining vigilant as to the risks of digitization to our business operations. In ensuring that the Bank stays as the market leader in its niche in the Philippine financial services industry, we are focused on maximizing the effectiveness of our corporate governance practices as a business enabler and driver of our performance in the proper context of risks and rewards, opportunities and prospects for the Bank in this new era. This is essential in going forward into the future as we continue to compete and remain relevant to our various stakeholders.

Financial Statements

Statement of Management's Responsibility for Financial Statements

The management of **BDO Private Bank, Inc.** (the Bank), is responsible for the preparation and fair presentation of the financial statements including the schedules attached therein, for the years ended December 31, 2018 and 2017, 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 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.

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

The Board of Directors reviews and approves the financial statements, and the additional supplementary information, and submits the same to the stockholders.

Punongbayan & Araullo, the independent auditor appointed by the stockholders, have audited the financial statements of the Bank in accordance with the Philippine Standards on Auditing, and in their report to the Board of Directors and stockholders, has expressed their opinion on the fairness of presentation upon completion of such audit.

Teresita T. Sy
Chairman of the Board

Albert S. Yeo
President

Maria Lourdes M. Sevilla
Vice President
Head — Financial Control Department

SUBSCRIBED and SWORN to me before this 5th day of March, 2019 affiant exhibiting to me their Competent Evidence of Identity (CEI), as follows:

Name	CEI Number
Teresita T. Sy	SSS No. – 03-2832705-4
Albert S. Yeo	SSS No. – 03-6738633-1
Maria Lourdes M. Sevilla	SSS No. – 33-3535551-1

WITNESS BY HAND AND SEAL on the day first above - mentioned in Makati City.

Doc No. 301
Page No. 62
Book No. XX
Series of 2019

Atty. GERVACIO B. ORTIZ, JR.
Notary Public for Makati City
Until December 31, 2020
PTR No. 7333104 / 01-08-2019 / Makati
IBP No. 656155 Lifetime Member
Appt. No. M104 / 2017 / Roll No. 4008
MCLE Compliance No. V-0006934
Unit 102 Peninsula Court Bldg.
8735 Makati Ave., Makati City

Report of Independent Auditors

The Board of Directors
BDO Private Bank, Inc.
(A Wholly Owned Subsidiary of BDO Unibank, Inc.)

2nd Floor, BDO Equitable Tower
8751 Paseo de Roxas, Makati City

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of BDO Private Bank, Inc. (the Bank), which comprise the statements of financial position as at December 31, 2018 and 2017, and the statements of income, statements of comprehensive income, statements of changes in equity and statements of cash flows for the years then ended, 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, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards (PFRS).

Basis for Opinion

We conducted our audits in accordance with Philippine Standards on Auditing (PSA). Our responsibilities under those standards are further described in the *Auditors' 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 audits 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.

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 PFRS, 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.

Auditors' 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 auditors' 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 PSA 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 PSA, 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 auditors' 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 auditors' 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.

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.

Report on Other Legal and Regulatory Requirements

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. As disclosed in Note 23 to the financial statements, the Bank presented the supplementary information required by the Bureau of Internal Revenue under Revenue Regulation (RR) No. 15-2010 in a supplementary schedule filed separately from the basic financial statements. RR No. 15-2010 requires the supplementary information to be presented in the notes to the financial statements. Such supplementary information is the responsibility of management. The supplementary information is not a required part of the basic financial statements prepared in accordance with PFRS; it is not also a required disclosure under Securities Regulation under Rule 68, as amended, of the Securities and Exchange Commission.

PUNONGBAYAN & ARAULLO

By: **Leonardo D. Cuaresma, Jr.**
Partner

CPA Reg. No. 0058647
TIN 109-227-862
PTR No. 7333690, January 3, 2019, Makati City
SEC Group A Accreditation
Partner - No. 0007-AR-5 (until July 9, 2021)
Firm - No. 0002-FR-5 (until March 26, 2021)
BIR AN 08-002511-7-2017 (until June 19, 2020)
Firm's BOA/PRC Cert. of Reg. No. 0002 (until July 24, 2021)

February 11, 2019

Statements of Financial Position

BDO PRIVATE BANK, INC.
(A WHOLLY OWNED SUBSIDIARY OF BDO UNIBANK, INC.)

DECEMBER 31, 2018 AND 2017
(Amounts in Philippine Pesos)

	Notes		2018		2017
RESOURCES					
DUE FROM BANGKO SENTRAL NG PILIPINAS	6	P	**4,425,182,127**	P	11,977,051,895
DUE FROM OTHER BANKS	6		**3,045,072,454**		8,586,596,043
TRADING AND INVESTMENT SECURITIES					
Financial assets at fair value through profit or loss	7		**3,747,091,347**		3,712,526,265
Financial assets at fair value through other comprehensive income - net	8		**11,449,767,007**		-
Held-to-collect investments - net	9		**19,499,420,895**		-
Available-for-sale securities	8		**-**		14,406,226,533
Held-to-maturity investments	9		**-**		12,979,898,768
LOANS AND RECEIVABLES – Net	10		**4,712,758,038**		11,694,542,996
BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT – Net	11		**44,635,643**		42,142,781
OTHER RESOURCES – Net	12		**1,925,267,686**		1,096,860,262
TOTAL RESOURCES		P	**48,849,195,197**	P	64,495,845,543
LIABILITIES AND EQUITY					
DEPOSIT LIABILITIES	13				
Demand		P	**27,616,715,846**	P	42,661,234,121
Time			**12,896,971,497**		14,150,655,851
Total Deposit Liabilities			**40,513,687,343**		56,811,889,972
DERIVATIVE FINANCIAL LIABILITIES	15		**2,821,555,027**		1,978,070,331
ACCRUED EXPENSES AND OTHER LIABILITIES	16		**377,587,098**		357,268,890
Total Liabilities			**43,712,829,468**		59,147,229,193
EQUITY	17		**5,136,365,729**		5,348,616,350
TOTAL LIABILITIES AND EQUITY		P	**48,849,195,197**	P	64,495,845,543

See Notes to Financial Statements.

Statements of Income

BDO PRIVATE BANK, INC.
(A WHOLLY OWNED SUBSIDIARY OF BDO UNIBANK, INC.)

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017
(Amounts in Philippine Pesos)

	Notes	2018	2017
INTEREST INCOME ON			
Held-to-collect investments	9	**P 726,554,035**	P -
Financial assets at fair value through other comprehensive income	8	**394,763,749**	-
Loans and receivables	10	**359,921,423**	466,400,635
Due from Bangko Sentral ng Pilipinas and other banks	6	**202,775,965**	327,893,805
Financial assets at fair value through profit or loss	7	**20,778,915**	41,501,679
Available-for-sale securities	8	**-**	538,529,889
Held-to-maturity investments	9	**-**	404,821,186
		1,704,794,087	1,779,147,194
INTEREST EXPENSE ON			
Deposit liabilities	13	**810,810,252**	596,792,147
Bills payable	14	**3,629,675**	385,634
Others	21	**2,334,621**	1,903,455
		816,774,548	599,081,236
NET INTEREST INCOME		**888,019,539**	1,180,065,958
IMPAIRMENT LOSSES (REVERSALS) – Net	8, 9, 10	**(1,558,163)**	1,827,375
NET INTEREST INCOME AFTER IMPAIRMENT LOSSES (REVERSALS)		**889,577,702**	1,178,238,583
OTHER INCOME			
Service charges, fees and commissions	18	**842,841,152**	713,878,572
Foreign exchange gain - net		**108,007,142**	144,364,552
Trading and securities gain - net	7, 8, 15	**42,082,474**	-
Others		**11,802,624**	2,108,883
		1,004,733,392	860,352,007
OTHER EXPENSES			
Employee benefits	21	**444,546,118**	429,035,143
Taxes and licenses		**293,484,270**	290,121,559
Supervision		**118,319,600**	108,729,270
Insurance		**103,601,810**	108,620,634
Representation and entertainment		**95,934,111**	102,336,333
Occupancy	26	**51,523,794**	47,631,867
Transportation and travel		**44,381,642**	46,849,412
Third party information	19	**40,050,743**	58,271,423
Depreciation and amortization	11, 12	**33,441,509**	28,678,063
Management and professional fees		**27,100,967**	30,441,719
Trading and securities loss - net	7, 8, 15	**-**	5,556,276
Others	20	**140,192,855**	145,305,972
		1,392,577,419	1,401,577,671
PROFIT BEFORE TAX		**501,733,675**	637,012,919
TAX EXPENSE	23	**200,439,365**	223,160,039
NET PROFIT		**P 301,294,310**	P 413,852,880

See Notes to Financial Statements.

Statements of Comprehensive Income

BDO PRIVATE BANK, INC.
(A WHOLLY OWNED SUBSIDIARY OF BDO UNIBANK, INC.)

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017
(Amounts in Philippine Pesos)

	Notes	2018	2017
NET PROFIT		**P 301,294,310**	P 413,852,880
OTHER COMPREHENSIVE INCOME (LOSS)			
Items that are or will be reclassified subsequently to profit or loss			
Unrealized losses on financial assets at fair value through other comprehensive income (FVOCI)	8, 17	**(382,276,783)**	-
Transfer of realized losses on disposed financial assets at FVOCI to statements of income	8, 17	**26,667,400**	-
Credit losses on financial assets at FVOCI	17	**1,508,395**	-
Unrealized gains on available-for-sale (AFS) securities	8	**-**	166,770,073
Transfer of realized gains on disposed AFS securities to statements of income	8	**-**	(7,803,256)
Amortization of unrealized losses on reclassified held-to-maturity investment to statements of income	8,17	**-**	15,787,943
		(354,100,988)	174,754,760
Item that will not be reclassified to profit or loss			
Actuarial gains (losses) on remeasurement of post-employment defined benefit obligation, net of tax	21	**(2,045,744)**	2,745,329
Total Other Comprehensive Income (Loss) – net of tax		**(356,146,732)**	177,500,089
TOTAL COMPREHENSIVE INCOME (LOSS)		**(P 54,852,422)**	P 591,352,969

See Notes to Financial Statements.

Statements of Changes in Equity

BDO PRIVATE BANK, INC.
(A WHOLLY OWNED SUBSIDIARY OF BDO UNIBANK, INC.)

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017
(Amounts in Philippine Pesos)

	Share Capital (Note 17)		Surplus (Notes 10 and 17)		Revaluation Reserves			
	Preferred Stock	Common Stock	Reserves	Free	Unrealized Gains (Losses) on Available-for-sale Securities (Note 17)	Unrealized Gains (Losses) on Financial Assets at Fari Value Through Other Comprehensive Income (Note 17)	Accumulated Actuarial Gains (Losses) (Note 17)	Total Equity
BALANCE AS OF JANUARY 1, 2018								
As previously reported	P -	P 2,165,000,000	P 298,132,703	P 3,015,983,451	(P 57,427,687)	P -	(P 73,072,117)	P 5,348,616,350
Effects of adoption of PFRS 9 (Note 2)	-	-	37,154,285	(45,740,030)	57,427,687	123,759,859	-	172,601,801
As restated	-	2,165,000,000	335,286,988	2,970,243,421	-	123,759,859	(73,072,117)	5,521,218,151
Total comprehensive income (loss) for the year	-	-	-	301,294,310	-	(354,100,988)	(2,045,744)	(54,852,422)
Cash dividend	-	-	-	(330,000,000)	-	-	-	(330,000,000)
Transfer to surplus reserves	-	-	70,147,933	(70,147,933)	-	-	-	-
BALANCE AS OF DECEMBER 31, 2018	**P -**	**P 2,165,000,000**	**P 405,434,921**	**P 2,871,389,798**	**P -**	**(P 230,341,129)**	**(P 75,117,861)**	**P 5,136,365,729**
BALANCE AS OF JANUARY 1, 2017	P 1,225,000,000	P 940,000,000	P 231,738,271	P 3,168,525,003	(P 232,182,447)	P -	(P 75,817,446)	P 5,257,263,381
Transfer to common stock	(1,225,000,000)	1,225,000,000	-	-	-	-	-	-
Total comprehensive income for the year	-	-	-	413,852,880	174,754,760	-	2,745,329	591,352,969
Cash dividend	-	-	-	(500,000,000)	-	-	-	(500,000,000)
Transfer to surplus reserves	-	-	66,394,432	(66,394,432)	-	-	-	-
BALANCE AS OF DECEMBER 31, 2017	P -	P 2,165,000,000	P 298,132,703	P 3,015,983,451	(P 57,427,687)	P -	(P 73,072,117)	P 5,348,616,350

See Notes to Financial Statements.

Statements of Cash Flows

BDO PRIVATE BANK, INC.
(A WHOLLY OWNED SUBSIDIARY OF BDO UNIBANK, INC.)

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017
(Amounts in Philippine Pesos)

	Notes	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		**P 501,733,675**	P 637,012,919
Adjustments for:			
Interest income	6, 7, 8, 9, 10	**(1,704,794,087)**	(1,779,147,194)
Interest received		**1,605,643,268**	2,196,169,493
Interest expense	13, 14, 21	**816,774,548**	599,081,236
Interest paid		**(787,626,301)**	(569,780,360)
Unrealized foreign exchange gains		**(545,296,141)**	(14,835,833)
Fair value losses	7	**137,763,188**	214,980,786
Depreciation and amortization	11, 12	**33,441,509**	28,678,063
Provision for (reversal of) allowance for impairment	8, 9, 10	**(1,558,163)**	1,827,375
Operating profit before changes in resources and liabilities		**56,081,496**	1,313,986,485
Decrease (increase) in financial assets at fair value through profit or loss		**(159,483,197)**	1,137,478,781
Increase in loans and receivables		**(325,066,356)**	(736,081,391)
Decrease (increase) in other resources		**(843,823,369)**	1,093,133,723
Increase (decrease) in deposit liabilities		**(16,325,016,255)**	3,768,460,000
Increase (decrease) in derivative financial liabilities		**843,484,696**	(1,705,229,952)
Increase (decrease) in accrued expenses and other liabilities		**18,002,671**	(10,159,971)
Cash generated from (used in) operations		**(16,735,820,314)**	4,861,587,675
Cash paid for income taxes		**(191,412,455)**	(214,202,747)
Net Cash From (Used in) Operating Activities		**(16,927,232,769)**	4,647,384,928
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from maturities of held-to-collect (HTC) investments	9	**11,780,601,000**	-
Acquisition of HTC investments	9	**(11,656,290,233)**	-
Proceeds from disposal of financial assets at fair value through other comprehensive income (FVOCI)		**5,385,708,857**	-
Acquisition of financial assets at FVOCI	8	**(5,204,576,397)**	-
Acquisitions of bank premises, furniture, fixtures and equipment	11	**(26,121,421)**	(17,767,469)
Proceeds from disposal of bank premises, furniture, fixtures and equipment	11	**11,357**	-
Proceed from disposal of available-for-sale (AFS) securities		**-**	10,818,358,545
Acquisition of held-to-maturity (HTM) investments	9	**-**	(7,387,442,901)
Acquisition of AFS securities	8	**-**	(6,733,144,570)
Proceeds from maturities of HTM investments	9	**-**	1,000,000
Net Cash From (Used in) Investing Activities		**279,333,163**	(3,318,996,395)
CASH FLOW FROM FINANCING ACTIVITY			
Dividends paid	17	**(330,000,000)**	(500,000,000)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**(16,977,899,606)**	828,388,533
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR			
Due from Bangko Sentral ng Pilipinas	6	**11,977,051,895**	13,009,025,298
Due from Other Banks	6	**8,586,596,043**	4,199,450,659
Securities Purchased Under Reverse Repurchase Agreement	10	**3,387,574,515**	6,411,289,697
Unquoted Debt Securities Classified as Loans		**496,931,734**	-
		24,448,154,187	23,619,765,654
CASH AND CASH EQUIVALENTS AT END OF YEAR			
Due from Bangko Sentral ng Pilipinas	6	**4,425,182,127**	11,977,051,895
Due from Other Banks	6	**3,045,072,454**	8,586,596,043
Securities Purchased Under Reverse Repurchase Agreement	10	**-**	3,387,574,515
Unquoted Debt Securities Classified as Loans		**-**	496,931,734
		P 7,470,254,581	P 24,448,154,187

Other Information

Certain amounts of securities purchased under reverse repurchased agreement and unquoted debt securities classified as loans with maturities of three months or less from placement date are included as part of cash and cash equivalents for cash flow purposes but are presented as part of Loans and Receivables in the 2017 statement of financial position (see Note 2.3).

See Notes to Financial Statements.

BDO PRIVATE BANK, INC.
(A WHOLLY OWNED SUBSIDIARY OF BDO UNIBANK, INC.)

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(Amounts in Philippine Pesos)

1. CORPORATE MATTERS

1.1 Organization and Operations

On December 22, 1995, the Bangko Sentral ng Pilipinas (BSP) authorized BDO Private Bank, Inc. (the Bank) to operate as a commercial bank. The Bank was incorporated in the Philippines to engage in banking activities, as well as to engage in and carry on the business of a trust Bank and to operate a foreign currency deposit unit.

The Bank is a wholly owned subsidiary of BDO Unibank, Inc. (BDO Unibank), a publicly listed bank incorporated and domiciled in the Philippines. BDO Unibank is authorized to operate as an expanded commercial bank and to engage in trust and foreign currency deposit operations.

As a banking institution, the Bank's operations are regulated and supervised by the BSP. In this regard, the Bank is required to comply with the rules and regulations of the BSP such as those relating to maintenance of reserve requirements on deposit liabilities and deposit substitutes and those relating to the adoption and use of safe and sound banking practices, among others, as promulgated by the BSP. The Bank is subject to the provisions of the General Banking Law of 2000 (Republic Act No. 8791).

The Bank's registered office, which is also its principal place of business, is located at the 2nd Floor, BDO Equitable Tower, 8751 Paseo de Roxas, Makati City. The registered office of BDO Unibank is at BDO Corporate Center, 7899 Makati Avenue, Makati City.

1.2 Approval of Financial Statements

The financial statements of the Bank as of and for the year ended December 31, 2018 (including the comparative financial statements as of and for the year ended December 31, 2017) were authorized for issue by the Bank's Board of Directors (BOD) on February 11, 2019.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies that have been used in the preparation of these financial statements are summarized below and in the succeeding pages. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of Preparation of Financial Statements

(a) *Statement of Compliance with Philippine Financial Reporting Standards*

The financial statements of the Bank have been prepared in accordance with Philippine Financial Reporting Standards (PFRS). PFRS are adopted by the Financial Reporting Standards Council (FRSC) from the pronouncements issued by the International Accounting Standards Board, and approved by the Philippine Board of Accountancy.

The financial statements have been prepared using the measurement bases specified by PFRS for each type of resources, liability, income and expense. The measurement bases are more fully described in the accounting policies that follow.

(b) *Presentation of Financial Statements*

The financial statements are presented in accordance with Philippine Accounting Standard (PAS) 1, *Presentation of Financial Statements*. The Bank presents statement of comprehensive income separate from the statement of income.

The Bank presents a third statement of financial position as of the beginning of the preceding period when it applies an accounting policy retrospectively, or makes a retrospective restatement or reclassification of items that has a material effect on the information in the statement of financial position at the beginning of the preceding period. The related notes to the third statement of financial position are not required to be disclosed.

In 2018, the Bank adopted PFRS 9, *Financial Instruments*, which was applied using the transitional relief allowed by the standard. This allows the Bank not to restate its prior periods' financial statements. Differences arising from the adoption of PFRS 9 in relation to classification and measurement and impairment of financial assets are recognized in the opening balance of Surplus Free or other components of equity in the current year [see Note 2.2(a)(iii)].

Further, the Bank adopted PFRS 15, *Revenue from Contracts with Customers*, which was applied using the modified retrospective approach. However, the said adoption did not cause material retrospective restatements to the opening balance of Surplus Free and in the statement of financial position as at January 1, 2018.

Accordingly, the adoption of these two new accounting standards did not require the Bank to present its third statement of financial position.

The table below shows the impact of the adoption of PFRS 9 to the Bank's total equity as at January 1, 2018.

	Effects on			
	Surplus			
	Free	Reserves	Revaluation Reserves	Total Equity
Balance at January 1, 2018	**P 3,015,983,451**	**P 298,132,703**	**(P 130,499,804)**	**P 5,348,616,350**
Impact of PFRS 9 [see Note 2.2(a)(iii)]				
Effect of reclassifications and remeasurements of financial assets	(55,712,558)	–	174,939,125	119,226,567
Decrease in allowance for impairment on loans and receivables	61,908,398	–	–	61,908,398
Recognition of allowance for impairment on:				
Debt securities reclassified to financial assets at fair value through other comprehensive income	(6,248,421)	–	6,248,421	–
Debt securities reclassified to amortized cost	(8,533,164)	–	–	(8,533,164)
Appropriation of surplus free for general loan loss provision per BSP requirement	(37,154,285)	37,154,285	–	–
Total impact of PFRS 9	(45,740,030)	37,154,285	181,187,546	172,601,801
Balance at January 1, 2018 under PFRS 9	**P 2,970,243,421**	**P 335,286,988**	**P 50,687,742**	**P 5,521,218,151**

The impact of PFRS 9 has no effects on deferred tax asset since the Bank opted not to recognize the deferred tax effects of the foregoing allowance for impairment.

(c) Functional and Presentation Currency

These financial statements are presented in Philippine pesos, the Bank's functional and presentation currency, and all values represent absolute amounts except when otherwise indicated.

Items included in the financial statements of the Bank are measured using its functional currency. Functional currency is the currency of the primary economic environment in which the Bank operates.

2.2 Adoption of New and Amended PFRS

(a) Effective in 2018 that are Relevant to the Bank

The Bank adopted for the first time the following new PFRS, amendments, interpretation and annual improvements to PFRS, which are mandatorily effective for annual periods beginning on or after January 1, 2018:

PAS 40 (Amendments)	:	Investment Property – Reclassification to and from Investment Property
PFRS 2 (Amendments)	:	Share-based Payment – Classification and Measurement of Share-based Payment Transactions
PFRS 9	:	Financial Instruments
PFRS 15	:	Revenue from Contracts with Customers; Clarifications to PFRS 15

International Financial Reporting Interpretations Committee (IFRIC) 22 : Foreign Currency Transactions and Advance Consideration

Discussed below are the relevant information about these new standards, amendments and interpretation.

(i) PAS 40 (Amendments), *Investment Property – Reclassification to and from Investment Property*. The amendments state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use. The amendments provided a non-exhaustive list of examples constituting change in use. The application of these amendments has no impact on the Bank's financial statements.

(ii) PFRS 2 (Amendments), *Share-based Payment – Classification and Measurement of Share-based Transactions*. The amendments contain three changes covering the following matters: the accounting for the effects of vesting conditions on the measurement of a cash-settled share-based payment; the classification of share-based payment transactions with a net settlement feature for withholding tax obligations; and, the accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. The application of these amendments has no significant impact on Bank's financial statements.

(iii) PFRS 9, *Financial Instruments* (issued in 2014). This new standard on financial instruments replaced PAS 39, *Financial Instruments: Recognition and Measurement,* and PFRS 9 issued in 2009, 2010 and 2013. This standard contains, among others, the following:

- three principal classification categories for financial assets based on the business model on how an entity is managing its financial instruments, i.e., financial assets at amortized cost, fair value through profit or loss (FVTPL), at fair value through other comprehensive income (FVOCI);

- an expected credit loss (ECL) model in determining impairment of all debt financial assets that are not measured at FVTPL, which generally depends on whether there has been a significant increase in credit risk since initial recognition of a financial asset; and,

- a new model on hedge accounting that provides significant improvements principally by aligning hedge accounting more closely with the risk management activities undertaken by entities when hedging their financial and non-financial risk exposures.

The Bank's new accounting policies relative to the adoption of PFRS 9 are fully disclosed in Notes 2.3 and 2.4 while the related risk management policies is disclosed in Note 4.

The following table shows the effects of the adoption of PFRS 9 in the carrying amounts and presentation of the categories of the affected financial asset accounts in the statement of financial position as at January 1, 2018:

	Notes	Carrying Value – PAS 39 December 31, 2017	Reclassifications	Remeasurements	Carrying Value – PFRS 9 January 1, 2018
Financial assets at FVTPL		P 3,712,526,265	P –	P –	P 3,712,526,265
Reclassification to					
Held-to-collect (HTC)					
investments	a	–	(19,662,298)	–	(19,662,298)
Financial assets at FVTPL		**P 3,712,526,265**	**(P 19,662,298)**	**P –**	**P 3,692,863,967**
Financial assets at FVOCI		P –	P –	P –	P –
Reclassification from:					
Available-for-sale (AFS)					
securities	b	–	7,455,253,668	–	7,455,253,668
HTM investments	e	–	4,072,734,228	8,781,351	4,081,515,579
Financial assets at FVOCI		**P –**	**P 11,527,987,896**	**P 8,781,351**	**P 11,536,769,247**
AFS Securities		P 14,406,226,533	P –	P –	P 14,406,226,533
Reclassification to:					
Financial assets at FVOCI	b	–	(7,455,253,668)	–	(7,455,253,668)
HTC investments	c	–	(6,945,472,765)	–	(6,945,472,765)
Other resources	g	–	(5,500,100)	–	(5,500,100)
AFS securities		**P 14,406,226,533**	**(P 14,406,226,533)**	**P –**	**P –**
HTC investments		P –	P –	P –	P –
Reclassification from:					
Financial assets at FVTPL	a	–	19,662,298	–	19,662,298
AFS securities	c	–	6,945,472,765	110,445,216	7,055,917,981
HTM investment	d	–	8,907,164,540	–	8,907,164,540
Other receivables	f	–	3,479,250,283	–	3,479,250,283
Allowance for impairment					
losses	i	–	–	(8,533,164)	(8,533,164)
HTC investments		**P –**	**P 19,351,549,886**	**P 101,912,052**	**P 19,453,461,938**
HTM investments		P 12,979,898,768	P –	P –	P 12,979,898,768
Reclassification to:					
HTM investments	d	–	(8,907,164,540)	–	(8,907,164,540)
Financial assets at FVOCI	e	–	(4,072,734,228)	–	(4,072,734,228)
HTM investments		**P 12,979,898,768**	**(P 12,979,898,768)**	**P –**	**P –**
Loans and receivables					
Gross amount		P 11,765,399,515	P –	P –	P 11,765,399,515
Allowance for impairment	h	(70,856,519)	–	61,908,398	(8,948,121)
Reclassification to					
HTC Investments	f	–	(3,479,250,283)	–	(3,479,250,283)
Loans and receivables		**P 11,694,542,996**	**(P 3,479,250,283)**	**P 61,908,398**	**P 8,277,201,111**

a. *Debt Instruments Reclassified to Amortized Cost or HTC Investments from FVTPL*

The Bank reclassified certain government securities under FVTPL securities as financial assets at amortized cost or HTC investments since the Bank determined that the objective of the business model is to hold these investments to collect the contractual cash flows, wherein said cash flows pertain solely to payment of principal and interest. Thus, these securities with fair value of P19,662,298 were reclassified to HTC investments wherein the fair value becomes the new gross carrying amount (see Note 9). The Bank also assessed whether these securities are impaired based on the ECL model developed by the Bank [see Note 2.2(a)(iii)i].

b. *Debt Instruments Reclassified to FVOCI from AFS Securities*

Certain debt securities which were previously classified as AFS securities are reclassified as financial assets at FVOCI because these securities were determined that the investment objective of the business model is to hold these investments to collect the contractual cash flows, and sell but are held for long-term strategic investment and are not expected to be traded in the short-to-medium term. In addition, the Bank made an assessment whether these securities are impaired based on the ECL model developed by the Bank [see Note 2.2(a)(iii)i].

c. *Debt Instruments Reclassified from AFS Securities to Amortized Cost or HTC Investments*

There are certain investments in debt securities previously classified as AFS securities that met the criteria to be classified as financial assets at amortized cost or HTC investments because the objective of the business model is to hold these debt instruments in order to collect the contractual cash flows (see Note 9). These debt instruments, were accordingly remeasured at their amortized cost of P6,945,472,765. The previously recognized accumulated net unrealized fair value losses on such AFS securities amounting to P110,445,216 [see Note 2.1(b)] was adjusted to the opening balance of Revaluation Reserves account as of January 1, 2018. Moreover, the Bank determined whether these securities are impaired based on the ECL model developed by the Bank [see Note 2.2(a)(iii)i].

d. *Debt Instruments Reclassified from HTM Investments to Amortized Cost or HTC Investments*

The Bank reclassified certain government and corporate debt securities under HTM investment as financial assets at amortized cost or HTC investments since the Bank determined that the objective of the Bank is to hold these securities to collect contractual cash flows. Portion of the securities represents government securities that were previously subjected to the tainting provisions of PAS 39 (see Notes 8 and 9). Under PFRS 9, these securities are no longer subject to the previous tainting rule but any disposal shall be within the context of the permitted sales as defined by its business model. In addition, the Bank determined whether these securities are impaired based on the ECL model developed by the Bank [see Note 2.2 (a)(iii)i].

e. *Debt Instruments Reclassified from HTM Investments to FVOCI*

The Bank reclassified certain government and corporate debt securities previously under HTM securities to financial assets at FVOCI since these securities are held as long-term strategic investments and are not expected to be traded in the short-to-medium term. Hence, these securities which were previously valued at amortized cost of P4,072,734,228 are remeasured at fair value of P4,081,515,579 at the reclassification date (see Note 8). As a result, the Bank recognized unrealized gain on FVOCI securities amounting to P8,781,351 [see Note 2.1(b)] which was adjusted to the opening balance of Revaluation Reserves account as of January 1, 2018. Also, the Bank made an assessment whether these securities are impaired based on the ECL model developed by the Bank [see Note 2.2(a)(iii)i].

f. Unquoted Debt Securities Reclassified from Loans and Receivable to Amortized Cost or HTC Investments

Unquoted debt securities amounting to P3,479,250,283 previously classified under loans and receivables are reclassified as at amortized cost or HTC investments that meet the criteria set by the business model for amortized cost (see Note 9). Furthermore, the Bank determines whether these securities are impaired based on the ECL model developed by the Bank [see Note 2.2(a)(iii)i].

g. Unquoted Equity Securities Reclassified from AFS Securities to Other Resources

Unquoted equity securities with a carrying amount of P5,500,100 which were previously classified as AFS securities are reclassified to Other Resources account (see Note 12) since the Bank is not entitled to a contractual right to receive cash but for a privilege to use the facilities and services of the issuing corporation. These securities are mainly subscription or membership rights as a participant-member bank for the use of the facilities of certain organization that support the banking operations of the members.

h. Credit Losses on Loans and Receivables

The application of the ECL model based on the stages of impairment assessment for loans and receivables resulted in the reversal of previously recognized allowance for impairment on loans and receivables amounting to P61,908,398 with adjustment charged against the opening balance of Surplus Free account [see Note 2.1(b)]. Also, in 2018, a general loan loss provision amounting to P37,154,285 [see Note 2.1(b)], which represents the excess of the 1% required allowance of the BSP over the computed allowance for ECL, was recognized by the Bank and reported as part of Surplus Reserves account in the Bank's statement of changes in equity.

i. Credit Losses on Investments in Debt Securities

All of the Bank's investment in debt securities classified as HTC investments and FVOCI are considered to have low credit risk, and the loss allowance recognized was therefore limited to 12-month expected credit loss. Management considers 'low credit risk' for listed and government bonds to be an investment grade credit rating with at least one reputable rating agency. Other debt securities are considered to have low credit risk when they have a low risk of default and the issuer has a strong capacity to meet its contractual cash flow obligations in the near term. The application of ECL model developed by the Bank resulted into the recognition of allowance for credit impairment in HTC investments as at January 1, 2018 amounting to P8,533,164 and was adjusted against the opening balance of Surplus Free [see Note 2.1(b)]. The Bank also recognized allowance for impairment on debt securities at FVOCI amounting to P6,248,421 and was adjusted against the opening balance of Revaluation Reserves [see Note 2.1(b)].

The reconciliation of the prior year's closing allowance for impairment losses measured in accordance with PAS 39 incurred loss model to the new impairment allowance measured in accordance with the PFRS 9 ECL is presented in Note 4.3.5.

The adoption of PFRS 9 has no impact on the classification and measurement of the Bank's financial liabilities. As of December 31, 2018, the Bank's financial liabilities are classified and measured at amortized cost, except for derivative financial liabilities which are measured at fair value.

(iv) PFRS 15, *Revenue from Contract with Customers together with the Clarification to PFRS 15* (herein referred to as PFRS 15). This standard replaced PAS 18, *Revenue*, and PAS 11, *Construction Contracts*, the related Interpretations on revenue recognition: IFRIC 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreement for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers*, and Standing Interpretations Committee 31, *Revenue – Barter Transactions Involving Advertising Services*. This new standard establishes a comprehensive framework for determining when to recognize revenue and how much revenue to recognize. The core principle in the said framework is for an entity to recognize revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The Bank's significant sources of revenue pertain to its lending and investing activities which generate interest income, service charges, fees and commissions. Except for service charges, fees and commissions, significant amount of the Bank's revenues are out of scope of PFRS 15. Recognition and measurement of revenue streams within the scope of PFRS 15 did not vary from PAS 18.

The Bank's adoption of PFRS 15 has resulted in changes in its accounting policies (see Note 2.12). The Bank has applied the new standard retrospectively without restatement, with the cumulative effect of initial application, if any, recognized as an adjustment to the opening balance of Surplus Free account at January 1, 2018. No remeasurements nor reclassifications were recognized by the Bank at the date of initial application since PFRS 15 has no material impact on its operations.

(v) IFRIC 22, *Foreign Currency Transactions and Advance Consideration – Interpretation on Foreign Currency Transactions and Advance Consideration*. The interpretation provides more detailed guidance on how to account for transactions that include the receipt or payment of advance consideration in a foreign currency. The Interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary asset (arising from advance payment) or liability (arising from advance receipt). If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. The application of this interpretation has no impact on the Bank's financial statements.

(b) Effective in 2018 that are not Relevant to the Bank

The following amendments and improvement to existing standards are mandatorily effective for annual periods beginning on or after January 1, 2018 but are not relevant to the Bank's financial statements:

PFRS 4 (Amendments)	:	Insurance Contracts – Applying PFRS 9 with PFRS 4, *Insurance Contracts*
Annual Improvements to PFRS (2014-2016 Cycle)		
PFRS 1 (Amendments)	:	First-time Adoption of Philippine Financial Reporting Standards – Deletion of Short-term Exemptions
PAS 28 (Amendments)	:	Investment in Associates – Clarification on Fair Value through Profit or Loss Classification

(c) Effective Subsequent to 2018 but not Adopted Early

There are new PFRS, interpretation, amendments and improvements to existing standards effective for annual periods subsequent to 2018, which are adopted by the FRSC. Management will adopt the following relevant pronouncements in accordance with their transitional provisions:

(i) PAS 19 (Amendments), *Employee Benefits – Plan Amendment, Curtailment or Settlement* (effective January 1, 2019). The amendments require the use of updated actuarial assumptions to determine current service cost and net interest for the remainder of the annual reporting period after the plan amendment, curtailment or settlement when the entity remeasures its net defined benefit liability (asset). Management is currently assessing the impact of these amendments on the Bank's financial statements.

(ii) PFRS 9 (Amendments), *Financial Instruments – Prepayment Features with Negative Compensation* (effective from January 1, 2019). The amendments clarify that prepayment features with negative compensation attached to financial instruments may still qualify under the "solely payments of principal and interests" (SPPI) test. As such, the financial assets containing prepayment features with negative compensation may still be classified at amortized cost or at FVOCI. Management initially assessed that these amendments will not affect the Bank's financial statements since it has no financial instruments having prepayment features with negative compensation.

(iii) PFRS 16, *Leases* (effective from January 1, 2019). The new standard will eventually replace PAS 17, *Leases*, and its related interpretation of IFRIC 4, *Determining Whether an Arrangement Contains a Lease*. For lessees, it requires to account for leases "on-balance sheet" by recognizing a "right-of-use" asset and a lease liability. The lease liability is initially measured as the present value of future lease payments. For this purpose, lease payments include fixed, non-cancellable payments for lease elements, amounts due under residual value guarantees, certain types of contingent payments and amounts due during optional periods to the extent that extension is reasonably certain. In subsequent periods, the "right-of-use" asset is accounted for similar to a purchased asset subject to depreciation or amortization. The lease liability is accounted for similar to a financial liability which is amortized using the effective interest method. However, the new standard provides important reliefs or exemptions for short-term leases and leases of low value assets. If these exemptions are used, the accounting is similar to operating lease accounting under PAS 17 where lease payments are recognized as expenses on a straight-line basis over the lease term or another systematic basis (if more representative of the pattern of the lessee's benefit).

For lessors, lease accounting is similar to PAS 17's. In particular, the distinction between finance and operating leases is retained. The definitions of each type of lease, and the supporting indicators of a finance lease, are substantially the same as PAS 17's. The basic accounting mechanics are also similar, but with some different or more explicit guidance in few areas. These include variable payments, sub-leases, lease modifications, the treatment of initial direct costs and lessor disclosures.

The management plans to adopt the modified retrospective application of PFRS 16 where the cumulative effect of initially applying the standard will be recognized as an adjustment to the opening balance of Surplus Free account at the date of initial application. The Bank will elect to apply the standard to contracts that were previously identified as leases applying PAS 17 and IFRIC 4 at the date of initial application. Management is currently assessing the financial impact of this new standard on the Bank's financial statements.

(iv) IFRIC 23, *Uncertainty Over Income Tax Treatments* (effective from January 1, 2019). The interpretation provides clarification on the determination of taxable profit, tax bases, unused tax losses, unused tax credits, and tax rates when there is uncertainty over income tax treatments. The core principle of the interpretation requires the Bank to consider the probability of the tax treatment being accepted by the taxation authority. When it is probable that the tax treatment will be accepted, the determination of the taxable profit, tax bases, unused tax losses, unused tax credits, and tax rates shall be on the basis of the accepted tax treatment. Otherwise, the Bank has to use the most likely amount or the expected value, depending on the surrounding circumstances, in determining the tax accounts identified immediately above. Management is currently assessing the impact of this interpretation on the Bank's financial statements.

(v) Annual Improvements to PFRS 2015-2017 Cycle (effective from January 1, 2019). Among the improvements, the following amendments are relevant to the Bank but had no material impact on the Bank's financial statements as these amendments merely clarify existing requirements:

- PAS 12 (Amendments), *Income Taxes – Tax Consequences of Dividends.* The amendments clarify that all income tax consequence of dividend payments should be recognized in profit or loss.

- PAS 23 (Amendments), *Borrowing Costs – Eligibility for Capitalization.* The amendments clarify that any specific borrowing which remains outstanding after the related qualifying asset is ready for its intended purpose, such borrowing will then form part of the entity's general borrowings when calculating the capitalization rate for capitalization purposes.

2.3 Financial Assets and Financial Liabilities

Financial assets and financial liabilities are recognized when the entity becomes a party to the contractual provisions of the instrument.

At initial recognition, the Bank measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are incremental or directly attributable to the acquisition or issue of the financial asset or financial liability, such as fees and commissions. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss are expensed in profit or loss.

(a) Classification, Measurement and Reclassification of Financial Assets in Accordance with PFRS 9

Under PFRS 9, the classification and measurement of financial assets is driven by the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. The classification and measurement of financial assets are described below and in the succeeding pages.

(i) Financial Assets at Amortized Cost

Financial assets are measured at amortized cost if both of the following conditions are met:

- the asset is held within the Bank's business model whose objective is to hold financial assets in order to collect contractual cash flows ("hold to collect"); and,

- the contractual terms of the instrument give rise, on specified dates, to cash flows that are SPPI on the principal amount outstanding.

Financial assets meeting these criteria are measured initially at fair value plus transaction costs. They are subsequently measured at amortized cost using the effective interest method, less any impairment in value.

Where the business model is to hold assets to collect contractual cash flows, the Bank assesses whether the financial instruments' cash flows represent SPPI. In making this assessment, the Bank considers whether the contractual cash flows are consistent with a basic lending arrangement, i.e., interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement [(see Note 3.1(c)]. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at FVTPL.

The Bank's financial assets at amortized cost are presented in the statement of financial position as Due from BSP, Due from Other Banks, Loans and Receivables, HTC Investments and Margin deposits (under Other Resources). Due from BSP and Due from Other Banks are considered cash and cash equivalents, which are readily convertible to known amounts of cash and subject to insignificant risk of changes in value. Loans and receivables include receivables from customers and all other receivables from customers and other banks.

For purposes of reporting cash flows, cash and cash equivalents include amounts due from BSP and other banks, SPURRA and certain UDSCL, if any, with maturities of three months or less from placement date.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of the financial assets except for those that are subsequently identified as credit-impaired. For credit-impaired financial assets, the effective interest rate is applied to the net carrying amount of the financial assets (after deduction of the loss allowance). The interest earned is recognized in the statement of income as part of Interest Income.

(ii) Financial Assets at Fair Value Through Other Comprehensive Income

The Bank accounts for financial assets at FVOCI if the assets meet the following conditions:

- they are held under a business model whose objective is to hold to collect the associated cash flows and sell ("hold to collect and sell"); and,

- the contractual terms of the financial assets give rise to cash flows that are SPPI on the principal amount outstanding.

At initial recognition, the Bank can make an irrevocable election (on an instrument-by-instrument basis) to designate equity investments as at FVOCI; however, such designation is not permitted if the equity investment is held by the Bank for trading or as mandatorily required to be classified as FVTPL. The Bank does not hold equity instruments on initial application of PFRS 9.

Financial assets at FVOCI are initially measured at fair value plus transaction costs. Subsequently, they are measured at fair value, with no deduction for any disposal costs. Gains and losses arising from changes in fair value, including the foreign exchange component, are recognized in other comprehensive income, net of any effects arising from income taxes, and are reported as part of Revaluation Reserves account in equity. When the asset is disposed of, the cumulative gain or loss previously recognized in the Revaluation Reserves account is not reclassified to profit or loss but is reclassified directly to Surplus Free account, except for those debt securities classified as FVOCI wherein cumulative fair value gains or losses are recycled to profit or loss.

Any dividends earned on holding equity instruments, if any, are recognized in the statement of income, when the Bank's right to receive dividends is established, it is probable that the economic benefits associated with the dividend will flow to the Bank, and the amount of the dividend can be measured reliably, unless the dividends clearly represent recovery of a part of the cost of the investment.

(iii) Financial Assets at Fair Value Through Profit or Loss

Financial assets that are held within a different business model other than "hold to collect" or "hold to collect and sell" are categorized at FVTPL. Further, irrespective of business model, financial assets whose contractual cash flows are not SPPI are accounted for at FVTPL. Also, equity securities, if any, are classified as financial assets at FVTPL, unless the Bank designates an equity investment that is not held for trading as at FVOCI at initial recognition. The Bank's financial assets at FVTPL include derivatives, corporate and government debt securities which are held for trading purposes or designated as at FVTPL.

Financial assets at FVTPL are measured at fair value with gains or losses recognized in profit or loss as part of Trading and securities gains under Other Income in the statement of income. Related transaction costs are recognized directly as expense in profit or loss. The fair values of these financial assets are determined by reference to active market transactions or using a valuation technique where no active market exists.

The interest earned is recognized as part of Interest Income account in the statement of income.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are SPPI.

The Bank can only reclassify financial assets if the objective of its business model for managing those financial assets changes. Accordingly, the Bank is required to reclassify financial assets: (i) from amortized cost to FVTPL, if the objective of the business model changes so that the amortized cost criteria are no longer met; and, (ii) from FVTPL to amortized cost, if the objective of the business model changes so that the amortized cost criteria start to be met and the characteristic of the instrument's contractual cash flows meet the amortized cost criteria.

A change in the objective of the Bank's business model will take effect only at the beginning of the next reporting period following the change in the business model.

(b) Classification, Measurement and Reclassification of Financial Assets in Accordance with PAS 39

Financial assets are assigned to different categories by management on initial recognition, depending on the purpose for which the investments were acquired and their characteristics. Financial assets, other than those designated and effective as hedging instruments, are classified into the following categories: financial assets at FVTPL, loans and receivables, HTM investments and AFS financial assets.

Regular purchases and sales of financial assets are recognized on their settlement date. All financial assets that are not classified as at FVTPL are initially recognized at fair value plus any directly attributable transaction costs. Financial assets carried at FVTPL are initially recorded at fair value and transaction costs related to it are recognized in profit or loss.

A more detailed description of the four categories of financial assets as of December 31, 2017 is as follows:

(i) Financial Assets at FVTPL

This category includes derivative financial instruments and financial assets that are either classified as held for trading (HFT) or that meets certain conditions and are designated by the Bank to be carried at FVTPL upon initial recognition. All derivatives fall into this category, except for those designated and effective as hedging instruments. A financial asset is classified in this category if acquired principally for the purpose of selling it in the near term or if so designated by management. Derivatives are also categorized as HFT unless they are designated and effective as hedging instrument. Financial assets at FVTPL include derivatives, government bonds and other debt securities.

Financial assets at FVTPL are measured at fair value, and changes therein are recognized in profit or loss. Financial assets (except derivatives and financial instruments originally designated as financial assets at FVTPL) may be reclassified out of FVTPL category, on rare circumstance, if they are no longer held for the purpose of being sold or repurchased in the near term.

(ii) Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These arise when the Bank provides money or services directly to a debtor with no intention of trading the receivables.

The Bank's financial assets categorized as loans and receivables are presented as Due from BSP, Due from Other Banks, Loans and Receivables and Margin deposits (under Other Resources) in the statement of financial position. Due from BSP and Due from Other Banks are considered cash and cash equivalents, which are readily convertible to known amounts of cash and subject to insignificant risk of changes in value. Loans and receivables include receivables from customers, Securities Purchased Under Reverse Repurchase Agreement (SPURRA), Unquoted Debt Securities Classified as Loans (UDSCL), and all other receivables from customers and other banks.

For purposes of reporting cash flows, cash and cash equivalents include amounts due from BSP and other banks, SPURRA and certain UDSCL with maturities of three months or less from placement date.

Loans and receivables are subsequently measured at amortized cost using the effective interest method, less impairment loss, if any.

(iii) HTM Investments

This category includes non-derivative financial assets with fixed or determinable payments and a fixed date of maturity that the Bank has the positive intention and ability to hold to maturity. Investments intended to be held for an undefined period are not included under this category.

HTM investments consist of government and other debt securities. If the Bank was to sell other than an insignificant amount of HTM investments, the entire category would be tainted and reclassified as AFS securities. The tainting provision will not apply if the sales or reclassifications of HTM investments: (i) are so close to maturity or the financial asset's call date that changes in the market rate of interest would not have a significant effect on its fair value; (ii) occur after the Bank has collected substantially all of the financial asset's original principal through scheduled payments or prepayments; or, (iii) are attributable to an isolated event that is beyond the control of the Bank, is nonrecurring and could not have been reasonably anticipated by the Bank. Upon tainting, the Bank shall not classify any financial assets as HTM investments for the next two reporting periods after the year of tainting.

Subsequent to initial recognition, HTM investments are measured at amortized costs using effective interest method, less impairment losses, if any.

(iv) AFS Financial Assets

This category includes non-derivative financial assets that are either designated to this category or do not qualify for inclusion in any of the other categories of financial assets. The Bank's AFS securities include government and corporate debt securities and unquoted equity securities.

All financial assets within this category are subsequently measured at fair value, except for equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured which are carried at cost, less impairment loss, if any. Gains and losses are recognized in other comprehensive income, net of any income tax effects, and are reported as part of the Revaluation Reserves account in equity, except for interest and dividend income, impairment losses and foreign exchange differences on monetary assets, which are recognized in profit or loss.

When the financial asset is disposed of or is determined to be impaired, that is, when there is a significant or prolonged decline in the fair value of the security below its cost, the cumulative fair value gains or losses recognized in other comprehensive income is reclassified from equity to profit or loss and is presented as reclassification adjustment within other comprehensive income even though the financial asset has not been derecognized.

Non-compounding interest, dividend income and other cash flows resulting from holding financial assets are recognized in profit or loss when earned, regardless of how the related carrying amount of financial assets is measured.

A financial asset is reclassified out of the FVTPL category when the financial asset is no longer held for the purpose of selling or repurchasing it in the near term or under rare circumstances. A financial asset that is reclassified out of the FVTPL category is reclassified at its fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable.

(c) Effective Interest Rate Method and Interest Income

Under both PFRS 9 and PAS 39, Interest income is recorded using the effective interest rate (EIR) method for all financial instrument measured at amortized cost and financial instrument designated at FVTPL. Interest income on interest bearing financial assets measured at FVOCI under PFRS 9, similar to interest bearing financial assets classified as available-for-sale or held to maturity under PAS 39, are also recorded by using the EIR method. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

The EIR is calculated by taking into account any discount or premium on acquisition, fees and costs that are an integral part of EIR. The Bank recognizes interest income using a rate of return that represents the best estimate of a constant rate of return over the expected life of the loan. Hence, it recognizes the effect of potentially different interest rates charged at various stages, and other characteristics of the product life cycle (including prepayments, penalty interest and charges).

If expectations regarding the cash flows on the financial asset are revised for reasons other than credit risk, the adjustment is booked as a positive (negative) adjustment to the carrying amount of the asset in the balance sheet with an increase (reduction) in Interest income. The adjustment is subsequently amortized through interest and similar income in the statement of income.

The Bank calculates interest income by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets.

For financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the net carrying amount of the financial assets (after deduction of the loss allowance). If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis. For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying a credit-adjusted effective interest rate to the amortized cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

(d) Impairment of Financial Assets Under PFRS 9

From January 1, 2018, the Bank assesses its ECL on a forward-looking basis associated with its financial assets carried at amortized cost and debt instruments measured at FVOCI and other contingent accounts. No impairment loss is recognized on equity investments, if any. Recognition of credit losses is no longer dependent on the Bank's identification of a credit loss event. Instead, the Bank considers a broader range of information in assessing credit risk and measuring expected credit losses, including past events, current conditions, reasonable and supportable forecasts that affect collectability of the future cash flows of the financial assets.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following financial instruments for which they are measured as 12-month ECL:

- debt securities that are identified to have 'low credit risk' at the reporting date; and,

- other financial instruments (other than lease receivables) on which credit risk has not increased significantly since their initial recognition.

For these financial instruments, the allowance for impairment is based on 12-month ECL associated with the probability of default of a financial instrument in the next 12 months (referred to as 'Stage 1' financial instruments). Unless there has been a significant increase in credit risk subsequent to the initial recognition of the financial asset, a lifetime ECL (which are the expected shortfalls in contractual cash flows, considering the potential for default at any point during the life of the financial asset) will be recognized (referred to as 'Stage 2' financial instruments). 'Stage 2' financial instruments also include those loan accounts and facilities where the credit risk has improved and have been reclassified from 'Stage 3'. A lifetime ECL shall be recognized for 'Stage 3' financial instruments, which include financial instruments that are subsequently credit-impaired, as well as purchased or originated credit impaired (POCI) assets.

The Bank's definition of credit risk and information on how credit risk is mitigated by the Bank are disclosed in Note 4.3.

Measurement of ECL

The key elements used in the calculation of ECL are as follows:

- *Probability of default (PD)* – it is an estimate of likelihood of a borrower defaulting on its financial obligation (see Note 4.3.5) over a given time horizon, either over the next 12 months (12-month PD) or over the remaining lifetime (lifetime PD) of the obligation.

- *Loss given default (LGD)* – it is an estimate of loss arising in case where a default occurs at a given time (either over the next 12 months or 12-month LGD, or over the remaining lifetime or lifetime LGD). It is based on the difference between the contractual cash flows of a financial instrument due from a counterparty and those that the Bank would expect to receive, including the realization of any collateral. It is presented as a percentage loss per unit of exposure at the time of default.

- *Exposure at default (EAD)* – it represents the gross carrying amount of the financial instruments subject to the impairment calculation; hence, this is the amount that the Bank expects to be owed at the time of default over the next 12 months (12-month EAD) or over the remaining lifetime (lifetime EAD). In case of a loan commitment, the Bank shall include the undrawn balance (up to the current contractual limit) at the time of default should it occur.

The measurement of the ECL reflects: (i) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes; (ii) the time value of money; and, (iii) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Measurement of the ECL is determined by a probability-weighted estimate of credit losses over the expected life of the financial instrument.

The Bank's detailed ECL measurement, as determined by the management, is disclosed in Note 4.3.5.

(e) Impairment of Financial Assets Under PAS 39

The Bank assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Bank about certain loss events, including, among others: (i) significant financial difficulty of the issuer or debtor; (ii) a breach of contract, such as a default or delinquency in interest or principal payments; (iii) the probability that the borrower will enter bankruptcy or other financial reorganization; (iv) the disappearance of an active market for that financial asset because of financial difficulties; or, (v) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets.

As of December 31, 2017, the Bank's assessed impairment of financial assets as follows:

(i) Carried at Amortized Cost – Loans and Receivables and HTM Investments

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant and individually 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, the Bank includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Financial 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 of impairment.

If there is objective evidence that an impairment loss on loans and receivables or HTM investments carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in profit or loss. If a loan and receivable or HTM investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. When practicable, the Bank may measure impairment on the basis of an instrument's fair value using an observable market price.

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 foreclosures less costs for obtaining and selling the collateral, whether or not the foreclosure is probable.

For the purpose of collective impairment, financial assets are grouped on the basis of similar credit risk characteristics, i.e., the Bank's or BSP's grading process that considers asset type, industry, collateral type, status and other relevant factors. Those characteristics are relevant to the estimation of future cash flows for groups of such assets being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the historical loss experience and to remove the effects of conditions in the historical loss experience that do not exist currently.

Estimates of changes in future cash flows for groups of assets should reflect and be consistent with changes in related observable data from period to period. The methodologies 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.

When a loan is uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures, including approval from the management and the BOD, have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognized as an income in the statement of income. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date of the impairment is reversed. The amount of the reversal is recognized in profit or loss.

(ii) Carried at Cost – AFS Financial Assets

The Bank assesses at the end of each reporting period whether there is objective evidence that any of the unquoted equity securities and derivative assets linked to and required to be settled in such unquoted equity instruments, which are carried at cost, may be impaired. The amount of impairment loss is the difference between the carrying amount of the equity security and the present value of the estimated future cash flows discounted at the current market rate of return of a similar asset. Impairment losses on assets carried at cost cannot be reversed.

(iii) Carried at Fair Value – AFS Financial Assets

When a decline in the fair value of an AFS financial asset has been recognized in other comprehensive income and there is objective evidence that the asset is impaired, the cumulative loss – measured as the difference between the acquisition cost (net of any principal repayment and amortization) and current fair value, less any impairment loss on that financial asset previously recognized in profit or loss – is reclassified from Revaluation Reserves to profit or loss as reclassification adjustment even though the financial assets has not been derecognized.

Impairment losses recognized in profit or loss on equity instruments are not reversed through profit or loss. Reversal of impairment losses is recognized in other comprehensive income, except for financial assets that are debt securities which are recognized in profit or loss only if the reversal can be objectively related to an event occurring after the impairment loss was recognized.

(f) Derecognition of Financial Assets

(i) Modification of Loans

When the Bank derecognizes a financial asset through renegotiation or modification of contractual cash flows of loans to customers, the Bank assesses whether or not the new terms are substantially different to the original terms. The Bank considers, among others:

- if the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay;
- whether any substantial new terms are introduced that will affect the risk profile of the loan;
- significant extension of the loan term when the borrower is not in financial difficulty;
- significant change in the interest rate;
- change in the currency the loan is denominated in; and/or,
- insertion of collateral, other security or credit enhancements that will significantly affect the credit risk associated with the loan.

If the terms are substantially different, the Bank derecognizes the financial asset and recognizes a "new" asset at fair value, and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Bank also assesses whether the new financial asset recognized is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are as gain or loss on derecognition of financial assets in profit or loss. As to the impact on ECL measurement, the expected fair value of the "new" asset is treated as the final cash flow from the existing financial asset at the date of derecognition. Such amount is included in the calculation of cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Bank recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognizes a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows of the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets). As to the impact on ECL measurement, the derecognition of the existing financial asset will result in the expected cash flows arising from the modified financial asset to be included in the calculation of cash shortfalls from the existing financial asset.

(ii) Derecognition of Financial Assets Other than Modification

The financial assets (or where applicable, a part of a financial asset or part of a group of financial assets) are derecognized when the contractual rights to receive cash flows from the financial instruments expire, or when the financial assets and all substantial risks and rewards of ownership have been transferred to another party. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

(g) Classification and Measurement of Financial Liabilities

As the accounting for financial liabilities remains largely the same under PFRS 9 compared to PAS 39, the Bank's financial liabilities were not impacted by the adoption of PFRS 9. However, for completeness, the accounting policy is disclosed below and in the succeeding page.

Financial liabilities which include deposit liabilities, bills payable, derivative financial liabilities and accrued expenses and other liabilities (except tax-related payables and post-employment defined benefit obligation). Financial liabilities are recognized when the Bank becomes a party to the contractual terms of the instrument. All interest-related charges are recognized as interest expense in the statement of income.

Deposit liabilities and bills payable are recognized initially at fair value, which is the fair value of consideration received (issue price), net of direct issue costs, and are subsequently measured at amortized cost. Any difference between the proceeds received, net of transaction costs and the redemption value is amortized in the profit or loss over the period of the borrowings using the effective interest method.

Derivative financial liabilities are recognized initially at fair value and subsequently valued at fair value with changes in fair value charged to profit or loss.

Accrued expenses and other liabilities are recognized initially at their fair value and subsequently measured at amortized cost less settlement payments.

Dividend distributions to shareholders are recognized as financial liabilities when the dividends are declared by the Bank and subject to the requirements of BSP Circular 888.

(b) Derecognition of Financial Liabilities

Financial liabilities are derecognized from the statement of financial position only when the obligations are extinguished either through discharge, cancellation or expiration. The difference between carrying amount of financial liability derecognized and the consideration paid or payable is recognized in profit or loss. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or if the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and a recognition of the new liability, and the difference in the respective carrying amounts is recognized as gain or loss in profit or loss.

2.4 Derivative Financial Instruments

The Bank is a party to various foreign currency forward contracts, cross currency and interest rate swaps. These contracts are entered into as a service to customers and as a means of reducing or managing the Bank's foreign exchange and interest rate exposure as well as for trading purposes.

Derivatives are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets and through valuation techniques, including discounted cash flow models and option pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e., the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Bank recognizes the profit or loss at initial recognition.

For more complex instruments, the Bank uses proprietary models, which usually are developed from recognized valuation models. Some or all of the inputs into these models may not be market observable, and are derived from market prices or rates or are estimated based on assumptions. When entering into a transaction, the financial instrument is recognized initially at the transaction price, which is the best indicator of fair value, although the value obtained from the valuation model may differ from the transaction price. This initial difference, usually an increase, in fair value indicated by valuation techniques is recognized in profit or loss depending upon the individual facts and circumstances of each transaction and not later than when the market data becomes observable.

The value produced by a model or other valuation technique is adjusted to allow for a number of factors as appropriate, because valuation techniques cannot appropriately reflect all factors market participants take into account when entering into a transaction. Valuation adjustments are recorded to allow for model risks, bid-ask spreads, liquidity risks, and other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state financial instruments carried at fair value in the statement of financial position.

2.5 Offsetting Financial Instruments

Financial assets and financial liabilities are offset and the resulting net amount, considered as a single financial asset or financial liability, is reported in the statement of financial position when the Bank currently has legally enforceable right to set-off the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously. The right of set-off must be available at the end of the reporting period, that is, it is not contingent on future event. It must also be enforceable in the normal course of business, in the event of default, and in the event of insolvency or bankruptcy; and must be legally enforceable for both entity and all counterparties to the financial instruments.

2.6 Other Resources

Other resources pertain to other assets controlled by the Bank as a result of past events. They are recognized in the financial statements when it is probable that the future economic benefits will flow to the Bank and the asset has a cost or value that can be measured reliably.

2.7 Intangible Assets

Intangible assets pertain to computer software licenses presented as part of Other Resources in the statement of financial position. Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and install the specific software. Capitalized costs are amortized on a straight line basis over the estimated useful life. The expected useful life of computer software is five years. In addition, computer software is subject to impairment testing as describe in Note 2.15. Costs associated with maintaining computer software are expensed as incurred.

When an intangible asset is disposed of, the gain or loss on disposal is determined as the difference between the proceeds and the carrying amount of the asset and is recognized in profit or loss.

2.8 Bank Premises, Furniture, Fixtures and Equipment

Bank premises, furniture, fixtures and equipment are carried at acquisition cost less accumulated depreciation and amortization and any impairment losses.

The cost of an asset comprises its purchase price and directly attributable cost of bringing the asset to working condition for its intended use. Expenditures for additions, improvements and renewals are capitalized while expenditures for repairs and maintenance are charged to expense as incurred.

The estimated useful life of furniture, fixtures, and equipment is five years. Leasehold improvements are amortized over the lease term or five years, whichever is shorter.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see Note 2.15).

The residual values, estimated useful lives and method of depreciation and amortization of bank premises, furniture, fixtures and equipment are reviewed, and adjusted if appropriate, at the end of each reporting period.

An item of bank premises, furniture, fixtures and equipment including related accumulated depreciation and impairment losses is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising from derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the statement of income in the year the item is derecognized.

2.9 Provisions and Contingencies

Provisions are recognized when present obligations will probably lead to an outflow of economic resources and they can be estimated reliably even if the timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive commitment that has resulted from past events.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the end of the reporting period, including the risks and uncertainties associated with the present obligation. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. When time value of money is material, long-term provisions are discounted to their present values using a pretax rate that reflects market assessments and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense. Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate.

In those cases, where the possible outflow of economic resource as a result of present obligations is considered improbable or remote, or the amount to be provided for cannot be measured reliably, no liability is recognized in the financial statements. Similarly, possible inflows of economic benefits to the Bank that do not yet meet the recognition criteria of an asset are considered contingent assets, hence, are not recognized in the financial statements. On the other hand, any reimbursement that the Bank can be virtually certain to collect from a third party with respect to the obligation is recognized as a separate asset not exceeding the amount of the related provision.

2.10 Equity

Preferred and common stocks represent the nominal value of shares that have been issued.

Surplus reserves pertain to reserve for trust business representing the accumulated amount set aside by the Bank under existing regulations requiring the Bank to carry to surplus 10% of its net profits accruing from its trust business until the surplus shall amount to 20% of its authorized capital stock and to the appropriation for general loan loss provision as prescribed by BSP.

Surplus free includes all current and prior period results as disclosed in statement of income and which are available and not restricted for use by the Bank, reduced by the amounts of dividends declared, if any.

Revaluation reserves include unrealized gains (losses) on financial assets at FVOCI (previously as AFS securities) which pertain to mark-to-market valuation and accumulated actuarial gains (losses) which relate to remeasurement of post-employment defined benefit plans.

2.11 Related Party Transactions and Relationships

Related party transactions consist of transfer of resources, services or obligations between the Bank and its related parties, regardless whether a price is charged.

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. These parties include: (a) individuals owning, directly or indirectly through one or more intermediaries, control or are controlled by, or under common control with the Bank; (b) associates; (c) individuals owning, directly or indirectly, an interest in the voting power of the Bank that gives them significant influence over the Bank and close members of the family of any such individual; and, (d) the Bank's funded retirement plan (see Note 21.2).

In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely on the legal form.

2.12 Other Income and Expense Recognition

In 2017 and prior years, revenue is recognized to the extent that the revenue can be reliably measured; it is probable that future economic benefits will flow to the Bank; and the expenses and costs incurred and to be incurred can be measured reliably. In 2018, revenue is recognized only when (or as) the Bank satisfies a performance obligation by transferring control of the promised services to the customer. A contract with a customer that results in a recognized financial instrument in the Bank's financial statements may be partially within the scope of PFRS 9 and partially within the scope of PFRS 15. In such case, the Bank first applies PFRS 9 to separate and measure the part of the contract that is in-scope of PFRS 9, and then applies PFRS 15 to the residual part of the contract. Expenses and costs, if any, are recognized in profit or loss upon utilization of the assets or services or at the date these are incurred. All finance costs are reported in profit or loss on accrual basis.

The Bank also earns service fees on various banking services which are supported by contracts approved by the parties involved. These revenues are accounted for by the Bank in accordance with PFRS 15.

For revenues arising from various banking services which are to be accounted for under PFRS 15, the following provides information about the nature and timing of satisfaction of performance obligations in contracts with customers, including significant payment terms, and the related revenue recognition policies:

(a) Individual and Corporate Banking Services

The Bank provides banking services to individual and corporate customers, including account management, servicing arrangements and all other banking transactions (i.e., lending, foreign currency transactions, settlement and remittance).

Transaction-based fees are charged to the customer's account; hence, revenues are recognized at the point in time when the transaction takes place.

(b) Asset Management Services

The Bank provides asset management services, which include trust and fiduciary activities. Related fees are recognized as follows:

(i) Asset management and trust fees – these are service fees calculated based on a fixed percentage of the value of assets managed and deducted from the customer's account balance on the scheduled collection date. Revenue from asset management services is recognized over time as the services are provided.

(ii) Non-refundable upfront fees – are charged to customers when opening certain types of trust account with the Bank. These fees give rise to material rights for future services and are recognized as revenue over the period for which a customer is expected to continue receiving asset management services.

2.13 Leases – Bank as Lessee

Leases, which do not transfer to the Bank substantially all the risks and benefits of ownership of the asset, are classified as operating leases. Operating lease payments (net of any incentive received from the lessor) are recognized as expense in profit or loss on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

The Bank determines whether an arrangement is, or contains, a lease based on the substance of the arrangement. It makes an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

2.14 Foreign Currency Transactions and Translation

The accounting records of the Bank are maintained in Philippine pesos. Foreign currency transactions during the year are translated into the functional currency at exchange rates which approximate those prevailing on transaction dates.

Foreign currency gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in statement of income under Foreign exchange gain – net.

Changes in the fair value of monetary financial assets denominated in foreign currency classified as financial assets at FVOCI (previously AFS securities) are analyzed between translation differences resulting from changes in the amortized cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortized cost are recognized in profit or loss, and other changes in the carrying amount are recognized in other comprehensive income (loss).

2.15 Impairment of Non-financial Assets

Bank premises, furniture, fixtures and equipment, computer software and other non-financial assets included in Other Resources account in the statement of financial position are subject to impairment testing whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Impairment loss is recognized in profit or loss for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amount, which is the higher of fair value less costs to sell, and value in use based on an internal discounted cash flow evaluation. The data used for impairment testing procedures are directly linked to the Bank's latest approved budget, adjusted as necessary to exclude the effects of asset enhancements. Discount factors are determined individually for each cash-generating unit and reflect management's assessment of respective risk profiles, such as market and asset-specific risk factors.

All assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist. An impairment loss is reversed if the asset's recoverable amount exceeds its carrying amount.

2.16 Employee Benefits

The Bank provides post-employment benefits to employees through a defined benefit plan and defined contribution plan, and other employee benefits which are recognized as follows:

(a) Post-employment Defined Benefit Plan

A defined benefit plan is a post-employment plan that defines an amount of post-employment benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and salary. The legal obligation for any benefits from this kind of post-employment plan remains with the Bank, even if plan assets for funding the defined benefit plan have been acquired. Plan assets may include assets specifically designated to a long-term benefit fund, as well as qualifying insurance policies. The Bank's defined benefit post-employment plan covers all regular full-time employees. The pension plan is tax-qualified, non-contributory and administered by a trustee.

The liability recognized in the statement of financial position for a defined benefit plan is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows for expected benefit payments using a discount rate derived from the interest rates of a zero coupon government bonds [using the reference rates published by Bloomberg using its valuation technology, Bloomberg Valuation (BVAL)], that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related post-employment liability. BVAL provides evaluated prices that are based on market observations from contributed sources.

Remeasurements, comprising of actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions and the return on plan assets (excluding amount included in net interest) are reflected immediately in the statement of financial position with a charge or credit recognized in other comprehensive income in the period in which they arise. Net interest is calculated by applying the discount rate at the beginning of the period, taking account of any changes in the net defined benefit liability or asset during the period as a result of contributions and benefit payments. Net interest is reported as part of Others under Interest Expense account in the statement of income.

Past-service costs are recognized immediately in profit or loss in the period of a plan amendment or curtailment.

(b) *Post-employment Defined Contribution Plan*

A defined contribution plan is a pension plan under which the Bank pays fixed contributions into an independent entity such as the Social Security System. The Bank has no legal or constructive obligations to pay further contributions after payment of the fixed contribution. The contributions recognized in respect of defined contribution plans are expensed as they fall due. Liabilities or assets may be recognized if underpayment or prepayment has occurred and are included in current liabilities or current assets as they are normally of a short-term nature.

(c) *Termination Benefits*

Termination benefits are payable when employment is terminated by the Bank before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Bank recognizes termination benefits at the earlier of when it can no longer withdraw the offer of such benefits and when it recognizes costs for a restructuring that is within the scope of PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, and involves the payment of termination benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the reporting period are discounted to their present value.

(d) *Bonus Plans*

The Bank recognizes a liability and an expense for bonuses based on a formula that takes into consideration the profit attributable to the Bank's shareholders after certain adjustments. The Bank recognizes a provision where it is contractually obliged to pay the benefits, or where there is a past practice that has created a constructive obligation.

(e) *Compensated Absences*

Compensated absences are recognized for the number of paid leave days (including holiday entitlement) remaining at the end of each reporting period. They are included in the Accrued Expenses and Other Liabilities account in the statement of financial position at the undiscounted amount that the Bank expects to pay as a result of the unused entitlement. Unavailed leaves of employees under the retirement plan are valued and funded as part of the present value of defined benefit obligation under item (a) in the previous page.

(f) Employee Stock Option Plan

The Bank grants stock option plan to its senior officers (from vice-president up) for their contribution to the Bank's performance and attainment of team goals. The stock option plan gives qualified employees the right to purchase the BDO Unibank's shares at an agreed strike price. The amount of stock option allocated to the qualified officers is based on the performance of the individual officers as determined by the management and is determined based on the Bank's performance in the preceding year and amortized over five years (vesting period) starting from date of approval of the BOD. The number of officers qualified at the grant date is regularly evaluated (at least annually) during the vesting period and the amount of stock option is decreased in case there are changes in the number of qualified employees arising from resignation or disqualification.

Liability recognized on the stock option plan for the amount charged by BDO Unibank attributable to the qualified officers of the Bank is included under Accrued Expenses and Other Liabilities in the statement of financial position and the related expense is presented in Employee benefits under Other Expenses in the statement of income (see Notes 16 and 21.1).

2.17 Income Taxes

Tax expense recognized in profit or loss comprises the sum of deferred tax and current tax not recognized in other comprehensive income or directly in equity, if any.

Current tax assets or liabilities comprise those claims from, or obligations to, fiscal authorities relating to the current or prior reporting period, that are uncollected or unpaid at the end of the reporting period. They are calculated according to the tax rates and tax laws applicable to the fiscal periods to which they relate, based on the taxable profit for the year. All changes to current tax assets or liabilities are recognized as a component of tax expense in profit or loss.

Deferred tax is accounted for, using the liability method, on temporary differences at the end of the reporting period between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes. Under the liability method, with certain exceptions, deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets are recognized for all deductible temporary differences and the carry forward of unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the deferred tax asset can be utilized. Unrecognized deferred tax assets are reassessed at the end of each reporting period and are recognized to the extent that it has become probable that future taxable profit will be available to allow such deferred tax assets to be recovered.

Deferred tax assets and deferred tax liabilities are measured at the tax rates that are expected to apply 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 end of each reporting period.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Most changes in deferred tax assets or liabilities are recognized as a component of tax expense in profit or loss, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity, respectively.

Deferred tax assets and deferred tax liabilities are offset if the Bank has a legally enforceable right to set-off current tax assets against current tax liabilities and the deferred taxes relate to the same entity and the same taxation authority.

2.18 Trust Operations

The Bank commonly acts as trustee and in other fiduciary capacities that result in the holding or placing of assets on behalf of individuals, trusts, post-employment benefit plans and other institutions. Resources and income arising thereon are excluded from these financial statements, as these are neither resources nor income of the Bank.

2.19 Events After the End of the Reporting Period

Any post-year-end event that provides additional information about the Bank's financial position at the end of the reporting period (adjusting event) is reflected in the financial statements. Post-year-end events that are not adjusting events, if any, are disclosed when material to the financial statements.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The Bank's financial statements prepared in accordance with PFRS require management to make judgments and estimates that affect the amounts reported in the financial statements and related notes. Judgments and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may likely differ from these estimates and the differences could be significant.

3.1 Critical Management Judgments in Applying Accounting Policies

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

(a) Application of ECL to HTC Investments and Financial Assets at FVOCI (2018)

The Bank uses a provision matrix to calculate ECL for all debt instruments carried at amortized cost and FVOCI, together with loan commitments and financial guarantee contracts, if any. The allowance for impairment is based on the ECLs associated with the probability of default of a financial instrument in the next 12 months, unless there has been a significant increase in credit risk since origination of the financial instrument, in such case, a lifetime ECL for the instrument is recognized.

The Bank has established a policy to perform an assessment, at the end of each reporting period, whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument.

(b) Evaluation of Business Model Applied in Managing Financial Instruments (2018)

The Bank manages its financial assets based on business models that maintain adequate level of financial assets to match its expected cash outflows, largely its core deposit funding arising from customers' withdrawals and continuing loan disbursements to borrowers, while maintaining a strategic portfolio of financial assets for trading activities consistent with its risk appetite.

Upon adoption of PFRS 9, the Bank developed business models which reflect how it manages its portfolio of financial instruments. The Bank's business models need not be assessed at entity level or as a whole but shall be applied at the level of a portfolio of financial instruments (i.e., group of financial instruments that are managed together by the Bank) and not on an instrument-by-instrument basis (i.e., not based on intention or specific characteristics of individual financial instrument).

In determining the classification of a financial instrument under PFRS 9, the Bank evaluates in which business model a financial instrument or a portfolio of financial instruments belongs to taking into consideration the objectives of each business model established by the Bank as those relate to the Bank's investment, trading and lending strategies.

(c) Testing the Cash Flow Characteristics of Financial Assets and Continuing Evaluation of the Business Model (2018)

In determining the classification of financial assets under PFRS 9, the Bank assesses whether the contractual terms of the financial assets give rise on specified dates to cash flows that are SPPI on the principal outstanding, with interest representing time value of money and credit risk associated with the principal amount outstanding. The assessment as to whether the cash flows meet the test is made in the currency in which the financial asset is denominated. Any other contractual term that changes the timing or amount of cash flows (unless it is a variable interest rate that represents time value of money and credit risk) does not meet the amortized cost criteria. In cases where the relationship between the passage of time and the interest rate of the financial instrument may be imperfect, known as modified time value of money, the Bank assesses the modified time value of money feature to determine whether the financial instrument still meets the SPPI criterion. The objective of the assessment is to determine how different the undiscounted contractual cash flows could be from the undiscounted cash flows that would arise if the time value of money element was not modified (the benchmark cash flows). If the resulting difference is significant, the SPPI criterion is not met. In view of this, the Bank considers the effect of the modified time value of money element in each reporting period and cumulatively over the life of the financial instrument.

In addition, PFRS 9 emphasizes that if more than an infrequent sale is made out of a portfolio of financial assets carried at amortized cost, an entity should assess whether and how such sales are consistent with the objective of collecting contractual cash flows. In making this judgment, the Bank considers certain circumstances documented in its business model manual to assess that an increase in the frequency or value of sales of financial instruments in a particular period is not necessarily inconsistent with a held-to-collect business model if the Bank can explain the reasons for those sales and why those sales do not reflect a change in the Bank's objective for the business model.

(d) Classification of Financial Assets as HTM Investments (2017)

The Bank followed the guidance of PAS 39 in classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as HTM investments. This classification requires significant judgment. In making this judgment, the Bank evaluates its intention and ability to hold such investments up to maturity. If the Bank fails to keep these investments to maturity other than for specific circumstances as allowed under the standards, it will be required to reclassify the whole class as AFS securities. In such a case, the investments would, therefore, be measured at fair value, not at amortized cost.

In 2013, the Bank reclassified its entire HTM investments to AFS securities, which were disposed in 2014. In accordance with the two-year tainting provision of PAS 39, the Bank did not classify financial assets as HTM from 2013 to 2015. The two-year tainting provision has ended in 2016 and the Bank started classifying back financial assets under the HTM portfolio (see Notes 8 and 9). Had the Bank remained tainted, the entire class of HTM investments will be measured at fair value resulting in unrealized fair value loss of P175,464,281 in 2017.

(e) Impairment of AFS Securities (2017)

The Bank follows the guidance of PAS 39 in determining when an investment is permanently impaired, which requires significant judgment. In making this judgment, the Bank evaluates, among other factors, the significant or prolonged decline in the fair value of an investment below its costs and the financial health of and near-term business outlook for the investee, including factors such as industry and sector performance, changes in technology and operational and financing cash flow.

Based on the evaluation of information and circumstances affecting the Bank's AFS securities, management did not recognized impairment loss on its AFS securities in 2017.

(f) Distinction Between Operating and Finance Leases

The Bank has entered into various lease agreements as a lessee. Critical judgment was exercised by management to distinguish each lease agreement as either an operating or finance lease by looking at the transfer or retention of significant risk and rewards of ownership of the properties covered by the agreements. Failure to make the right judgement will result in either overstatement or understatement of resources and liabilities.

(g) Determination of Timing of Satisfaction of Performance Obligations (2018)

The Bank determines that its revenues from services for asset management and other non-refundable upfront fees shall be recognized over time. In making its judgment, the Bank considers the timing of receipt and consumption of benefits provided by the Bank to the customers. As the work is performed, the Bank becomes entitled to payments. This demonstrates that the customers simultaneously receive and consume the benefits of the Bank's rendering of these banking services as it performs.

In determining the best method of measuring the progress of the Bank's rendering of aforementioned services, the management considers the output method, which uses direct measurements of the value to the customer of the services transferred to date relative to the remaining services promised as basis in recognizing revenues. Such measurements include results of performance completed to date, time elapsed, and appraisals of milestones reached or activities already performed.

(h) Recognition of Provisions and Contingencies

Judgment is exercised by management to distinguish between provisions and contingencies. Policies on recognition of provisions and contingencies are discussed in Note 2.9 and relevant disclosures are presented in Note 26.

3.2 Key Sources of Estimation Uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of resources and liabilities within the next reporting period:

(a) Estimation of Allowance for ECL (2018)

The measurement of the allowance for ECL on financial assets at amortized cost is an area that requires the use of significant assumptions about the future economic conditions and credit behavior (e.g., likelihood of customers defaulting and the resulting losses). Explanation of the inputs, assumptions and estimation used in measuring ECL is further detailed in Note 4.3.5.

The carrying value of financial assets at FVOCI, Investments securities at amortized cost and Loans and other receivables and, the analysis of the allowance for impairment on such financial assets, are shown in Notes 8, 9, 10, respectively.

(b) Impairment of Financial Assets (Loans and Receivables, HTM Investments and AFS Securities) (2017)

The Bank reviewed its Loans and receivables, HTM investments and AFS securities portfolios to assess for impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in profit or loss, the Bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from the portfolio before the decrease can be identified with an individual item in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers or issuers in a group, or national or local economic conditions that correlate with defaults on assets in the group.

Management used estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

As a result of its loan loss provisioning assessment, the Bank recognized impairment loss on loans and receivables amounting to P1,827,375 in 2017 (see Note 10).

(c) Fair Value Measurements for Financial Instruments

Management applies valuation techniques to determine the fair value of financial instruments where active market quotes are not available. Valuation techniques are used to determine fair values which are validated and periodically reviewed. To the extent practicable, models use observable data, however, areas such as counterparty credit risk, volatilities and correlations require management to make estimates. Changes in assumptions could affect the reported fair value of financial instruments. The Bank uses judgment to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period.

The carrying values of the Bank's financial assets at FVTPL and financial assets at FVOCI (previously as AFS securities) and the amounts of fair value changes recognized during the years on those assets are disclosed in Notes 7 and 8, respectively.

(d) Determination of Fair Value of Derivatives

The fair value of derivative financial instruments that are not quoted in an active market is determined through valuation techniques using the net present value computation.

Valuation techniques are used to determine fair values, which are validated and periodically reviewed. To the extent practicable, models use observable data, however, areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions and correlations require management to make estimates.

The Bank use judgment to select a variety of methods and make assumptions that are mainly based on conditions existing at the end of each reporting period.

(e) Estimation of Useful Lives of Bank Premises, Furniture, Fixtures and Equipment and Computer Software

The Bank estimates the useful lives of bank premises, furniture, fixtures and equipment and computer software based on the period over which the assets are expected to be available for use. The estimated useful lives of bank premises, furniture, fixtures and equipment and computer software are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets. Actual results, however, may vary due to changes in estimates brought about by changes in factors mentioned above.

Analyses of the carrying amounts of bank premises, furniture, fixtures, and equipment and computer software are disclosed in Notes 11 and 12, respectively.

(f) Determination of Realizable Amount of Deferred Tax Assets

The Bank reviews its deferred tax assets at the end of each reporting period and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Management assessed that the deferred tax assets recognized as of December 31, 2018 and 2017 will be fully utilized in the coming years. The carrying value of deferred tax assets as of those dates is disclosed in Notes 12 and 23.

(g) Impairment of Non-financial Assets

In assessing impairment, management estimates the recoverable amount of each asset or a cash-generating unit based on expected future cash flows and uses an interest rate to calculate the present value of those cash flows. Estimation uncertainty relates to assumptions about future operating results and the determination of a suitable discount rate (see Note 2.15). Though management believes that the assumptions used in the estimation of fair values reflected in the financial statements are appropriate and reasonable, significant changes in those assumptions may materially affect the assessment of recoverable values and any resulting impairment loss could have a material adverse effect on the results of operations.

No impairment losses on non-financial assets were recognized in 2018 and 2017.

(h) Valuation of Post-employment Defined Benefit Obligation

The determination of the Bank's obligation and cost of post-employment defined benefit is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions include, among others, discount rates, expected rate of return on plan assets, salary rate increase and employee turnover rate. A significant change in any of these actuarial assumptions may generally affect the recognized expense, other comprehensive income or losses and the carrying amount of the post-employment benefit obligation in the next reporting period.

The amounts of post-employment benefit obligation and expense and an analysis of the movements in the estimated present value of post-employment benefit, as well as the significant assumptions used in estimating such obligation are presented in Note 21.2.

4. RISK MANAGEMENT

With its culture of managing risk prudently within its capacity and capabilities, the Bank pursues its strategy and business plans to provide consistent quality service to its customers, to achieve its desired long-term target returns to its shareholders and satisfy or abide by the needs of its other stakeholders, including its depositors and regulators.

The Bank believes that, as there are opportunities, there are associated risks and the objective is not to totally avoid risks, but to adequately and consistently evaluate, manage, control, and monitor the risks and ensure that the Bank is adequately compensated for all the risks taken. Good risk management involves making informed and rational decisions about the level of risks the institution wants to take, in the pursuit of its objectives, but with consideration to return commensurate with the risk-taking activity.

The Bank's goal is to remain a strong bank that is resilient to possible adverse events. Hence, the Bank ensures:

- strong financial position by maintaining capital ratios in excess of regulatory requirements;
- sound management of liquidity; and,
- ability to generate sustainable earnings commensurate with the risks taken.

For credit risk, market risk, and liquidity risk, the Bank ensures that these are within Board-approved operating limits. For operational risk (which includes legal, regulatory, compliance risks), and reputational risks, these are invariably managed by the development of both a strong "control culture" and an effective internal control system that constantly monitors and updates operational policies and procedures with respect to the Bank's activities and transactions.

Risk management at the Bank begins at the highest level of the organization. At the helm of the risk management infrastructure is the BOD who is responsible for establishing and maintaining a sound risk management system. The BOD assumes oversight over the entire risk management process and has the ultimate responsibility for all risks taken. It regularly reviews and approves the institution's tolerance for risks, as well as, its business strategy and risk philosophy.

The BOD has constituted the Risk Management Committee (RMC) as the Board-Level Committee responsible for the development and oversight of the risk management program. Considering the importance of appropriately addressing credit risk, the BOD has also constituted the Credit Committee. The Credit Committee is responsible for approving credit-specific transactions, while the RMC is responsible for approving credit portfolio risk-related policies and limits, as well as, market, liquidity, and operational risk policies and limits.

Within the Bank's overall risk management system is the Assets and Liabilities Committee (ALCO) which is responsible for managing the Bank's statement of financial position, including the Bank's liquidity, interest rate and foreign exchange related risks. In addition, ALCO formulates investment and financial policies by determining the asset allocation and funding mix strategies that are likely to yield the targeted financial results.

The Bank operates an integrated risk management system to address the risks it faces in its banking activities, including credit, market (foreign exchange, interest rate, and price risks), liquidity, and operational risks. The Risk Management Group (RMG) is mandated to adequately and consistently evaluate, manage, control, and monitor the overall risk profile of the Bank's activities across the different risk areas (i.e., credit, market, liquidity and operational risks) to optimize the risk-reward balance and maximize return on capital. RMG also has the responsibility for recommending to the appropriate body, risk policies across the full range of risks to which the Bank is exposed. RMG functionally reports to the RMC.

The evaluation, analysis, and control performed by the Risk Function, in conjunction with the Risk Takers, constitute the risk management process. The risk management process is applied at three levels: the transaction level, the business unit level and the portfolio level. This framework ensures that risks are properly identified, quantified and analyzed, in the light of its potential effect on the Bank's business. The goal of the risk management process is to ensure rigorous adherence to the Bank's standards for precision in risk measurement and reporting and to make possible, in-depth analysis of the deployment of capital and the returns that are delivered to the shareholders.

4.1 Market Risk

The Bank's exposure to market risk, the risk of future loss from changes in the price of a financial instrument, relates primarily to its holdings in foreign exchange instruments, debt securities and derivatives. The Bank manages its risk by identifying, analyzing and measuring relevant or likely market risks. Market Risk Management recommends market risk limits based on relevant activity indicators for approval by the Bank's RMC and BOD.

4.1.1 Foreign Exchange Risk

The Bank manages its exposure to effects of fluctuations in the foreign currency exchange rates by maintaining foreign currency exposure within the existing regulatory guidelines and at a level that it believes to be relatively conservative for a financial institution engaged in that type of business.

The Bank's net foreign exchange exposure is computed as its foreign currency resources less foreign currency liabilities plus contingent assets less contingent liabilities. BSP regulations impose a cap of 20% of unimpaired capital or US$50 million, whichever is lower, on the consolidated excess foreign exchange holdings of banks in the Philippines. The Bank's foreign exchange exposure is primarily foreign exchange trading with corporate accounts and other financial institutions. The Bank, as a market participant in the Philippine Dealing System, may engage in proprietary trading to take advantage of foreign exchange fluctuations.

The Bank's foreign exchange exposure at end-of-day is guided by the limits set forth in the Bank's Risk Management Manual. These limits are within the prescribed ceilings mandated by the BSP. At the end of each day, the Bank reports to the BSP on its compliance with the mandated foreign currency exposure limits.

The tables below set out the composition of the Bank's financial resources and financial liabilities as to currency as of December 31, 2018 and 2017 (amounts in thousands):

	2018		
	Foreign Currencies	**Philippine Peso**	**Total**
Resources:			
Due from BSP	**P –**	**P 4,425,182**	**P 4,425,182**
Due from other Banks	**3,003,023**	**42,049**	**3,045,072**
Financial assets at FVTPL	**242,063**	**3,505,028**	**3,747,091**
Financial assets at FVOCI	**7,789,348**	**3,660,419**	**11,449,767**
HTC investments	**7,272,526**	**12,226,895**	**19,499,421**
Loans and receivables	**377,282**	**4,335,476**	**4,712,758**
Other resources	**1,738,954**	**1,567**	**1,740,521**
	P 20,423,196	**P 28,196,616**	**P 48,619,812**
Liabilities:			
Deposit liabilities	**P 18,155,392**	**P 22,358,295**	**P 40,513,687**
Derivative financial liabilities	**49,046**	**2,772,509**	**2,821,555**
Other liabilities	**2,224**	**79,175**	**81,399**
	P 18,206,662	**P 25,209,979**	**P 43,416,641**

	2017		
	Foreign Currencies	Philippine Peso	Total
Resources:			
Due from BSP	P –	P 11,977,052	P 11,977,052
Due from other Banks	8,320,342	266,254	8,586,596
Financial assets at FVTPL	477,060	3,235,466	3,712,526
AFS securities	8,445,661	5,955,065	14,400,726
HTM investments	2,023,121	10,956,778	12,979,899
Loans and receivables	436,343	11,258,200	11,694,543
Other resources	988,907	1,442	990,349
	P 20,691,434	P 43,650,257	P 64,341,691
Liabilities:			
Deposit liabilities	P 22,170,813	P 34,641,077	P 56,811,890
Derivative financial liabilities	45,010	1,933,060	1,978,070
Other liabilities	2,142	214,601	216,743
	P 22,217,965	P 36,788,738	P 59,006,703

4.1.2 Interest Rate Risk

The Bank prepares a gap analysis in the banking book to measure the sensitivity of its resources, liabilities and off-book items to interest rate fluctuations. The focus of analysis is the impact of changes in interest rates on accrual or reported earnings. This analysis would give management a glimpse of the repricing profile of its interest sensitive resources and liabilities. An interest rate gap report is prepared by classifying all financial assets and liabilities into various time buckets according to contracted maturities if fixed or anticipated repricing dates if floating or based on behavioural assumptions if more applicable.

In the interest rate gap presented, loans and investments are profiled based on next repricing if floating; or contracted maturity if fixed; while non-maturity deposit liabilities are considered non-rate sensitive. The difference in the amount of resources 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 following table shows the amounts of the Bank's resources and liabilities that are subject to different interest rate arrangements as of December 31, 2018 and 2017 (amounts in thousands):

	2018		2017	
	Resources	**Liabilities**	Resources	Liabilities
Subject to floating interest rates	**P 1,628,255**	**P 190,041**	P 386,834	P 55,536
Subject to fixed interest rates	**41,014,897**	**42,313,701**	54,859,883	58,182,573
Non-interest-bearing	**6,206,043**	**1,209,087**	9,249,129	909,120
	P 48,849,195	**P 43,712,829**	P 64,495,846	P 59,147,229

The analyses of the groupings of resources, liabilities and off-book items as of December 31, 2018 and 2017 based on expected interest realization or recognition are presented in the next table (amounts in millions):

	2018					
	One to Three Months	**More Than Three Months to One Year**	**More Than One Year to Five Years**	**More Than Five Years**	**Non-Rate Sensitive**	**Total**
Resources:						
Due from BSP	P –	P –	P –	P –	P 4,425	P 4,425
Due from other banks	1,706	1,313	26	–	–	3,045
Trading and investment securities	3,081	3,257	11,305	13,341	3,712	34,696
Loans and receivables	2,026	454	564	1,669	–	4,713
Other resources*	–	–	–	45	1,925	1,970
Total Resources	**6,813**	**5,024**	**11,895**	**15,055**	**10,062**	**48,849**
Liabilities and Equity:						
Deposit liabilities	28,398	3,960	1,679	1,218	5,259	40,514
Other liabilities	–	–	–	–	3,199	3,199
Total Liabilities	28,398	3,960	1,679	1,218	8,458	43,713
Equity	–	–	–	–	5,136	5,136
Total Liabilities and Equity	**28,398**	**3,960**	**1,679**	**1,218**	**13,594**	**48,849**
On-book Gap	(21,585)	1,064	10,216	13,837	(3,532)	–
Cumulative On-book Gap	**(21,585)**	**(20,521)**	**(10,305)**	**3,532**	**–**	**–**
Contingent Resources	5,051	1,618	–	–	–	6,669
Contingent Liabilities	4,943	1,577	–	–	–	6,520
Off-book Gap	108	41	–	–	–	149
Cumulative Total Gap	**(P 21,477)**	**(P 20,372)**	**(P 10,156)**	**P 3,681**	**P 149**	**P –**

	2017					
	One to Three Months	More Than Three Months to One Year	More Than One Year to Five Years	More Than Five Years	Non-rate sensitive	Total
Resources:						
Due from BSP	P 4,205	P –	P –	P –	P 7,772	P 11,977
Due from other banks	8,586	–	–	–	–	8,586
Trading and investment securities	1,451	739	13,499	11,698	3,713	31,100
Loans and receivables	6,308	1,974	2,747	665	–	11,694
Other resources*	–	–	–	42	1,097	1,139
Total Resources	20,550	2,713	16,246	12,405	12,582	64,496
Liabilities and Equity:						
Deposit liabilities	38,056	3,967	5,233	1,528	8,028	56,812
Other liabilities	–	–	–	–	2,335	2,335
Total Liabilities	38,056	3,967	5,233	1,528	10,363	59,147
Equity	–	–	–	–	5,349	5,349
Total Liabilities and Equity	38,056	3,967	5,233	1,528	15,712	64,496
On-book Gap	(17,506)	(1,254)	11,013	10,877	(3,130)	–
Cumulative On-book Gap	(P 17,506)	(P 18,760)	(P 7,747)	P 3,130	P –	P –

	2017					
	One to Three Months	More Than Three Months to One Year	More Than One Year to Five Years	More Than Five Years	Non-rate sensitive	Total
Cumulative On-book Gap	(P 17,506)	(P 18,760)	(P 7,747)	P 3,130	P –	P –
Contingent Resources	4,355	777	–	–	–	5,132
Contingent Liabilities	4,248	750	–	–	–	4,998
Off-book Gap	107	27	–	–	–	134
Cumulative Total Gap	(P 17,399)	(P 18,626)	(P 7,613)	P 3,264	P 134	P –

* *Other resources include bank premises, furniture, fixtures and equipment, margin deposits, petty cash and other deposits.*

The Bank's market risk management limits are generally categorized as limits on:

- Value-at-risk (VaR) – The RMG computes the VaR benchmarked at a level which is a percentage of projected earnings. The Bank uses the VaR model to estimate the daily potential loss that the Bank can incur from its trading book, based on a number of assumptions with a confidence level of 99%. The measurement is designed such that exceptions over limits should only arise in very exceptional circumstances.

- Stop loss – The RMG sets the amount of each risk-bearing activity at a percentage of the budgeted annual income for such activity.

- Nominal position – The RMG sets the nominal amount to prevent over-trading, excessive concentration, and to limit financial loss supplementing other already established limits.

- Trading volume – The RMG sets the volume of transactions that any employee may execute at various levels based on the rank of the personnel making the risk-bearing decision.

- Earnings-at-risk – The RMG computes the earnings-at-risk based on the repricing profile of the Banking Book and benchmarks against projected annual net interest income and capital.

VaR is one of the key measures in the Bank's management of market risk. VaR is defined as a statistical estimate of the maximum possible loss on a given position during a time horizon within a given confidence interval. The Bank uses a 99% confidence level and a 260-day observation period in VaR calculation. The Bank's VaR limit is established as a percentage of projected earnings and is used to alert senior management whenever the potential losses in the Bank's portfolios exceed tolerable levels.

Because the VaR measure is tied to market volatility, it therefore allows management to react quickly and adjust its portfolio strategies in different market conditions in accordance with its risk philosophy and appetite. The VaR model is validated through back-testing.

Although VaR is an important tool for measuring market risk, the following assumptions stated below and in the succeeding page are the assumptions on which the model is based to give rise to some limitations.

- A one-day holding period assumes that it is possible to hedge or dispose of positions within that period. This is considered to be a realistic assumption in almost all cases but may not be the case in situations in which there is severe market illiquidity for a prolonged period;

- A 99% confidence level does not reflect losses that may occur beyond this level. Even within the model used, there is a one percent probability that losses could exceed the VaR;

- VaR is calculated on an end-of-day basis and does not reflect exposures that may arise on positions during the trading day;

- The use of historical data as a basis for determining the possible range of future outcomes may not always cover all possible scenarios, especially those of an exceptional nature; and,

- The VaR measure is dependent upon the Bank's position and the volatility of market prices. The VaR of an unchanged position reduces if the market price volatility declines and vice versa.

The limitations of the VaR methodology are recognized by supplementing VaR limits with other position and sensitivity limit structures, including limits to address potential concentration risks within each trading portfolio. In addition, the Bank uses a wide range of stress tests to model the financial impact of a variety of exceptional market scenarios on individual trading portfolios and the Bank's overall position.

Stress VaR is also performed on all portfolios as a complementary measure of risk. While VaR deals with risk during times of normality, stress testing is used to measure the potential effect of a crisis or low probability event.

A summary of the VaR position of the Bank's trading portfolios as of December 31, 2018 and 2017 follows:

	December 31, 2018		December 31, 2017	
	VaR	**Stress VaR**	VaR	Stress VaR
Foreign currency risk	**P 2,143,704**	**P 34,540,828**	P 1,601,195	P 26,381,096
Interest rate risk – Peso	**7,716,546**	**103,433,436**	25,159,027	246,419,942
Interest rate risk – USD	**6,089,388**	**254,335,891**	3,760,124	184,268,396
	P 15,949,638	**P 392,310,155**	P 30,520,346	P 457,069,434

The earnings-at-risk before tax in a rising and declining interest rate scenario for financial assets and liabilities repriced during 2018 and 2017 is shown below (amounts in millions).

	2018			
	Change in Interest Rates (in basis points)			
	-100	**+100**	**-50**	**+50**
Change in annualized net interest income	**P 146.48**	**(P 146.48)**	**P 73.24**	**(P 73.24)**
As a percentage of the Bank's net interest income for 2018	**16.50%**	**(16.50%)**	**8.25%**	**(8.25%)**
Earnings-at-risks	**P 261.17**			

	2017			
	Change in Interest Rates (in basis points)			
	-100	+100	-50	+50
Change in annualized net interest income	P 99.55	(P 99.55)	P 49.77	(P 49.77)
As a percentage of the Bank's net interest income for 2017	8.44%	(8.44%)	4.22%	(4.22%)
Earnings-at-risks	P 247.74			

4.2 Liquidity Risk

Liquidity risk is the risk that there will could be insufficient funds available to adequately meet the credit demands of the Bank's customers and repay deposits on maturity. The Bank manages liquidity risk by holding sufficient liquid assets of appropriate quality to ensure short-term funding requirements are met and by maintaining a balanced loan portfolio which is repriced on a regular basis. In addition, the Bank seeks to maintain sufficient liquidity to take advantage of interest rate and exchange rate opportunities when they arise.

The analyses of the maturity groupings of resources, liabilities and off-book items as of December 31, 2018 and 2017, in accordance with the account classifications of the BSP, are presented as follows (amounts in millions). The amounts disclosed in the maturity analysis are the contractual undiscounted cash flows using the primary contractual maturities or behavioural assumptions on core levels (e.g. core deposit liabilities), if the latter is more relevant in profiling the liquidity gap. Such undiscounted cash flows may differ from the amounts included in the statements of financial position because certain items in the statements of financial position are based on discounted cash flows.

	2018				
	One to Three Months	**More Than Three Months To One Year**	**More Than One Year To Five Years**	**More Than Five Years**	**Total**
Resources:					
Due from BSP	P 431	P 9	P –	P 3,985	P 4,425
Due from other banks	1,706	1,313	26	–	3,045
Trading and investment securities	2,668	3,257	11,305	17,466	34,696
Loans and receivables	1,898	277	869	1,669	4,713
Other resources*	–	–	–	1,970	1,970
Total Resources	**6,703**	**4,856**	**12,200**	**25,090**	**48,849**
Liabilities and Equity:					
Deposit liabilities	5,375	3,073	624	31,442	40,514
Other liabilities**	48	222	–	2,929	3,199
Total Liabilities	5,423	3,295	624	34,371	43,713
Equity	–	–	–	5,136	5,136
Total Liabilities and Equity	**5,423**	**3,295**	**624**	**39,507**	**48,849**
On-book Gap	1,280	1,561	11,576	(14,417)	–
Cumulative On-book Gap	**1,280**	**2,841**	**14,417**	**–**	**–**
Contingent Resources	5,698	17,064	16,825	–	39,587
Contingent Liabilities	5,568	16,779	16,542	–	38,889
Off-book Gap	130	285	283	–	698
Cumulative Total Gap	**P 1,410**	**P 3,256**	**P 15,115**	**P 698**	**P –**

	2017				
	One to Three Months	More Than Three Months to One Year	More Than One Year to Five Years	More Than Five Years	Total
Resources:					
Due from BSP	P 11,977	P –	P –	P –	P 11,977
Due from other banks	8,587	–	–	–	8,587
Trading and investment securities	1,451	739	13,499	15,410	31,099
Loans and receivables	6,128	1,787	3,114	665	11,694
Other resources*	–	–	–	1,139	1,139
Total Resources	28,143	2,526	16,613	17,214	64,496
Liabilities and Equity:					
Deposit liabilities	10,132	1,086	1,460	44,134	56,812
Other liabilities**	115	158	–	2,062	2,335
Total Liabilities	10,247	1,244	1,460	46,196	59,147
Equity	–	–	–	5,349	5,349
Total Liabilities and Equity	10,247	1,244	1,460	51,545	64,496
On-book Gap	17,896	1,282	15,153	(34,331)	–
Cumulative On-book Gap	17,896	19,178	34,331	–	–
Contingent Resources	5,084	2,709	29,850	142	37,785
Contingent Liabilities	5,033	2,568	29,376	140	37,117
Off-book Gap	51	141	474	2	668
Cumulative Total Gap	P 17,947	P 19,370	P 34,997	P 668	P –

** Other resources include banks premises, furniture, fixtures and equipment, margin deposits, petty cash and other deposits.*
*** Other liabilities include manager's check, accrued expenses, unclaimed balances and other liabilities.*

Contractual Maturity Analysis - Derivative Financial Liabilities

As of December 31, 2018 and 2017, the Bank's derivative financial liabilities for which contractual maturities are essential for the understanding of cash flows have contractual maturities as follows (amounts in thousands):

	2018				
	One to Three Months	**More Than Three Months to One Year**	**More Than One Year to Five Years**	**More Than Five Years**	**Total**
Forwards (FX swaps/outrights)	**P 351**	**P –**	**P –**	**P –**	**P 351**
Cross-currency swaps	**267**	**1,571,314**	**1,025,073**	**–**	**2,596,654**
Interest rate swaps	**5,523**	**72,271**	**146,756**	**–**	**224,550**
	P 6,141	**P 1,643,585**	**P 1,171,829**	**P –**	**P 2,821,555**

	2017									
		One to Three Months		More Than Three Months to One Year		More Than One Year to Five Years		More Than Five Years		Total
Cross-currency swaps	P	9	P	310,205	P	1,581,680	P	1,864	P	1,893,758
Interest rate swaps		2,422		44,700		37,190		–		84,312
	P	2,431	P	354,905	P	1,618,870	P	1,864	P	1,978,070

4.3 Credit Risk

Credit risk is the risk that the counterparty in a transaction may default and arises from lending, treasury, derivatives and other activities undertaken by the Bank. The Bank manages its credit risk and loan portfolio through the RMG, which undertakes several functions with respect to credit risk management.

The RMG undertakes credit analysis and review to ensure consistency in the Bank's risk assessment process. The RMG performs account risk ratings and ensures that the Bank's credit policies and procedures are adequate to meet the demands of the business. The RMG is also responsible for developing procedures to streamline and expedite the processing of credit applications.

The RMG also undertakes portfolio management by reviewing the Bank's loan portfolio, including the portfolio risks associated with particular industry sectors, regions, loan size and maturity, and development of a strategy for the Bank to achieve its desired portfolio mix and risk profile.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower or issuer, or groups of borrowers or issuers, and to geographical and industry segments. Such risks are monitored on a regular basis and subject to an annual or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits when appropriate. Exposure to credit risk is also managed in part by securing eligible collateral/guarantees.

4.3.1 Exposure to Credit Risk

Loan classification and credit risk rating are an integral part of the Bank's management of credit risk. On an annual basis, loans are reviewed, classified as necessary, and rated based on internal and external factors that affect its performance. On a monthly basis, loan classifications of impaired accounts are assessed and the results are used as basis for the review of loan loss provisions.

The Bank's definition of its loan classification and corresponding credit risk ratings are as follows:

- Current/Unclassified : Grades AAA to B
- Watchlisted : Grade B-
- Loans Especially Mentioned : Grade C
- Substandard : Grade D
- Doubtful : Grade E
- Loss : Grade F

Once an account is Watchlisted or Adversely Classified, the resulting risk rating grade is aligned based on the above classification.

(a) Unclassified

These are individual credits that do not have a greater-than-normal risk and do not possess the characteristics of adversely classified loans. These are credits that have the apparent ability to satisfy their obligations in full and therefore, no loss in ultimate collection is anticipated. These are adequately secured by readily marketable collateral or other forms of support security or are supported by sufficient credit and financial information of favorable nature to assure repayment as agreed.

(b) Watchlisted

Since early identification of troublesome or potential accounts is vital in portfolio management, a "Watchlisted" classification of credit accounts is maintained. These accounts are not adversely classified but they require more than normal attention to prevent these accounts from deteriorating to said category.

Past due or individually impaired financial assets comprise accounts under the following risk ratings:

(c) Adversely Classified

(i) Loans Especially Mentioned (LEM)

It is an adverse classification of loans/accounts that have potential weaknesses and deserves management's close attention. These potential weaknesses, if left uncorrected, may affect the repayment of the loan and thus increase credit risk to the Bank.

(ii) Substandard

Accounts classified as "Substandard" are individual credits or portions thereof, that have well-defined weakness/(es) that may jeopardize repayment/liquidation in full, either in respect of the business, cash flow or financial position, which may include adverse trends or developments that affect willingness or repayment ability of the borrower.

(iii) Doubtful

Accounts classified as "Doubtful" are individual credits or portions thereof which exhibit more severe weaknesses that those classified as "Substandard" whose characteristics on the basis of currently known facts, conditions and values make collection or liquidation highly improbable, however, the exact amount remains undeterminable as yet. Classification as "Loss" is deferred because of specific pending factors, which may strengthen the assets.

(iv) Loss

Accounts classified as "Loss" are individual credits or portions thereof, which are considered uncollectible or worthless, and of such little value that their continuance as bankable assets are not warranted although the loans may have some recovery or salvage value.

This shall be viewed as a transitional category for loans and other credit accommodations, which have been identified as requiring write-off during the current reporting period even though partial recovery may be obtained in the future.

In addition to the above, credit portfolio review is another integral part of the Bank's management of credit risk. This exercise involves the conduct of periodic post approval review of individual credits whose main objective is to help monitor and maintain sound and healthy risk asset portfolio. Parameters of the credit portfolio review are structured so as to reflect both sides of the risk management equation such as credit quality and process. This function actuates the philosophy that credit quality is derived from sound risk management process. The credit quality of financial assets is managed by the Bank using internal credit ratings.

4.3.2 Credit Quality Analysis

The following table sets out information about the credit quality of financial assets measured at amortized cost, FVOCI for 2018 and AFS securities for 2017. Unless specifically indicated, the amounts in the table represent gross carrying amounts. As of December 31, 2018, the Bank has no loan commitments and financial guarantee contracts. Thus, there are no amounts committed or guaranteed in the table below and in the succeeding page.

The following table shows the exposure to credit risk as of December 31, 2018 and 2017 for each internal risk grade and the related allowance for impairment (amounts in thousands):

	2018				2017
	Stage 1	Stage 2	Stage 3	Total	Total
Receivables from customers – corporate					
Grades AAA to B: Current	P 4,336,880	P -	P -	P 4,336,880	P 4,524,069
Expected credit loss allowance	(6,573)	-	-	(6,573)	(69,125)
Carrying amount	**P 4,330,307**	**P -**	**P -**	**P 4,330,307**	P 4,454,944
Receivables from customers – individual					
Grades AAA to B: Current	P 142,584	P -	P -	P 142,584	P 172,982
Expected credit loss allowance	(1,403)	-	-	(1,403)	(1,731)
Carrying amount	**P 141,181**	**P -**	**P -**	**P 141,181**	P 171,251
Other receivables					
Grades AAA to B: Current	P 241,271	P -	P -	P 241,271	P 201,523
Expected credit loss allowance	-	-	-	-	-
Carrying amount	**P 241,271**	**P -**	**P -**	**P 241,271**	P 201,523
Debt securities – Financial assets at FVOCI (2018)/ AFS Securities (2017)					
Grades AAA to B: Current	P 11,449,767	P -	P -	P 11,449,767	P 14,406,227
Expected credit loss allowance	(7,757)	-	-	(7,757)	(-)
Carrying amount	**P 11,442,010**	**P -**	**P -**	**P 11,442,010**	P 14,406,227
Debt securities – HTC Investments (2018)/HTM Investments (2017)					
Grades AAA to B: Current	P 19,506,337	P -	P -	P 19,506,337	P 12,979,899
Expected credit loss allowance	(6,916)	-	-	(6,916)	(-)
Carrying amount	**P 19,499,421**	**P -**	**P -**	**P 19,499,421**	P 12,979,899

The following table sets out the credit quality of trading debt securities measured at FVTPL (see Note 7).

		2018		2017
Grade:				
AAA	**P**	**–**	P	548,280
AA+ to AA-		**111,921**		212,219
A+ to A-		**–**		174,516
BBB+ to BBB-		**7,732**		6,820
BB+ to BB-		**14,037**		–
	P	**133,690**	P	941,835

The following table shows an analysis of counterparty credit exposures arising from derivative transactions. Outstanding derivative exposures to counterparties are generally to investment grade counterparty banks. Derivative transactions with non-bank counterparties are on a fully secured basis (amounts in thousands):

	Total		**Exchange-traded**		**Over-the-counter: Central counterparties**		**Over-the-counter: Other bilateral collateralized**	
	Notional Amount	**Fair value**	**Notional amount**	**Fair value**	**Notional amount**	**Fair value**	**Notional amount**	**Fair value**
2018								
Derivative assets	**P29,921,159**	**P 3,613,401**	**P -**	**P -**	**P -**	**P -**	**P29,921,159**	**P 3,613,401**
Derivative liabilities	**15,659,252**	**2,821,555**	**-**	**-**	**-**	**-**	**15,659,252**	**2,821,555**
2017								
Derivative assets	P27,382,950	P2,770,691	P 603,790	P 1,162	P -	P -	P 26,779,160	P 2,769,529
Derivative liabilities	14,119,286	1,978,070	-	-	-	-	14,119,286	1,978,070

The following table sets out the credit quality by class of the Bank's on-book financial assets (gross of allowance for impairment) as of December 31, 2017 (amounts in thousands).

	2017		
	Cash and Cash Equivalents*	Loans and Receivables	Trading and Investment Securities
Neither past due nor impaired:			
Grade: Unclassified	P 25,438,503	P 7,880,894	P 31,093,151

**In addition to the accounts that comprise cash and cash equivalent in Note 2.3, the amount also includes margin deposits with foreign bank and other financial assets classified under Other Resources (see Note 12) totalling P990,349 as of December 31, 2017.*

4.3.3 Concentration of Credit Risk

The RMG reviews the Bank's loan portfolio in line with the Bank's policy of not having significant unwarranted concentrations of exposure to individual counterparties, in accordance with the BSP's prohibitions on maintaining a financial exposure to any single person or group of connected persons in excess of 25% of its net worth.

The Bank monitors concentrations of credit risk by sector and by geographic location. An analysis of concentrations of credit risk (gross of allowance for impairment) at the reporting date is shown below (amounts in thousands).

	2018		
	Cash and Cash Equivalents*	**Loans and Receivables**	**Trading and Investment Securities**
Concentration by sector:			
Financial and insurance activities	**P 9,210,776**	**P 1,660,887**	**P 10,596,554**
Electricity, gas, steam and air-conditioning supply	–	**569,155**	**1,272,775**
Arts, entertainment and recreation	–	**1,100,470**	–
Real estate activities	–	**226,849**	**1,438,884**
Transportation and storage	–	–	**117,681**
Construction	–	**96,008**	–
Information	–	**48,642**	–
Wholesale and retail trade	–	–	**54,379**
Government	–	–	**20,018,106**
Mining and quarrying	–	–	–
Other service activities	–	**1,018,723**	**1,204,816**
	P 9,210,776	**P 4,720,734**	**P 34,703,195**
Concentration by location:			
Philippines	**P 9,210,776**	**P 4,604,608**	**P 27,337,387**
Other	–	**116,126**	**7,365,808**
	P 9,210,776	**P 4,720,734**	**P 34,703,195**

	2017		
	Cash and Cash Equivalents*	Loans and Receivables	Trading and Investment Securities
Concentration by sector:			
Financial and insurance activities	P 25,438,503	P 5,023,007	P 6,848,898
Electricity, gas, steam and air-conditioning supply	–	645,042	940,578
Arts, entertainment and recreation	–	1,141,351	–
Real estate activities	–	240,818	1,211,843
Transportation and storage	–	5,029	117,572
Construction	–	90,927	–
Wholesale and retail trade	–	93,452	–
Government	–	–	54,479
Mining and quarrying	–	–	20,949,557
Agriculture	–	–	–
Other service activities	–	641,268	970,224
	P 25,438,503	P 7,880,894	P 31,093,151

	2017					
	Cash and Cash Equivalents*		Loans and Receivables		Trading and Investment Securities	
Concentration by location:						
Philippines	P	25,438,503	P	4,730,061	P	25,467,903
Other		–		3,150,833		5,625,248
	P	25,438,503	P	7,880,894	P	31,093,151

**In addition to the accounts that comprise cash and cash equivalent in Note 2.3, the amount also includes margin deposits with foreign bank and other financial assets classified under Other Resources (see Note 12) totalling P1,740,521 and P990,349 as of December 31, 2018 and 2017, respectively.*

The table below shows the maximum exposure to credit risk for the components of the statements of financial position, including derivatives. The maximum exposure is gross, before the effect of mitigation through the use of netting and collateral agreements (amounts in thousands).

	Notes	**2018**		2017	
Due from BSP	6	**P**	**4,425,182**	P	11,977,052
Due from other banks	6		**3,045,072**		8,586,596
Financial assets at FVTPL	7				
Derivatives			**3,613,401**		2,770,691
Corporate debt securities			**127,000**		386,735
Government securities			**6,690**		555,100
Financial assets at FVOCI	8				
Corporate debt securities			**6,312,283**		–
Government securities			**5,137,484**		–
AFS securities	8				
Government securities			**–**		8,034,660
Corporate debt securities			**–**		6,366,066
HTC investments	9				
Government securities			**15,650,103**		–
Corporate debt securities			**3,856,234**		–
HTM investments	9				
Government securities			**–**		12,423,692
Corporate debt securities			**–**		556,207
Loans and receivables (gross)	10				
Receivable from customer			**4,479,464**		4,697,052
Other receivables			**241,271**		7,068,347
Other resources	12				
Margin deposits			**1,738,954**		988,907
Others			**1,567**		1,442
Total			**48,634,705**		64,412,547
Loan commitments	26		**–**		72,335
		P	**48,634,705**	P	64,484,882

4.3.4 Collateral Held as Security and Other Credit Enhancements

The Bank holds some collateral against loans to customers in the form of deposits and money market investments; fixed, floater and zero coupon bonds and notes guaranteed by the government; fixed, floater or zero coupon bonds issued by domestic corporations; and listed and publicly traded liquid equity issues. The market values of collaterals are based on the previous day's closing price and are revalued daily. Collateral generally is not held over due from other banks, interbank loans and investment securities, except when securities are held as part of reverse repurchase and securities borrowing activities.

Estimate of the fair value of collateral and other security enhancements held against the following loans and receivables risk groupings as of December 31 are as follows (amounts in thousands):

		2018		2017
Neither past due nor impaired				
Equity securities	**P**	**882,373**	P	693,155
Debt securities		**316,217**		598,995
Others		**145,144**		67,603
	P	**1,343,734**	P	1,359,753

4.3.5 Amounts Arising from Expected Credit Losses

At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI are credit-impaired (referred to as Stage 3 financial assets). A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Bank measures credit risk using PD, LGD and EAD.

(a) Significant Increase in Credit Risk

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Bank's historical experience and expert credit assessment and including forward-looking information.

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- the remaining lifetime PD as at the reporting date; with
- the remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

The Bank uses the following criteria in determining whether there has been a significant increase in credit risk: (i) quantitative test based on movement in PD; and (ii) qualitative indicators, such as substantial decline in sales or intermittent delays in payment;

(i) Credit risk grading

The Bank allocates each exposure to a credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgement. Credit risk grades are defined using qualitative and quantitative factors that are indicative of risk of default. These factors vary depending on the nature of the exposure and the type of borrower.

The credit grades are defined and calibrated such that the risk of default increases exponentially at each higher risk grade so, for example, the difference PD between an AAA and AA rating grade is lower than the difference in the PD between a B and B- rating grade.

(ii) *Generating the term structure of PD*

Credit risk grades are a primary input into the determination of the term structure of PD for exposures. The Bank collects performance and default information about its credit risk exposures analysed by jurisdiction or region and by type of product and borrower as well as by credit risk grading. For some portfolios, information from external credit reference agencies is also used.

The Bank employs statistical models to analyze the data collected and to generate the term structure of PD estimates.

(iii) *Determining whether credit risk has significantly increased*

The Bank assesses whether credit risk has increased significantly since initial recognition at each reporting date. Determining whether an increase in credit risk is significant depends on the characteristics of the financial instrument and the borrower. What is considered significant varies across financial assets of the Bank.

The credit risk may also be deemed to have increased significantly since initial recognition based on qualitative factors linked to the Bank's credit risk management processes that may not otherwise be fully reflected in its quantitative analysis on a timely basis. This will be the case for exposures that meet certain heightened risk criteria, such as substantial decline in sales and intermittent delays in payments.

If there is evidence that there is no longer a significant increase in credit risk relative to initial recognition, then the loss allowance on an instrument returns to being measured as 12-month ECL.

(b) *Definition of Default*

The Bank considers a financial asset to be in default when:

- the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realizing security (if any is held);
- the borrower is more than 90 days past due on any material credit obligation to the Bank; or,
- it is becoming probable that the borrower will restructure the asset as a result of bankruptcy due to the borrower's inability to pay its credit obligations.

In assessing whether a borrower is in default, the Bank considers indicators that are qualitative (e.g., breaches of covenant) and, quantitative (overdue or non-payment).

Inputs into the assessment of whether a financial instrument is in default as well as their significance may vary over time to reflect changes in circumstances.

(c) Forward-looking Information

The Bank incorporates forward-looking information (FLI) into both the assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and the measurement of ECL.

The Bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses.

The relevant macro-economic variables for selection generally include, but are not limited to, Gross Domestic Product (GDP) growth, unemployment rate, foreign exchange, stock market index, oil prices and interest rates.

Predicted relationships between the key macro-economic indicators and default and loss rates on various portfolios of financial assets have been developed based on analyzing historical data over the past 10 to 15 years.

The significance of the selected macro-economic variables as predictors of default may change over time as historical information is added. As such, the generated macro-economic models are updated at least on an annual basis.

Management has also considered other FLIs not incorporated within the above economic scenarios, such as any regulatory, legislative, or political changes, but are not deemed to have a significant impact on the calculation of ECL. Management reviews and monitors the appropriateness of FLIs at least annually.

(d) Modified Financial Assets

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer.

When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

- its remaining lifetime PD at the reporting date based on the modified terms; with
- the remaining lifetime PD estimated based on data on initial recognition and the original contractual terms.

When modification results in derecognition, a new loan is recognized and allocated to Stage 1 (assuming it is not credit-impaired at that time).

The Bank renegotiates loans to customers in financial difficulties (referred to as 'restructuring') to maximize collection opportunities and minimize the risk of default. Under the Bank's restructuring policy, loan restructuring is granted on a selective basis if the debtor is currently in default on its debt; or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms usually include extending the maturity, changing the timing of interest payments and amending the terms of loan covenants. Individual and corporate loans are subject to restructuring. The Bank's Credit Committee regularly reviews reports on restructured activities.

For financial assets modified as part of the Bank's restructuring policy, the estimate of PD reflects whether the modification has improved or restored the Bank's ability to collect interest and principal and the Bank's previous experience of similar action. As part of this process, the Bank evaluates the borrower's payment performance against the modified contractual terms and considers various behavioral indicators.

Generally, restructuring is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired. A customer needs to demonstrate consistently good payment behaviour over a period of time before the exposure is no longer considered to be credit-impaired/in default or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to Stage 1.

(e) Measurement of ECL

The key inputs into the measurement of ECL are the term structure of PD, LGD and EAD.

ECL for exposures in Stage 1 is calculated by multiplying the 12-month PD by LGD and EAD. Lifetime ECL is calculated by multiplying the lifetime PD by LGD and EAD.

The methodology of estimating PD is discussed in the preceeding section under the heading 'Generating the term structure of PD'.

LGD is the magnitude of the likely loss if there is a default. The Bank estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset. For loans secured by retail property, LTV ratios are a key parameter in determining LGD. LGD estimates are recalibrated for different economic scenarios and, for real estate lending, to reflect possible changes in property prices. They are calculated on a discounted cash flow basis using the effective interest rate as the discounting factor.

EAD represents the expected exposure in the event of a default. The Bank derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract and arising from amortisation. The EAD of a financial asset is its gross carrying amount at the time of default. For lending commitments, the EADs are potential future amounts that may be drawn under the contract, which are estimated based on historical observations and forward-looking forecasts. For some financial assets, EAD is determined by modelling the range of possible exposure outcomes at various points in time using scenario and statistical techniques.

As described above, and subject to using a maximum of a 12-month PD for Stage 1 financial assets, the Bank measures ECL considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk, even if, for credit risk management purposes, the Bank considers a longer period. The maximum contractual period extends to the date at which the Bank has the right to require repayment of an advance or terminate a loan commitment or guarantee.

Where modelling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics that include:

- instrument type;
- credit risk grading;
- collateral type;
- LTV ratio for retail mortgages;
- date of initial recognition;
- remaining term to maturity;
- industry; and,
- geographic location of the borrower.

The groupings are subject to regular review to ensure that exposures within a particular group remain appropriately homogeneous.

For portfolios in respect of which the Bank has limited historical data, external benchmark information (e.g., PD from external credit rating agencies, Basel LGD) is used to supplement the internally available data. The portfolios for which external benchmark information represent a significant input into measurement of ECL include exposures to foreign borrowers and low default borrower segments.

(f) *Loss Allowance*

The following tables show the reconciliation from the opening to the closing balance of the loss allowance by class of financial instrument. Comparative amounts for 2017 represent the allowance account for credit losses and reflect the measurement basis under PAS 39 (amounts in thousands).

	2018				2017
	Stage 1	**Stage 2**	**Stage 3**	**Total**	Total
Receivables from customers – corporate					
Balance at January 1	**P 7,163**	**P -**	**P -**	**P 7,163**	P 67,292
Transfers	**-**	**-**	**-**	**-**	-
New financial assets originated	**4,116**	**-**	**-**	**4,116**	1,833
Derecognition of financial assets	**(4,814)**	**-**	**-**	**(4,814)**	-
Foreign exchange	**108**	**-**	**-**	**108**	-
Balance at December 31	**P 6,573**	**P -**	**P -**	**P 6,573**	P 69,125
Receivables from customers – individual					
Balance at January 1	**P 1,785**	**P -**	**P -**	**P 1,785**	P 1,725
Transfers	**-**	**-**	**-**	**-**	-
New financial assets originated	**1,328**	**-**	**-**	**1,328**	6
Derecognition of financial assets	**(1,660)**	**-**	**-**	**(1,660)**	-
Foreign exchange	**(50)**	**-**	**-**	**(50)**	-
Balance at December 31	**P 1,403**	**P -**	**P -**	**P 1,403**	P 1,731

	2018				2017
	Stage 1	Stage 2	Stage 3	Total	Total
Debt securities – Financial assets at FVOCI (2018)/ AFS Securities (2017)					
Balance at January 1	**P 6,248**	**P -**	**P -**	**P 6,248**	P -
Net remeasurement of loss allowance	**861**	**-**	**-**	**861**	-
New financial assets purchased	**973**	**-**	**-**	**973**	-
Foreign exchange	**153**	**-**	**-**	**153**	-
Derecognition of financial assets	**(478)**	**-**	**-**	**(478)**	-
Balance at December 31	**P 7,757**	**P -**	**P -**	**P 7,757**	P -
Debt securities – HTC Investments (2018)/HTM Investments (2017)					
Balance at January 1	**P 8,533**	**P -**	**P -**	**P 8,533**	P -
Net remeasurement of loss allowance	**41**	**-**	**-**	**41**	-
New financial purchased	**2,286**	**-**	**-**	**2,286**	-
Foreign exchange	**142**	**-**	**-**	**142**	-
Derecognition of financial assets	**(4,086)**	**-**	**-**	**(4,086)**	-
Balance at December 31	**P 6,916**	**P -**	**P -**	**P 6,916**	P -

An aging of neither past due nor impaired Loans and receivables account reckoned from the last unpaid due date follows (amounts in thousands):

	2018	2017
Up to 30 days	**P 146,620**	P 303,683
31 to 60 days	**157,487**	314,538
61 to 90 days	**2,030,352**	939,573
More than 90 days	**2,145,006**	3,139,257
	P 4,479,465	P 4,697,051

4.4 Equity Risk

Equity risk is the risk that the fair values of equity investments will decrease as a result of changes in the levels of equity indices and the value of individual stocks (whether traded or not). The Bank has no significant equity risk.

4.5 Operational Risk

Operational risk is the risk of loss due to the Bank's:

- failure to comply with defined Bank operational procedures;
- inability to address fraud committed internally or externally;
- inability to handle system failures; and,
- inability to cope with the impact of external events.

The Bank manages its operational risks by having policies to minimize its expected losses, allocating capital for the unexpected losses, and having insurance and/or a business continuity plan to prepare for catastrophic losses.

4.5.1 Framework

True to its commitment to sound management and corporate governance, the Bank considers operational risk management as a critical element in the conduct of its business. Under the Bank's Operational Risk Management (ORM) framework, the BOD has the ultimate responsibility for providing leadership in the management of risk in the Bank. The business and service unit heads, as risk owners, are responsible for identifying, assessing and limiting the impact of risk in their respective businesses. The RMG provides the common risk language and management tools across the Bank as well as monitors the implementation of the ORM framework and policies.

The Bank continued to pursue its proactive management of identified operational risks, focusing on the ongoing adoption of the Risk and Control Self-Assessment process so that business process owners could document both their operational risks and the control mechanisms they have put in place to manage those risks. This ORM tool allows the Bank to identify risks the business/operation faces, assess the severity of those risks, evaluate the adequacy of key controls associated to the identified risks, and take proactive action to address any deficiencies identified.

Operational risks arising from health, safety and environmental issues are appropriately managed through policies and measures that are integrated into the Bank's day-to-day operations. These include Environmental Consciousness, Occupational Health and Safety, and Community Health and Safety.

5. CATEGORIES AND OFFSETTING OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

5.1 Comparison of Carrying Amounts and Fair Values

The table below and in the succeeding page summarizes the carrying amounts and fair values by categories of those financial assets and financial liabilities in the statements of financial position (amounts in thousands):

		2018		2017	
	Notes	**Carrying Amounts**	**Fair Values**	Carrying Amounts	Fair Values
Financial Assets					
Financial assets at Amortized Cost:					
Due from BSP	6	**P 4,425,182**	**P 4,425,182**	P 11,977,052	P 11,977,052
Due from other banks	6	**3,045,072**	**3,045,072**	8,586,596	8,586,596
Receivables from customers – net	10	**4,471,487**	**4,268,371**	4,626,195	4,705,072
Other receivables	10	**241,271**	**241,271**	7,068,348	7,068,348
Other resources*	12	**1,740,521**	**1,740,521**	990,349	990,349
		13,923,533	**13,720,417**	33,248,540	33,327,417
Financial assets at FVTPL:	7				
Derivative financial assets		**3,613,401**	**3,613,401**	2,770,691	2,770,691
Corporate debt securities		**127,000**	**127,000**	386,735	386,735
Government debt securities		**6,690**	**6,690**	555,100	555,100
		3,747,091	**3,747,091**	3,712,526	3,712,526
Financial assets at FVOCI:	8				
Corporate debt securities		**6,312,283**	**6,312,283**	-	-
Government debt securities		**5,137,484**	**5,137,484**	-	-
		11,449,767	**11,449,767**	-	-
AFS securities:	8				
Government debt securities		**-**	**-**	8,034,660	8,034,660
Corporate debt securities		**-**	**-**	6,366,066	6,366,066
		P -	**P -**	P 14,400,726	P 14,400,726

	Notes	2018 Carrying Amounts	2018 Fair Values	2017 Carrying Amounts	2017 Fair Values
HTC investments:	9				
Government debt securities		**P 15,650,103**	**P 14,457,052**	P -	P -
Corporate debt securities		**3,849,318**	**3,718,305**	-	-
		19,499,421	**18,175,357**	-	-
HTM investments:	9				
Government debt securities		**-**	**-**	12,423,692	12,247,174
Corporate debt securities		**-**	**-**	556,207	557,583
		-	**-**	12,979,899	12,804,757
		P 48,619,812	**P 47,092,632**	P 64,341,691	P 64,245,426
Financial Liabilities					
Financial liabilities at Amortized Cost:					
Deposit liabilities	13	**P 40,513,687**	**P 40,515,529**	P 56,811,890	P 56,662,159
Other liabilities**	16	**81,399**	**81,399**	216,743	216,743
Financial liabilities at Fair Value – Derivative financial liabilities	15	**2,821,555**	**2,821,555**	1,978,070	1,978,070
		P 43,416,641	**P 43,418,483**	P 59,006,703	P 58,856,972

* *Other resources include margin deposits, petty cash and other deposits.*
** *Other liabilities include manager's check, accrued expenses, unclaimed balances and other liabilities.*

5.2 Fair Value Hierarchy

In accordance with PFRS 13, *Fair Value Measurement*, the fair value of financial assets and financial liabilities and non-financial assets which are measured at fair value on a recurring or non-recurring basis and those assets and liabilities not measured at fair value but for which fair value is disclosed in accordance with other relevant PFRS, are categorized into three levels based on the significance of inputs used to measure the fair value. The fair value hierarchy has the following levels:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that an entity can access at the measurement date;
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and,
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The level within which the asset or liability is classified is determined based on the lowest level of significant input to the fair value measurement.

For purposes of determining the market value at Level 1, a market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

For investments which do not have quoted market price, the fair value is determined by using generally acceptable pricing models and valuation techniques or by reference to the current market of another instrument which is substantially the same after taking into account the related credit risk of counterparties, or is calculated based on the expected cash flows of the underlying net asset base of the instrument.

When the Bank uses valuation technique, it maximizes the use of observable market data where it is available and relies as little as possible on entity specific estimates. If all significant inputs required to determine the fair value of an instrument are observable, the instrument is included in Level 2. Otherwise, it is included in Level 3.

5.3 Financial Instruments Measured at Fair Value

The table below shows the fair value hierarchy of the Bank's classes of financial assets and financial liabilities measured at fair value in the statements of financial position on a recurring basis as of December 31, 2018 and 2017 (amounts in thousands).

	Level 1	Level 2	Level 3	Total
December 31, 2018				
Resources:				
Financial assets at FVTPL:				
Derivative financial assets	**P –**	**P 3,613,401**	**P –**	**P 3,613,401**
Corporate debt securities	**127,000**	**–**	**–**	**127,000**
Government securities	**6,690**	**–**	**–**	**6,690**
Financial assets at FVOCI:				
Corporate debt securities	**6,312,283**	**–**	**–**	**6,312,283**
Government debt securities	**5,137,484**	**–**	**–**	**5,137,484**
Total Resources	**P 11,583,457**	**P 3,613,401**	**P –**	**P 15,196,858**
Liabilities –				
Derivatives financial liabilities	**P –**	**P 2,821,555**	**P –**	**P 2,821,555**
December 31, 2017				
Resources:				
Financial assets at FVTPL:				
Derivative financial assets	P –	P 2,770,691	P –	P 2,770,691
Corporate debt securities	555,100	–	–	555,100
Government securities	386,735	–	–	386,735
AFS securities:				
Government debt securities	8,034,660	–	–	8,034,660
Corporate debt securities	6,366,066	–	–	6,366,066
Total Resources	P 15,342,561	P 2,770,691	P –	P 18,113,252
Liabilities –				
Derivatives financial liabilities	P –	P 1,978,070	P –	P 1,978,070

There have been no significant transfers among Levels 1 and 2 in the reporting periods.

Described below is the information about how the fair values of the Bank's classes of financial assets are determined.

(a) Debt securities

The fair value of the Bank's debt securities, which are categorized within Level 1 is discussed below.

(i) In 2018, fair values of peso-denominated government debt securities issued by the Philippine government, are determined based on the reference price per Bloomberg which used Bloomberg Valuation Service (BVAL). These BVAL reference rates are computed based on the weighted price derived using an approach based on a combined sequence of proprietary BVAL algorithms of direct observations or observed comparables. In 2017, fair value is determined to be the reference price per Philippine Dealing & Exchange Corp. which is computed based on the weighted average of done or executed deals, the simple average of all firm bids per benchmark tenor or interpolated yields. This is consistent with BSP Circular No. 813, *Amendment on Market Valuation of Government Securities*, issued by the BSP pursuant to Monetary Board Resolution No. 1504 dated September 13, 2013.

(ii) For other quoted debt securities, fair value is determined to be the current mid-price, which is computed as the average of ask and bid prices as appearing on Bloomberg.

(b) Derivatives

The fair value of derivative financial instruments, which are categorized within Level 2, is determined through valuation techniques using the net present value computation [see Note 3.2(d)].

5.4 Financial Instruments Measured at Amortized Cost for which Fair Value is Disclosed

The table below and in the succeeding page summarizes the fair value hierarchy of the Bank's financial assets and financial liabilities which are not measured at fair value in the statements of financial position but for which fair value is disclosed (amounts in thousands).

	Level 1	Level 2	Level 3	Total
December 31, 2018				
Resources:				
Due from BSP	P 4,425,182	P –	P –	P 4,425,182
Due from other banks	3,045,072	–	–	3,045,072
HTC investments	15,567,788	2,607,568	–	18,175,356
Loans and other receivables	241,271	–	4,268,371	4,509,642
Other resources	1,738,954	–	1,567	1,740,521
	P 25,018,267	P 2,607,568	P 4,269,938	P 31,895,773
Liabilities:				
Deposit liabilities	P 27,616,716	P –	P 12,898,813	P 40,515,529
Other liabilities	–	–	81,399	81,399
	P 27,616,716	P –	P 12,980,212	P 40,596,928

	Level 1	Level 2	Level 3	Total
December 31, 2017				
Resources:				
Due from BSP	P 11,977,052	P –	P –	P 11,977,052
Due from other banks	8,586,596	–	–	8,586,596
HTM investments	12,804,757	–	–	12,804,757
Loans and other receivables	3,589,097	3,478,535	4,705,788	11,773,420
Other resources	988,907	–	1,442	990,349
	P 37,946,409	P 3,478,535	P 4,707,230	P 46,132,174
Liabilities:				
Deposit liabilities	P 42,661,234	P –	P 14,000,925	P 56,662,159
Other liabilities	–	–	216,743	216,743
	P 42,661,234	P –	P 14,217,668	P 56,878,902

For financial assets and financial liabilities, management considers that the carrying amounts of those short-term financial instruments approximate their fair values. The following are the methods used to determine the fair value of financial assets and financial liabilities presented in the statements of financial position at their amortized cost:

(a) Due from BSP and other banks

Due from BSP pertains to deposits made by the Bank to the BSP for clearing, reserve requirements and placement of excess liquidity in Overnight Deposit Facility (ODF) and Term Deposit Facility (TDF) in 2018 and 2017, respectively. Due from other banks include interbank placements and items in the course of collection. The fair value of floating rate placements and overnight deposits is their carrying amount. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity, which for short-term deposits approximates the nominal value.

(b) HTC investments (2018)/HTM investments (2017)

The fair value of HTC investments (2018)/ HTM investments (2017) are determined by direct reference to published price quoted in an active market for traded debt and equity securities.

The Bank will hold into the investments until management decides to sell them when there will be offers to buy out such investments on the appearance of an available market where the investments can be sold.

(c) Loans and other receivables

Receivables from customers and other receivables are presented net of provisions for impairment, if any. The estimated fair value of loans and receivables represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

The carrying amounts of other receivables arising from accrued trust fees are considered to be reasonable approximation of their fair values due to their short duration, hence, categorized within Level 1.

(d) Deposits and borrowings

The estimated fair value of demand deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand. The estimated fair value of long-term fixed interest-bearing deposits and other borrowings without quoted market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

(e) Other resources and liabilities

Due to their short duration, the carrying amounts of other resources and liabilities in the statements of financial position are considered to be reasonable approximation of their fair values.

5.5 Offsetting of Financial Assets and Financial Liabilities

The table below and in the succeeding page shows the financial assets of the Bank as of December 31, 2018 and 2017 which are subject to offsetting, enforceable master netting arrangements and similar agreements which are not set off in the statements of financial position (amounts in thousands).

	December 31, 2018			
	Financial Assets	**Financial Liabilities Available for Set-off**	**Collateral Received**	**Net Amount**
Financial assets at FVTPL				
Currency forwards	P 322,258	P 296,645	P –	P 25,613
Interest rate swaps	65,266	65,266	–	–
Loans and receivables				
Receivables from customers	138,687	–	46,445	92,242
Other resources				
Margin deposits on currency forwards	1,731,459	1,731,459	–	–
	P 2,257,670	**P 2,093,370**	**P 46,445**	**P 117,855**

	December 31, 2017			
	Financial Assets	Financial Liabilities Available for Set-off	Collateral Received	Net Amount
Financial assets at FVTPL				
Currency forwards	P 310,132	P 282,098	P –	P 28,034
Interest rate swaps	35,469	35,469	–	–
Loans and receivables				
Receivables from customers	173,670	–	67,603	106,067
Other resources				
Margin deposits on currency forwards	985,119	985,119	–	–
	P 1,504,390	P 1,302,686	P 67,603	P 134,101

The following financial liabilities with net amounts presented in the statements of financial position are not set-off in the statements of financial position subject to offsetting, enforceable master netting arrangements and similar agreements which are (amount in thousands):

	December 31, 2018			
	Financial Liabilities	**Financial assets Available for Set-off**	**Collateral Given**	**Net Amount**
Deposit liabilities	**P 46,445**	**P 138,687**	**P –**	**(P 92,242)**
Financial liabilities				
Currency forwards	**2,028,104**	**296,645**	**1,731,459**	**–**
Interest rate swaps	**67,868**	**65,266**	**–**	**2,602**
	P 2,142,417	**P 500,598**	**P 1,731,459**	**(P 89,640)**

	December 31, 2017			
	Financial Liabilities	Financial assets Available for Set-off	Collateral Given	Net Amount
Deposit liabilities	P 67,603	P 173,670	P –	(P 106,067)
Financial liabilities				
Currency forwards	1,267,217	282,098	985,119	–
Interest rate swaps	44,589	35,469	–	9,120
	P 1,379,409	P 491,237	P 985,119	(P 96,947)

For the financial assets and financial liabilities subject to enforceable master netting arrangements or similar arrangements in the previous pages, each agreement between the Bank and counterparties allows for net settlement of the relevant financial assets and financial liabilities when both elect to settle on a net basis. In the absence of such an election, financial assets and liabilities will be settled on a gross basis; however, each party to the master netting agreement or similar agreement will have the option to settle all such amounts on a net basis in the event of default of the other party.

6. DUE FROM BSP AND OTHER BANKS

6.1 Due from BSP

This account is composed of the following:

	2018	2017
Mandatory reserves	**P 4,425,182,127**	P 7,772,321,917
Other than mandatory reserves	**–**	4,204,729,978
	P 4,425,182,127	P 11,977,051,895

Mandatory reserves represent the balance of the deposit account maintained with the BSP to meet reserve requirements and to serve as clearing account for interbank claims. Deposits with the BSP other than mandatory reserves comprise of ODF and TDF as of December 31, 2018 and 2017.

Due from BSP, excluding mandatory reserves which has no interest, bears annual effective interest rates of 2.50% to 4.80% and 2.50% to 3.50% in 2018 and 2017, respectively. Total interest income earned amounted to P114,987,532 and P275,190,111 in 2018 and 2017, respectively, and is included as part of Interest Income on Due from BSP and Other Banks in the statements of income.

Due from BSP is included in cash and cash equivalents for cash flow statement reporting purposes.

Under Section 254, *Composition of Reserves*, of the Manual of Regulations for Banks (MORB), a bank is required to maintain reserve requirements in the form of deposits with the BSP as among the allowable instruments for reserve cover. Section 254.1 of the MORB further provides that such deposit account with the BSP is not considered as a regular current account as BSP checks for drawings against such deposits shall be limited to (a) settlement of obligations with the BSP, and; (b) withdrawals to meet cash requirements.

6.2 Due from Other Banks

The balance of this account represents regular deposits with the following:

	Note	2018	2017
Foreign banks		**P 2,504,221,257**	P 7,942,343,483
Local banks	22.1(c)	**540,851,197**	644,252,560
		P 3,045,072,454	P 8,586,596,043

A breakdown of this account by currency follows:

	2018	2017
United States (U.S.) dollar	**P 2,489,960,430**	P 8,148,051,557
Philippine peso	**42,048,715**	266,253,564
Other foreign currencies	**513,063,309**	172,290,922
	P 3,045,072,454	P 8,586,596,043

These deposits earn effective interest at rates ranging from 0.25% to 1.67% per annum in 2018 and 2017.

The total interest earned on due from other banks amounted to P87,788,433 and P52,703,694 in 2018 and 2017, respectively, and is included as part of Interest Income on Due from BSP and Other Banks in the statements of income.

7. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

This account is composed of the following:

	Notes	2018	2017
Derivatives	15, 22.1(b)	**P 3,613,401,187**	P 2,770,691,178
Corporate debt securities		**126,999,948**	386,734,637
Government securities		**6,690,212**	555,100,450
		P 3,747,091,347	P 3,712,526,265

As to currency, this account is composed of the following:

	2018	2017
Philippine peso	**P 3,505,027,789**	P 3,235,466,231
Foreign currencies	**242,063,558**	477,060,034
	P 3,747,091,347	P 3,712,526,265

Corporate debt securities include local and foreign corporate securities that earn coupon interest from 4.13% to 6.50% and 4.25% to 7.38% per annum in 2018 and 2017, respectively.

Government securities consist of various treasury bills and other securities issued by the government that earn coupon interest from 4.70% to 7.20% and 3.63% to 9.88% per annum in 2018 and 2017, respectively.

In 2018, effective interest rates range from 4.63% to 6.25% and 1.73% to 4.43% for peso denominated and foreign currency denominated FVTPL securities, respectively. In 2017, effective interest rates range from 3.54% to 4.91% and 1.38% to 4.67% for peso denominated and foreign currency denominated FVTPL securities, respectively. The total interest earned on financial assets at FVTPL are presented in the statements of income which amounted to P20,778,915 and P41,501,679 in 2018 and 2017, respectively.

The Bank recognized net realized trading gains on financial assets at FVTPL amounting to P153,178,262 and P233,015,709 in 2018 and 2017, respectively. Unrealized fair value losses of P137,763,188 and P214,980,786 were recognized by the Bank in 2018 and 2017, respectively. Both realized and unrealized trading gains and losses are presented as part of Trading and Securities Gain/Loss in the statements of income.

8. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (2018)/AVAILABLE-FOR-SALE SECURITIES (2017)

This account is composed of the following:

	2018	2017
Debt securities:		
Government securities	**P 5,137,484,289**	P 8,034,660,211
Corporate debt securities	**6,312,282,718**	6,366,066,222
Equity securities – not quoted	**–**	5,500,100
	P 11,449,767,007	P 14,406,226,533

As to currency, this account is composed of the following:

	2018	2017
Foreign currencies	**P 7,789,348,208**	P 8,445,661,130
Philippine peso	**3,660,418,799**	5,960,565,403
	P 11,449,767,007	P 14,406,226,533

Changes in the Bank's holdings of financial assets at FVOCI in 2018 and AFS Securities in 2017 are summarized below.

	2018	2017
Balance at beginning of year		
As previously stated	P –	P 18,366,501,754
Effect of adoption of PFRS 9 [see Note 2.2(a)(iii)]:		
Reclassifications from:		
AFS Securities	7,455,253,668	–
HTM Investments	4,081,515,579	–
As restated	11,536,769,247	18,366,501,754
Additions	5,204,576,397	6,733,144,570
Disposals	(5,347,358,479)	(10,952,249,407)
Fair value gains (losses)	(382,276,783)	166,770,073
Foreign currency revaluation	438,056,625	92,059,543
Balance at end of year	P 11,449,767,007	P 14,406,226,533

In 2016, the Bank back reclassified government securities from AFS securities with total carrying value and unrealized fair value losses of P3,994,809,107 and P88,158,119, respectively, to HTM investments [see Notes 9 and 3.1(d)]. Of the total unrealized fair value losses, P15,787,943 were amortized in 2017. As of December 31, 2017, the outstanding unamortized fair value losses amounted to P55,712,558. Due to transition to PFRS 9, such outstanding unamortized fair value losses were charged to the opening balance of Surplus Free account as at January 1, 2018 [see Note 2.1(b)].

Debt securities earn interest from 3.20% to 7.38% and 3.25% to 7.38% per annum in 2018 and 2017, respectively. These debt securities pertain to local and foreign securities issued by corporate and government entities. Effective interest rates of peso denominated securities range from 3.46% to 7.78% and 3.06% to 6.63% in 2018 and 2017, respectively. On the other hand, foreign currency denominated securities earn effective interest ranging from 1.40% to 7.36% and 1.05% to 6.71% in 2018 and 2017, respectively.

Total interest earned amounted to P394,763,749 in 2018 and P538,529,889 in 2017. Disposals of securities resulted in net gains of P26,667,400 in 2018 and net loss of P7,803,256 in 2017 (see Note 17.4) and are included as part of Trading and Securities Gain/Loss in the statements of income.

In compliance with the regulations that govern the Bank's trust functions, government bonds owned by the Bank with a total face value of P1,850,000,000 as of December 31, 2017 are deposited with the BSP (see Note 24). Due to transition to PFRS 9, these bonds were reclassified to HTC Investments as part of hold-to-collect under regulatory/compliance portfolio in accordance with the business model for managing financial assets.

The impairment loss for debt securities charged to the opening balance of Revaluation Reserve account as at January 1, 2018 amounted to P6,248,421 [see Note 2.1(b)]. In 2018, the Bank recognized credit losses on financial assets at FVOCI amounting to P1,225,676 presented as part of Impairment Losses (Reversals) account in the 2018 statement of profit or loss with corresponding charge to Unrealized Gains (Losses) on Financial Assets at FVOCI in the 2018 statement of comprehensive income.

9. HELD-TO-COLLECT INVESTMENTS (2018)/HELD-TO-MATURITY INVESTMENTS (2017)

This account is composed of the following:

	2018	2017
Debt securities:		
Government securities	**P 15,650,102,922**	P 12,423,691,627
Corporate debt securities	**3,856,233,959**	556,207,141
	19,506,336,881	12,979,898,768
Allowance for impairment	**(6,915,986)**	–
	P 19,499,420,895	P 12,979,898,768

As to currency, this account is composed of the following:

	2018	2017
Philippine peso	**P 12,226,895,399**	P 10,956,778,220
Foreign currencies	**7,272,525,496**	2,023,120,548
	P 19,499,420,895	P 12,979,898,768

Changes in the Bank's holdings of HTC investments in 2018 and HTM investments in 2017 are summarized below.

	2018	2017
Balance at beginning of year		
As previously stated	**P –**	P 5,499,730,198
Effects of adoption of PFRS 9 [see Note 2.2(a)(iii)]:		
Reclassifications from:		
HTM Investments	**8,907,164,540**	–
AFS Securities	**7,055,917,981**	–
FVTPL Securities	**19,662,298**	–
UDSCL	**3,479,250,283**	–
Allowance for impairment	**(8,533,164)**	–
As restated	**19,453,461,938**	5,499,730,198
Additions	**11,656,290,233**	7,387,442,901
Interest accrued	**61,276,830**	78,889,836
Foreign currency revaluation	**107,239,516**	14,835,833
Maturities	**(11,780,601,000)**	(1,000,000)
Recovery of impairment	**1,753,378**	–
Balance at end of year	**P 19,499,420,895**	P 12,979,898,768

Annual coupon interest rates on government debt securities range from 3.00% to 9.50% and 3.38% to 9.50% in 2018 and 2017, respectively. On the other hand, corporate debt securities have annual coupon interest rates ranging from 1.40% to 6.65% and 5.19% to 5.81% in 2018 and 2017, respectively. Effective interest rate of government debt securities ranges from 1.90% to 5.69% and 1.95% to 4.91% in 2018 and 2017, respectively. While, corporate debt securities earn effective interest ranging from 2.89% to 6.63% and 5.19% to 5.81% in 2018 and 2017, respectively. Interest earned amounted P726,554,035 and P404,821,186 in 2018 and 2017, respectively.

In 2016, after the end of the two-year tainting provision of PAS 39 [see Note 3.1(d)], the Bank reclassified back certain government securities from AFS securities to HTM investments (see Note 8). The carrying value of the securities reclassified to HTM investments from AFS securities amounted to P3,874,782,752 as of December 31, 2017, with a related unamortized fair value loss of P55,712,558. As part of the Bank's transition to PFRS 9, these HTM investments were further reclassified to measurement categories according to the business model for managing these financial assets. As a result, these HTM investments that were previously subjected to the tainting provision were reclassified as HTC investments which should be remeasured at amortized cost, taking into consideration their related unamortized fair value losses. However, as it is no longer practical to determine the effective interest rate and other related information during the dates these securities were purchased due to voluminous transactions and lapse of time, the appropriate amortized cost of these securities could no longer be determined. Accordingly, as allowed under the transition provision of PFRS 9, the fair value of the financial assets at the date of initial application was considered as the new gross carrying amount; hence, remaining unamortized fair value losses amounting to P55,712,558 were charged to the opening balance of Surplus Free account as at January 1, 2018 [see Note 2.1(b)]

In compliance with the regulations that govern the Bank's trust functions, government bonds owned by the Bank are deposited with the BSP with a total face value of P4,507,832,093 and P1,328,100,000 as of December 31, 2018 and 2017, respectively (see Note 24).

The allowance for impairment for debt securities as at December 31, 2017 reconciled to the opening allowance as at January 1, 2018 [see Note 2.1(b)] and the closing allowance as at December 31, 2018 as follows:

Balance at the beginning of year – PAS 39	P –
Effect of adoption of PFRS 9 [see Note 2.2(a)(iii)]:	8,533,164
Balance at the beginning of year – PFRS 9	8,533,164
Net impairment (recovery)	(1,753,378)
Revaluation	136,200
Balance at end of year	**P 6,915,986**

10. LOANS AND RECEIVABLES

Loans and receivables consist of the following:

	2018	2017
Receivables from customers		
- commercial	**P 4,479,463,725**	P 4,697,051,854
Allowance for impairment	**(7,976,408)**	(70,856,519)
	4,471,487,317	4,626,195,335
UDSCL	**–**	3,479,250,283
SPURRA	**–**	3,387,574,515
Other receivables	**241,270,721**	201,522,863
	P 4,712,758,038	P 11,694,542,996

The maturity profile of the Bank's receivables from customers follow:

	2018	2017
Within one year	**P 1,899,361,927**	P 772,419,067
Beyond one year within five years	**880,906,129**	3,180,338,226
Beyond five years	**1,699,195,669**	744,294,561
	P 4,479,463,725	P 4,697,051,854

As to security, receivables from customers are classified into:

	2018	2017
Secured	**P 954,572,293**	P 873,085,684
Unsecured	**3,524,891,432**	3,823,966,170
	P 4,479,463,725	P 4,697,051,854

The SPURRA held by the Bank in 2017 has an average term of one day. In addition, UDSCL amounting to P3,479,250,283 in 2017 have maturities of three months or less from placement date.

Receivables from customers earn effective interest at rates ranging from 3.25% to 7.75% and 2.00% to 6.75% per annum in 2018 and 2017, respectively. The total interest earned on loans and receivables amounted to P359,921,423 and P466,400,635 in 2018 and 2017, respectively.

Movements of the Bank's allowance for impairment taking into consideration the effect of adoption of PFRS 9 [see Notes 2.1(b) and 2.2(a)(iii)] are as follows:

	2018	2017
Balance at the beginning of year, as previously stated	**P 70,856,519**	P 69,017,565
Effect of adoption of PFRS 9 – reversal of allowance for impairment	**(61,908,398)**	–
Balance at the beginning of year, as restated	**8,948,121**	69,017,565
Provision for (reversal of) allowance for impairment	**(1,030,461)**	1,827,375
Revaluation	**58,748**	11,579
Balance at end of year	**P 7,976,408**	P 70,856,519

In 2018, the Bank made an appropriation of P37,154,285 out of the Surplus Free to comply with the requirement of the BSP to provide general loan loss provisions. The appropriation is presented as part of Surplus Reserves (see Note 17.5).

11. BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT

The gross carrying amounts and accumulated depreciation and amortization at the beginning and end of 2018 and 2017 are shown below.

	Furniture, Fixtures and Equipment	**Leasehold Improvements**	**Total**
December 31, 2018			
Cost	P 162,368,610	P 157,776,154	P 320,144,764
Accumulated depreciation and amortization	(136,743,718)	(138,765,403)	(275,509,121)
Net carrying amount	**P 25,624,892**	**P 19,010,751**	**P 44,635,643**
December 31, 2017			
Cost	P 151,836,070	P 142,619,273	P 294,455,343
Accumulated depreciation and amortization	(126,011,805)	(126,300,757)	(252,312,562)
Net carrying amount	P 25,824,265	P 16,318,516	P 42,142,781

A reconciliation of the carrying amounts of bank premises, furniture, fixtures and equipment at the beginning and end of 2018 and 2017, as follows:

	Furniture, Fixtures and Equipment	Leasehold Improvements	Total
Balance at January 1, 2018, net of accumulated depreciation and amortization	P 25,824,265	P 16,318,516	P 42,142,781
Additions	10,964,540	15,156,881	26,121,421
Disposal	(11,357)	–	(11,357)
Depreciation and amortization charges for the year	(11,152,556)	(12,464,646)	(23,617,202)
Balance at December 31, 2018, net of accumulated depreciation and amortization	**P 25,624,892**	**P 19,010,751**	**P 44,635,643**
Balance at January 1, 2017, net of accumulated depreciation and amortization	P 19,194,260	P 24,732,191	P 43,926,451
Additions	15,493,035	2,274,434	17,767,469
Depreciation and amortization charges for the year	(8,863,030)	(10,688,109)	(19,551,139)
Balance at December 31, 2017, net of accumulated depreciation and amortization	P 25,824,265	P 16,318,516	P 42,142,781

Total cost of fully depreciated assets, consisting of furniture, fixtures and equipment amounted to P112,942,868 and P105,490,161 in 2018 and 2017, respectively, and are still being used by the Bank.

The BSP requires that investments in bank premises, furniture, fixtures and equipment do not exceed 50% of the Bank's unimpaired capital. As of December 31, 2018 and 2017, the Bank has satisfactorily complied with this requirement.

12. OTHER RESOURCES

This account consists of:

	Note	2018	2017
Margin deposits		**P 1,738,954,057**	P 988,907,240
Sundry debits		**77,511,140**	1,589,926
Creditable withholding taxes		**33,788,614**	26,759,245
Deferred tax assets	23	**28,812,262**	31,401,304
Computer software– net		**17,486,603**	25,771,580
Prepaid expenses		**16,503,104**	12,846,230
Documentary stamps		**2,968,282**	5,278,806
Others		**9,243,624**	4,305,931
		P 1,925,267,686	P 1,096,860,262

Margin deposits consist of placements with foreign banks that are offered by the Bank as security on its derivative transactions with certain counterparties. Interest rates on margin deposits ranged between 1.00% to 2.70% and 1.10% to 1.70% in 2018 and 2017, respectively.

Amortization charges related to software costs amounted to P9,824,307 and P9,126,924 in 2018 and 2017, respectively, and are included as part of Depreciation and Amortization in the statements of income.

13. DEPOSIT LIABILITIES

The maturity profile of the Bank's deposit liabilities follows:

	2018	2017
Within one year	**P 35,034,221,884**	P 48,315,074,402
Beyond one year up to five years	**5,479,465,459**	8,496,815,570
	P 40,513,687,343	P 56,811,889,972

The classification of the Bank's deposit liabilities as to currency follows:

	2018	2017
Philippine peso	**P 22,358,295,205**	P 34,641,076,867
Foreign currencies	**18,155,392,138**	22,170,813,105
	P 40,513,687,343	P 56,811,889,972

Interest expense on deposit liabilities comprises of:

	2018	2017
Demand	**P 587,909,710**	P 461,305,911
Time	**222,900,542**	135,486,236
	P 810,810,252	P 596,792,147

Interest rates on time deposits ranged from 1.50% to 5.00% and 1.50% to 2.48% per annum for 2018 and 2017, respectively. For demand deposits, interest rates ranged from 0.00% to 1.00% and 0.13% to 2.63% per annum for 2018 and 2017, respectively.

14. BILLS PAYABLE

Bills payable represents the Bank's borrowings from other local and foreign banks and entities which bear annual interest rates of 2.50% to 5.13% in 2018 and 2.50% in 2017. As of December 31, 2018 and 2017, the Bank has no outstanding secured liabilities and assets pledged as security.

15. DERIVATIVE FINANCIAL INSTRUMENTS

The Bank uses derivative instruments for both hedging and non-hedging purposes. Currency forwards represent commitments to purchase foreign and domestic currency, including undelivered spot transactions. Currency and interest swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies or interest rates or a combination of all these. No exchange of principal takes place, except for certain currency swaps. The Bank's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligation.

This risk is monitored on an on-going basis with reference to the current fair value, a proportion of the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Bank assesses counterparties using the same techniques as for its lending activities.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognized in the statements of financial position but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Bank's exposure to credit or price risks.

The derivative instruments become favorable or unfavorable as a result of fluctuations in market interest rates, foreign exchange rates and other underlying relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favorable or unfavorable, and thus the aggregate fair values of derivative financial assets and liabilities, can fluctuate significantly from time to time.

The fair values of derivative instruments held are set out below [see Notes 7 and 22.1(b)].

	Notional Amount	Fair Values	
		Assets	Liabilities
December 31, 2018			
Free-standing			
Cross currency swaps	**P 25,951,145,955**	**P 3,254,782,610**	**P 2,596,654,271**
Interest rate swaps	**13,223,380,000**	**243,823,761**	**224,550,358**
Forward contracts			
Sell: USD/PHP	**6,405,885,000**	**114,794,816**	**350,398**
	P 45,580,410,955	**P 3,613,401,187**	**P 2,821,555,027**
December 31, 2017			
Free-standing			
Cross currency swaps	P 25,348,077,505	P 2,529,081,875	P 1,893,758,627
Interest rate swaps	10,418,065,000	113,575,240	84,311,704
Forward contracts			
Sell: USD/PHP	5,132,303,600	126,871,635	–
Futures	603,790,000	1,162,428	–
	P 41,502,236,105	P 2,770,691,178	P 1,978,070,331

The changes in fair value of derivative assets and liabilities determined using a valuation technique amounted to a loss of P4,810,953 and P102,458,811 in 2018 and 2017, respectively, and were included in Trading and Securities Gain/Loss in the statements of income.

16. ACCRUED EXPENSES AND OTHER LIABILITIES

The breakdown of this account follows:

	Note	**2018**	2017
Accrued taxes		**P 77,581,080**	P 66,892,465
Sundry credits		**68,235,513**	1,708,613
Accrued expenses		**64,576,440**	89,574,430
Manager's check		**47,487,063**	117,657,138
Post-employment defined benefit obligation	21.2	**45,797,732**	38,542,853
Withholding taxes		**38,005,427**	32,427,004
Others		**35,903,843**	10,466,387
		P 377,587,098	P 357,268,890

In 2018, Others include amount payable to BDO Unibank amounting to P26,172,279 representing the Bank's liability arising from the stock option plan offered to the Bank's employees [see Note 2.16(f)]. In 2017, the Bank's liability to BDO Unibank arising from the stock option plan were all settled as of December 31, 2017.

17. EQUITY

17.1 Capital Stock

Capital stock as of December 31, 2018 and 2017 consists of number of shares and amounts in thousands:

	Number of Shares Authorized		**Number of Shares Issued and Outstanding**		**Amount**	
	2018	2017	**2018**	2017	**2018**	2017
Preferred shares						
Balance at beginning of year	–	1,250	–	1,225	**P –**	P 1,225,000
Conversion to common shares	–	(1,225)	–	(1,225)	–	(1,225,000)
Reclassification to common shares	–	(25)	–	–	–	–
Balance at end of year	–	–	–	–	**P –**	P –
Common shares						
Balance at beginning of year	**2,500**	1,250	**2,165**	940	**P 2,165,000**	P 940,000
Conversion of preferred shares	–	1,225	–	1,225	–	1,225,000
Reclassification from preferred shares	–	25	–	–	–	–
Balance at end of year	**2,500**	2,500	**2,165**	2,165	**P 2,165,000**	P 2,165,000

By the majority vote of the Bank's BOD and by the vote of the stockholders owning or representing at least two-thirds of the outstanding capital stock, the conversion of the Bank's entire preferred shares into common shares was approved during the BOD and Stockholders meeting held on April 17, 2017, to be effected through:

- Conversion of its 1,225,000 outstanding preferred shares with a par value of P1,000 per share into 1,225,000 outstanding common shares with a par value of P1,000 per share; and,

- Reclassification of its 25,000 unissued preferred shares with a par value of P1,000 per share into 25,000 unissued common shares with a par value of P1,000 per share. The conversion and reclassification was approved by the Philippine Securities and Exchange Commission (SEC) on October 20, 2017.

As of December 31, 2018 and 2017, the Bank has only one stockholder owning 100 or more shares of the Bank's capital stock.

17.2 Preferred Shares

Prior to the conversion and reclassification (see Note 17.1), the Bank has authorized and issued preferred shares equivalent to 1,250,000 and 1,225,000, respectively. The following were the features of the Bank's preferred shares:

(a) The BOD may specify the terms, conditions, qualifications, restrictions and privileges of the preferred non-voting stock. All preferred shares shall be of equal rank, preference, priority and shall be identical in all respects regardless of series.

(b) The holders of serial preferred stock shall be entitled to receive dividends, when, as and if declared by the BOD out of funds legally available and not before any dividends on the common stock shall be paid or set apart for payments.

(c) The holders of the preferred shares shall not be entitled to vote at any meeting of the stockholders for the election of directors or for any other purpose or participate in any action taken by the Bank or its stockholders.

17.3 Common Shares

The Bank has an authorized common stock of 2,500,000 voting shares with a par value of P1,000 per share.

17.4 Revaluation Reserves

The components and reconciliation of items of other comprehensive income presented in the statements of changes in equity at their aggregate amount under Revaluation Reserves account, are shown below.

	Notes	Unrealized Gains (Losses)on Financial Assets at FVOCI/ AFS Securities	Accumulated Actuarial Gains (Losses)	Total
Balance as of January 1, 2018, as previously stated		**(P 57,427,687)**	**(P 73,072,117)**	**(P 130,499,804)**
Effects of adoption of PFRS 9 – reclassifications and measurements	2.1(b)	**181,187,546**	**–**	**181,187,546**
Balance as of January 1, 2018, as restated		**123,759,859**	**(73,072,117)**	**50,687,742**
Unrealized gains during the year	8	**(382,276,783)**	**–**	**(382,276,783)**
Transfer of net realized gains to profit or loss on disposal of debt securities	8	**26,667,400**	**–**	**26,667,400**
Credit losses on financial assets at FVOCI	8	**1,508,395**	**–**	**1,508,395**
Remeasurements of post-employment defined benefit obligation	21.2	**–**	**(2,922,492)**	**(2,922,492)**
Other comprehensive income before tax		**(354,100,988)**	**(2,922,492)**	**(357,023,480)**
Tax income	23.1	**–**	**876,748**	**876,748**
Other comprehensive income after tax		**(354,100,988)**	**(2,045,744)**	**(356,146,732)**
Balance as of December 31, 2018		**(P 230,341,129)**	**(P 75,117,861)**	**(P 305,458,990)**
Balance as of January 1, 2017		(P 232,182,447)	(P 75,817,446)	(P 307,999,893)
Unrealized gains during the year	8	166,770,073	–	166,770,073
Amortization of unrealized losses on reclassified HTM investment	9	15,787,943	–	15,787,943
Transfer of net realized gains to profit or loss on disposal of securities	8	(7,803,256)	–	(7,803,256)
Remeasurements of post-employment defined benefit obligation	21.2	–	3,921,898	3,921,898
Other comprehensive income before tax		174,754,760	3,921,898	178,676,658
Tax expense	23.1	–	(1,176,569)	(1,176,569)
Other comprehensive income after tax		174,754,760	2,745,329	177,500,089
Balance as of December 31, 2017		(P 57,427,687)	(P 73,072,117)	(P 130,499,804)

17.5 Surplus Reserve

In compliance with the requirements of the General Banking Act relative to the Bank's trust functions, certain percentage of the trust income is transferred to surplus reserve. This yearly transfer is required until the surplus reserve for trust function is equivalent to 20% of the Bank's authorized capital stock. As of December 31, 2018 and 2017, accumulated appropriated surplus related to the Bank's trust functions amounted to P368,280,636 and P298,132,703, respectively.

As part of its transition to PFRS 9 [see Note 2.1(b)] and in compliance with the requirements of the BSP, the Bank appropriated P37,154,285 for general loan loss provision representing the excess of the 1% required allowance of the BSP over the computed allowance for ECL on loans (see Note 10).

17.6 Surplus Free

On April 16, 2018, the BOD approved dividends amounting to P330,000,000 (or P152.42 per share for common stock). The dividend was paid on April 30, 2018. On July 17, 2017, the BOD approved dividends amounting to P500,000,000 (or P230.95 per share for preferred and common stock). The dividend was paid on July 26, 2017 [see Note 22.1(a)].

17.7 Capital Management

On January 15, 2009, the BSP issued Circular No. 639 articulating the need for banks to adopt and document an Internal Capital Adequacy Assessment Process (ICAAP). All universal and commercial banks are expected to perform a thorough assessment of all their material risks and maintain adequate capital to support these risks. This is intended to complement the current regulatory capital requirement of at least 10% of risk assets, which covered only credit, market and operational risks.

The BDO Group is complying with the BSP's ICAAP requirements. BDO Unibank is driving the preparation and compliance requirements of the ICAAP bankwide/group-wide policies. Annually, as required, BDO Unibank submits its updated ICAAP to the BSP. The Bank is closely coordinating with BDO Unibank regarding said policies.

The Bank's lead regulator, the BSP, sets and monitors capital requirements for the Bank. In implementing current capital requirements, the BSP requires the Bank to maintain a prescribed ratio of qualifying capital to risk-weighted assets.

The BSP has adopted the Basel 3 risk-based capital adequacy framework effective January 1, 2014, which requires the Bank, as a subsidiary of a universal bank required to adopt Basel 3, to maintain the following:

(a) Common Equity Tier 1 (CET1) of at least 10.17% of risk-weighted assets;
(b) Tier 1 Capital of at least 7.5% of risk-weighted assets;
(c) Qualifying Capital (Tier 1 plus Tier 2 Capital) of at least 11.67% of risk-weighted assets; and,
(d) Capital Conservation Buffer of 2.5% of risk-weighted assets, comprised of CET1 Capital.

The regulatory capital is analyzed as CET1 Capital, Additional Tier 1 Capital and Tier 2 Capital, each adjusted for prescribed regulatory deductions.

Risk assets consist of total assets after exclusion of 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 as determined by the Monetary Board of the BSP.

The Bank's policy is to maintain a strong capital base as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholder's return is recognized by the Bank as well as the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

At the end of each reporting period, the Bank has complied with the prescribed ratio of qualifying capital to risk-weighted assets.

Further, under an existing BSP circular, commercial banks must meet a minimum capital threshold amounting to P2.0 billion. As of December 31, 2018 and 2017, the Bank has complied with the above capitalization requirement.

The Bank's regulatory capital position based on the Basel 3 risk-based capital adequacy framework as of December 31, 2018 and 2017 are as follows:

	2018	2017
Tier 1 Capital		
CET 1	**P 5,100,657,595**	P 5,348,567,460
Additional Tier 1	**–**	–
	5,100,657,595	5,348,567,460
Tier 2 Capital	**45,341,760**	70,856,519
Total Regulatory Capital	**5,145,999,355**	5,419,423,979
Deductions	**(45,422,118)**	(57,172,884)
Total Qualifying Capital	**P 5,100,577,237**	P 5,362,251,095
Total Risk Weighted Assets	**P 27,538,546,809**	P 27,486,533,380
Capital ratios:		
CET 1 Ratio	**18.36%**	19.25%
Capital Conservation Buffer	**12.36%**	13.25%
Tier 1 Capital Ratio	**18.36%**	19.25%
Total Capital Adequacy Ratio	**18.52%**	19.51%

18. SERVICE CHARGES, FEES AND COMMISSIONS

This account is composed of the following:

	Note	**2018**	2017
Trust fees	24	**P 828,738,177**	P 701,479,327
Others – net		**14,102,975**	12,399,245
		P 842,841,152	P 713,878,572

Trust fees are revenue from asset management services and are recognized over time as the services are provided.

19. THIRD PARTY INFORMATION

Third party information account under Other Expenses refers to service charges incurred by the Bank for market data obtained from service providers such as Reuters, Prebon, Morningstar and Bloomberg (used in the Bank's treasury operations and research activities).

20. OTHER EXPENSES

This account is composed of the following:

		2018		2017
Custodianship fees	**P**	**30,943,908**	P	27,783,720
Security, messengerial and janitorial services		**20,852,475**		19,579,360
Transfer fees and charges		**20,263,915**		13,892,319
Repairs and maintenance		**19,206,529**		18,731,004
Advertising		**11,673,264**		18,642,764
Fines, penalties and other charges		**10,204,500**		23,200,000
Communication		**7,553,945**		7,789,859
Stationery and supplies		**4,960,052**		4,616,765
Contractual services		**1,592,408**		1,178,492
Courier services		**720,784**		1,490,303
Miscellaneous		**12,221,075**		8,401,386
	P	**140,192,855**	P	145,305,972

21. EMPLOYEE BENEFITS

21.1 Employee Benefits

The total expense recognized by the Bank for employee benefits is broken down below.

	Note		2018		2017
Salaries and wages		**P**	**396,935,825**	P	384,687,621
Post-employment defined benefit	21.2		**35,856,044**		33,858,278
Social security and medical benefits			**10,863,911**		9,369,024
Others			**890,338**		1,120,220
		P	**444,546,118**	P	429,035,143

The salaries and wages account includes the expense recognized arising from the Executive Stock Option Plan [see Note 2.16(f)].

21.2 Post-employment Defined Benefit

(a) Characteristics of the Defined Benefit Plan

The Bank maintains a funded, tax-qualified, non-contributory and multi-employer post-employment benefit plan that is being administered by a trustee bank that is legally separated from the Bank. The post-employment plan covers all regular full-time employees.

The normal retirement age is 60 with a minimum of 5 years of credited service. The plan also provides for an early retirement at age 50 with a minimum of five years of credited service and late retirement after age 60, both subject to the approval of the Bank's BOD. Normal retirement benefit is an amount equivalent to 150% of the final monthly covered compensation (average monthly basic salary during the last 12 months of credited service) for every year of credited service.

(b) Explanation of Amounts Presented in the Financial Statements

Actuarial valuations are made annually to update the retirement benefit costs and the amount of contributions. All amounts presented below are based on the actuarial valuation report obtained from an independent actuary in 2018 and 2017.

The amounts of post-employment defined benefit obligation recognized in the statements of financial position are presented as part of Accrued Expenses and Other Liabilities are as follows (see Note 16):

	2018	2017
Present value of obligation	**P 412,992,408**	P 410,128,525
Fair value of plan assets	**(367,194,676)**	(371,585,672)
	P 45,797,732	P 38,542,853

The movements in the present value of the post-employment benefit obligation recognized in the books are as follows:

	2018	2017
Balance at beginning of year	**P 410,128,525**	P 395,188,671
Current service cost	**35,856,044**	33,858,278
Interest cost	**23,377,326**	21,735,377
Remeasurements – Actuarial losses (gains) arising from:		
- experience adjustments	**117,829,559**	79,385,863
- changes in financial assumptions	**(21,533,860)**	(50,410,801)
- changes in demographic assumptions	**(113,976,079)**	(46,217,061)
Benefits paid	**(38,689,107)**	(23,411,802)
Balance at end of year	**P 412,992,408**	P 410,128,525

The movements in the fair value of plan assets are presented below.

		2018		2017
Balance at beginning of year	**P**	**371,585,672**	P	356,086,966
Interest income		**21,042,705**		19,831,922
Return on plan assets (excluding amounts included in net interest)		**(20,602,872)**		(13,320,101)
Benefits paid		**(38,689,107)**		(23,411,802)
Contributions		**33,858,278**		32,398,687
Balance at end of year	**P**	**367,194,676**	P	371,585,672

The composition of the fair value of plan assets at the end of the reporting period for each category and risk characteristics is shown below.

		2018		2017
Placements in debt instruments:				
Government bonds	**P**	**36,487,066**	P	118,662,810
Corporate bonds		**202,383,699**		82,664,126
Cash and cash equivalents		**15,600,970**		36,100,529
Unit investment trust funds (UITF)		**78,865,232**		101,901,167
Loans and other receivables		**22,393,307**		18,524,287
Equity instruments		**7,237,029**		8,733,131
Other properties		**4,227,373**		4,999,622
Balance at end of year	**P**	**367,194,676**	P	371,585,672

The fair value of the plan assets is at Level 1 in the fair value hierarchy except for UITFs which are at Level 2, loans and other receivables and other properties, which are at Level 3.

Actual return on plan assets amounted to P439,833 and P6,511,821 in 2018 and 2017, respectively.

Plan assets do not comprise any of the Bank's own financial instruments or any of its assets occupied and/or used in its operations.

The components of amounts recognized in profit or loss and in other comprehensive income in respect of the defined benefit plan are as follows:

	Note		2018		2017
Recognized in profit or loss:					
Current service cost	21.1	**P**	**35,856,044**	P	33,858,278
Net interest expense			**2,334,621**		1,903,455
		P	**38,190,665**	P	35,761,733

	Notes	2018	2017
Recognized in other comprehensive income (loss):			
Actuarial gains (losses) arising from changes in:			
- experience adjustment		**(P 117,829,559)**	(P 79,385,863)
- financial assumptions		**21,533,860**	50,410,801
- demographic assumptions		**113,976,079**	46,217,061
Return on plan assets (excluding amounts included in net interest expense)		**(20,602,872)**	(13,320,101)
	17.4	**(2,922,492)**	3,921,898
Deferred tax income (expense)	23.1	**876,748**	(1,176,569)
		(P 2,045,744)	P 2,745,329

Current service cost is presented in the statements of income under Employee Benefits while net interest expense is classified as Others under Interest Expense in the statements of income.

Amounts recognized in other comprehensive income (loss) were presented as an item that will not be reclassified subsequently to profit or loss.

In determining retirement benefits, the following actuarial assumptions were used:

	2018	2017
Discount rates	**7.50%**	5.70%
Salary increase rate	**8.50%**	8.20%

Assumptions regarding future mortality experience are based on published statistics and mortality tables. The average remaining working lives of an individual retiring at the age of 65 is 22 for both males and females. These assumptions were developed by management with the assistance of an independent actuary. Discount factors are determined close to the end of each reporting period by reference to the interest rates of interpolated yields of government bonds with terms to maturity approximating to the terms of the retirement obligation. Other assumptions are based on current actuarial benchmarks and management's historical experience.

(c) *Risks Associated with Retirement Plan*

The plan exposes the Bank to actuarial risks such as investment risk, interest rate risk, longevity risk and salary risk.

(i) Investment and Interest Risk

The present value of the defined benefit obligation is calculated using a discount rate determined by reference to market yields of government bonds. Generally, a decrease in the interest rate of a reference government bonds will increase the plan obligation. However, this will be partially offset by an increase in the return on the plan's investments in debt securities and if the return on plan asset falls below this rate, it will create a deficit in the plan. Currently, the plan has investments in debt instruments, cash and cash equivalents, UITF, loans and other receivables, equity securities and other properties. Due to the long-term nature of plan obligation, a level of continuing debt investments is an appropriate element of the Bank's long-term strategy to manage the plans efficiently.

(ii) Longevity and Salary Risks

The present value of the defined benefit obligation is calculated by reference to the best estimate of the mortality of the plan participants both during and after their employment and to their future salaries. Consequently, increases in the life expectancy and salary of the plan participants will result in an increase in the plan obligation.

(d) Other Information

The information on the sensitivity analysis for certain significant actuarial assumptions, the Bank's asset-liability matching strategy, and the timing and uncertainty of future cash flows related to the retirement plan are described as follows:

(i) Sensitivity Analysis

The following table summarizes the effects of changes in the significant actuarial assumptions used in the determination of the defined benefit obligation as of December 31:

	Impact on defined benefit obligation		
	Change in assumption	**Increase in assumption**	**Decrease in assumption**
December 31, 2018			
Discount rate	**+/- 1%**	**(P 13,407,208)**	**P 14,411,583**
Salary increase rate	**+/- 1%**	**14,218,950**	**(13,479,500)**
December 31, 2017			
Discount rate	+/- 1%	(P 29,736,943)	P 34,093,276
Salary increase rate	+/- 1%	29,316,597	(26,209,426)

The sensitivity analysis is based on a change in an assumption while holding all other assumptions constant. This analysis may not be representative of the actual change in the defined benefit obligation as it is unlikely that the change in assumptions would occur in isolation of one another as some of the assumptions may be correlated. Furthermore, in presenting the above sensitivity analysis, the present value of the defined benefit obligation has been calculated using the projected unit credit method at the end of the reporting period, which is the same as that applied in calculating the retirement benefit obligation recognized in the statements of financial position.

The methods and types of assumptions used in preparing the sensitivity analysis did not change compared to the previous year.

(ii) Asset-liability Matching Strategies

To efficiently manage the retirement plan, the Bank through its BOD, ensures that the investment positions are managed in accordance with its asset-liability matching strategy to achieve that long-term investments are in line with the obligations under the retirement scheme. This strategy aims to match the plan assets to the retirement obligations by investing in long-term fixed interest securities (i.e., government or corporate bonds) with maturities that match the benefit payments as they fall due and in the appropriate currency. The Bank actively monitors how the duration and the expected yield of the investments are matching the expected cash outflows arising from the retirement obligations. In view of this, investments are made in reasonably diversified portfolio, such that the failure of any single investment would not have a material impact on the overall level of assets.

A large portion of assets as of December 31, 2018 and 2017 consists of debt instruments and UITF, although the Bank also invests in cash and cash equivalents, loans and other receivables, equity securities and other properties.

There has been no change in the Bank's strategies to manage its risks from previous periods.

(iii) Funding Arrangements and Expected Contributions

The plan is currently underfunded by P45.8 million based on the latest actuarial valuation as of December 31, 2018. While there are no minimum funding requirement in the country, the size of the underfunding may pose a cash flow risk in about 10 years' time when a significant number of employees is expected to retire.

The Bank expects to make contribution of P45.0 million to the plan during the next financial year.

The maturity profile of undiscounted expected benefits payments as of December 31, 2018 from the plan follows:

Within one year	P	132,581,362
More than one year to five years		322,902,456
More than five years		272,710,324
	P	**728,194,142**

22. RELATED PARTY TRANSACTIONS

The summary of the Bank's transactions with its related parties as of and for the years ended December 31, 2018 and 2017 are as follows (amounts in thousands):

		2018		2017	
Related Party Category	Notes	**Amount of Transaction**	**Outstanding Balance**	Amount of Transaction	Outstanding Balance
BDO Unibank:					
Dividends declared	22.1(a)	**P 330,000**	**P –**	P 500,000	–
Derivative transactions	22.1(b)				
Derivative assets					
Buy: USD/PhP		**$ 325,000**	**–**	$ 264,000	–
Interest Rate Swaps		**–**	**–**	–	P 100,000
Derivative liabilities					
Buy: PhP/USD		**$ 340,000**	**–**	$ 284,000	$ 20,000
Interest Rate Swaps		**–**	**–**	–	P 100,000
FX Spot Transactions					
Buy EUR/ USD		**$ 8,412**	**–**	$ 3,834	$ 298
Buy USD/ EUR		**$ 4,033**	**–**	$ 1,735	–
Buy USD/ AUD		**$ 170**	**–**	$ 889	–
Buy SGD/ USD		**$ 1,444**	**–**	$ 720	–
Buy AUD/ USD		**$ 201**	**–**	$ 521	–
Buy PHP/ USD		**–**	**–**	$ 300	–
Buy JPY/ USD		**$ 50**	**–**	$ 215	–
Buy USD/ SGD		**$ 885**	**–**	$ 70	–
Buy USD/ PHP		**–**	**–**	–	–
Buy USD/ JPY		**$ 250**	**–**	–	–
Due from other banks (net of withdrawals)	22.1(c)	**P 65,776**	**P 488,182**	P 65,088	P 422,406
Rental	22.1(d)	**P 33,701**	**–**	P 30,481	–
Management services	22.1(e)	**P 17,302**	**–**	P 20,812	–
Entity under Common Ownership:					
Deposit liabilities (net of withdrawals)	22.1(c)	**(P 49,326)**	**P 62,653**	P 497	P 111,980
Key Management Personnel Compensation	22.2	**P 144,944**	**–**	P 97,512	–

None of the Bank's outstanding balances with related parties has indications of impairment; hence, no impairment losses were recognized in both years.

22.1 Nature of Related Party Transactions

The transactions conducted by the Bank with related parties in the normal course of business are described below.

(a) On April 16, 2018, the BOD approved dividends amounting to P330,000,000 (or P152.42 per share for common stock). Such dividends were paid on April 30, 2018. On July 17, 2017, the BOD approved dividends amounting to P500,000,000 (or P230.95 per share for preferred and common stock) which were paid on July 26, 2017 (see Note 17.6).

(b) In 2018 and 2017, the Bank entered into currency forward, interest rate swap and cross currency swap transactions with BDO Unibank. The outstanding derivative assets and liabilities are shown as part of Financial assets at FVTPL under Trading and Investment Securities account and Derivative Financial Liabilities account in statements of financial position (see Notes 7 and 15).

(c) The Bank holds demand deposits from BDO Securities Corporation, an entity under common ownership, with annual interest rates at 1.25% and 1.00% for 2018 and 2017, respectively. The Bank maintains deposits with BDO Unibank which are included as part of Due from Other Banks in the statements of financial position (see Note 6.2). The interest rates on these deposits ranged from 0.00% to 0.25% per annum in both 2018 and 2017.

(d) In 2018, the Bank entered into a new lease agreement with BDO Unibank for its Ortigas Lounge, for a monthly rental of P272,739. The lease term is for a period of five years and is payable in cash. Other lease agreement for the Bank's Main Office and Lounges remain outstanding in 2018 for a total monthly rental of P2,750,003. Total rent expense incurred pertaining to these agreements are presented as part of the Occupancy in the statements of income. There were no outstanding payable to BDO Unibank as of December 31, 2018 and 2017 in relation to the lease agreement.

(e) In March 2012, the BSP approved the outsourcing of several functions to BDO Unibank. The arrangement will allow the Bank to tap the resources and expertise of BDO Unibank in the areas covered by the new agreement, specifically in the Bank's asset management, central operations, human resources management, information technology, internal audit services and risk management. Total expense incurred pertaining to this contract is presented as part of Management and Professional Fees in the statements of income. As of December 31, 2018 and 2017, there are no outstanding liabilities in relation to the agreement.

22.2 Key Management Personnel Compensation

The salaries and short-term benefits given to the Bank's key management personnel are as follows (amounts in thousands):

		2018		2017
Salaries and other benefits	**P**	**119,476**	P	87,115
Retirement expense		**25,468**		10,397
	P	**144,944**	P	97,512

23. TAXES

23.1 Current and Deferred Taxes

The components of tax expense for the years ended December 31 follow:

	Notes	2018	2017
Reported in profit or loss:			
Final tax at 20%, 10%		**P 187,820,455**	P 205,646,048
Minimum corporate income tax (MCIT)at 2% - Regular Banking Unit (RBU)		**8,502,696**	12,310,336
Regular corporate income tax (RCIT) at 30% - Foreign Currency Deposit Unit (FCDU)		**650,424**	879,947
		196,973,575	218,836,331
Deferred tax expense relating to origination and reversal of temporary differences		**3,465,790**	4,323,708
		P 200,439,365	P 223,160,039
Reported in other comprehensive income – Deferred tax expense (income) related to accumulated actuarial gains and losses	17.4, 21.2	**(P 876,748)**	P 1,176,569

Current taxes include corporate income tax and final taxes paid on income from FCDU and final withholding tax on gross interest income from debt securities and other deposit substitutes.

In 2018 and 2017, the Bank continued to claim itemized deductions. The Bank is also subject to percentage and other taxes, which consist principally of gross receipts tax or GRT, presented as part of Taxes and Licenses in the statements of income.

The reconciliation of tax on pre-tax profit computed at the applicable statutory rates to tax expense attributable to continuing operations follows:

	2018	2017
Tax on pretax profit at 30%	**P 150,520,103**	P 191,103,876
Adjustment for income subjected to lower tax rates	**(88,287,443)**	(105,188,861)
Tax effects of:		
Non-deductible expenses	**196,226,233**	131,226,159
Income from FCDU	**(117,446,495)**	(35,975,139)
Unrecognized deferred tax assets (DTA)	**60,408,234**	12,558,751
Income exempted from income taxes	**(9,483,963)**	16,557,801
Unrecognized MCIT	**8,502,696**	12,310,336
Derecognition of DTA on NOLCO	**–**	567,116
	P 200,439,365	P 223,160,039

The deferred tax assets (included as part of Other Resources – see Note 12) as of December 31 relate to the following:

	Statements of Financial Position		Statement of Income		Statement of Comprehensive Income	
	2018	2017	**2018**	2017	**2018**	2017
Unamortized past service cost	**P 15,322,966**	P 20,088,472	**P 4,765,506**	P 4,765,506	**P –**	P –
Post-employment benefit obligation	**13,489,296**	11,312,832	**(1,299,716)**	(1,008,914)	**(876,748)**	1,176,569
NOLCO	**–**	–	**–**	567,116	**–**	–
Deferred tax assets	**P 28,812,262**	P 31,401,304				
Deferred tax expense (income)			**P 3,465,790**	P 4,323,708	**(P 876,748)**	P 1,176,569

The Bank is subject to MCIT which is computed at 2% of gross income, as defined under tax regulations, or RCIT, whichever is higher. In both 2018 and 2017, the Bank is subject to MCIT on its RBU since MCIT was higher than the RCIT.

The details of unrecognized deferred tax assets as of December 31, 2018 and 2017 are as follows:

	2018		2017	
	Amount	**Tax Effect**	Amount	Tax Effect
NOLCO	**P 298,605,795**	**P 89,581,739**	P 97,245,039	P 29,173,512
Allowance on general loan loss provision	**9,733,226**	**2,919,968**	70,856,519	21,256,956
MCIT	**31,286,842**	**31,286,842**	34,443,311	34,443,311
	P 339,625,863	**P 123,788,549**	P 202,544,869	P 84,873,779

The composition of and movement in the Bank's NOLCO follow:

Year	Amount	Applied and Expired in Current Year	Remaining Balance	Valid Until
2018	P 201,360,756	P –	P 201,360,756	2021
2017	40,862,502	–	40,862,502	2020
2016	56,382,537	–	56,382,537	2019
	P 298,605,795	**P –**	**P 298,605,795**	

The composition of and movements in the Bank's MCIT follow:

Year	Amount	Applied and Expired in Current Year	Remaining Balance	Valid Until
2018	P 8,502,696	P –	P 8,502,696	2021
2017	12,310,336	–	12,310,336	2020
2016	10,473,810	–	10,473,810	2019
2015	11,659,165	(11,659,165)	–	
	P 42,946,007	**(P 11,659,165)**	**P 31,286,842**	

23.2 Supplemental Information Required By the Bureau of Internal Revenue

The Bureau of Internal Revenue (BIR) issued Revenue Regulation (RR) No. 15-2010 on November 25, 2010 which required certain tax information to be disclosed as part of the notes to the financial statements.

The supplementary information is, however, not a required part of the basic financial statements prepared in accordance with PFRS; it is neither a required disclosure under the Philippine SEC rules and regulations covering form and content of financial statements under the Securities Regulation Code Rule 68, as amended.

The Bank presented this tax information required by the BIR as a supplementary schedule filed separately from the basic financial statements.

24. TRUST OPERATIONS

As of December 31, 2018 and 2017, the following cash, securities and other properties held by the Bank in fiduciary or agency capacity for a fee amounting to P828,738,177 and P701,479,327, respectively, presented as Trust Fees under Service Charges, Fees and Commissions in the statements of income (see Note 18) for its customers are not included in the Banking statements of financial position since these are not resources of the Bank (see Note 26.3):

		2018		2017
Cash	**P**	**58,555,906,319**	P	35,661,164,532
Investments		**243,002,534,048**		250,243,354,020
Real estate		**4,671,040,035**		4,730,724,384
Loans and other receivables		**4,072,351,218**		2,060,602,537
Others		**2,268,242,952**		1,700,586,584
	P	**312,570,074,572**	P	294,396,432,057

The trust operations of the Bank relate mainly to management of funds. Certain government bonds owned by the Bank are deposited with the BSP, as mentioned in Notes 8 and 9.

25. SELECTED FINANCIAL PERFORMANCE INDICATORS

The following are some of the financial performance indicators of the Bank:

	2018	2017
Return on average equity		
$\frac{\text{Net profit}}{\text{Average total capital accounts}}$	**5.8%**	7.8%
Return on average common equity		
$\frac{\text{Net profit}}{\text{Average common equity}}$	**5.8%**	9.2%

	2018	2017
Return on average resources		
Net profit / Average total resources	**0.5%**	0.7%
Net interest margin		
Net interest income / Average interest-earning resources	**1.7%**	2.0%
Net income margin ratio		
Net income x 100 / Total revenues	**11.1:1**	15.7:1
Current ratio		
Current resources / Current liabilities	**267%**	267%
Cost to income ratio		
Operating cost / Operating income	**80.3%**	74.7%
Debt to equity ratio		
Total Liabilities / Total Equity	**8.5:1**	11.1:1
Asset to equity ratio		
Total Resources / Total Equity	**9.5:1**	12.1:1
Interest rate coverage		
Earnings before interest and taxes / Interest expense	**1.6:1**	2.1:1
Capital to risk assets ratio*		
Combined credit, market and operational risk	**18.5%**	19.5%

**Computed using balances prepared under PFRS*

26. COMMITMENTS AND CONTINGENT LIABILITIES

26.1 Litigations

On March 15, 2011, the BIR issued RR No. 4-2011 regarding the alleged violation relating to the proper allocation of costs and expenses amongst income earnings of banks and other financial institutions for income tax reporting purposes. RR No. 4-2011 essentially prescribed the method of allocation of cost and expenses such that when computing the amount allowable as deduction from regular banking unit operations, all costs and expenses should first be allocated between the regular banking unit and FCDU/expanded FCDU or offshore banking unit.

On April 6, 2015, the Bank, together with 18 other banks (Petitioners) filed a Petition for Declaratory Relief with Application for Temporary Restraining Order and/or Preliminary Injunction, with the Regional Trial Court of Makati. The Bank is among the Petitioners in Civil Case No. 15-287 assailing the validity of RR No. 4-2011. In the Petition, the Petitioners claimed that there is no provision in the National Internal Revenue Code which justifies the issuance of RR No. 4-2011 and that the scope of RR No. 4-2011 unduly expands the power of the BIR to allocate a taxpayer's costs and expenses. The Petitioners also claimed that RR No. 4-2011 limits their rights to claim ordinary and necessary expenses as deductions.

On April 8, 2015, the Regional Trial Court (RTC) of Makati issued a temporary restraining order, enjoining the BIR from enforcing RR No. 4-2011. Also, on April 27, 2015, the RTC of Makati issued a Writ of Preliminary Injunction also enjoining the BIR from enforcing, carrying out, or implementing in any way or manner RR No. 4-2011 against the Petitioners, including the issuance of Preliminary Assessment Notice or Final Assessment Notice, as the case may be, based on the revenue regulations, pending litigation, unless sooner dissolved.

On May 25, 2018, the RTC of Makati declared RR No. 4-2011 as null and void. The writs of preliminary injunction issued by the RTC of Makati on April 27, 2015 and February 28, 2018 were also made permanent, thereby enjoining Department of Finance (DOF) and BIR from implementing RR No. 4-2011 and prohibiting them from issuing a preliminary assessment notice or final assessment notice, or deciding any administrative matter pending before it, according to or in relation to said regulation.

On July 10, 2018, the DOF and BIR filed a Motion for Extension of Time to File a Petition for Review on Certiorari ("Motion for Extension"). The Supreme Court granted the Motion for Extension.

On August 9, 2018, Petitioners filed a Petition for Review on Certiorari dated August 1, 2018 ("Petition") to assail the RTC of Makati's decision based on the following grounds: (i) the RTC of Makati had no jurisdiction over petitions assailing the constitutionality and validity of tax laws, rules and regulation, and other administrative issuance of the BIR. Allegedly, it is the Court of Tax Appeals that has exclusive jurisdiction to determine the constitutionality or validity of tax laws, rules and regulations issued by the Commissioner of Internal Revenue; and, (ii) RR No. 4-2011 is a valid regulation issued pursuant to the rule-making power of the DOF and the BIR.

The case remains pending as of December 31, 2018.

26.2 Operating Leases Commitments – Bank as Lessee

As of December 31, 2018 and 2017, the estimated minimum future annual rentals of the Bank follow:

		2018		2017
Within one year	**P**	**48,531,392**	P	43,774,229
More than one year but not more than five years		**203,725,191**		184,377,198
More than five years		**–**		–
	P	**252,256,583**	P	228,151,427

Total rentals from these operating leases amounted to P51,523,794 in 2018 and P47,631,867 in 2017, which were reported as Occupancy in the statements of income.

26.3 Others

In the normal course of its operations, the Bank has various outstanding commitments and contingent liabilities such as guarantees, commitments to extend credit, etc., which are not reflected in the Banking financial statements. The Bank recognizes in its books any losses and liabilities incurred in the course of its operations as soon as these become known and quantifiable.

As of December 31, 2018, the Bank's management believes that losses, if any, from the commitments and contingencies will not have a material effect on the Bank's financial statements.

The following is a summary of the Bank's commitments and contingent accounts as of December 31:

	Notes	2018	2017
Trust department accounts	24	**P 312,570,074,572**	P 294,396,432,057
Cross currency swap receivable	15	**11,268,654,360**	11,442,454,360
Cross currency swap payable	15	**14,682,491,595**	13,905,623,145
Interest rate swap receivable	15	**13,223,380,000**	10,418,065,000
Interest rate swap payable	15	**13,223,380,000**	10,418,065,000
Forward exchange sold	15	**6,405,885,000**	5,132,303,600
Loan commitments	4.3	**–**	72,334,814
Spot exchange bought		**528,084,814**	343,688,785
Spot exchange sold		**528,084,814**	343,622,185
Outstanding guarantees		**–**	12,667,050

Supplementary Management Disclosures

(Amounts in Philippine Pesos)

On Capital Structure and Capital Adequacy

A. CET 1 Capital and Breakdown of Components (including deductions solely from CET 1)

	2018	2017
Paid-up common stock	2,165,000,000	2,165,000,000
Retained earnings	3,239,070,841	3,314,067,263
Other comprehensive income	(303,413,246)	(130,499,803)
Sub-total	5,100,657,595	5,348,567,460
Less deduction:		
Deferred income tax	27,935,514	31,401,304
Other intangible assets	17,486,603	25,771,580
Total CET 1 capital	5,055,235,478	5,291,394,576

B. Tier 1 Capital and Breakdown of Components (including deductions solely from Tier 1)

	2018	2017
Paid-up common stock	2,165,000,000	2,165,000,000
Retained earnings	3,239,070,841	3,314,067,263
Other comprehensive income	(303,413,246)	(130,499,803)
Sub-total	5,100,657,595	5,348,567,460
Less deduction:		
Deferred income tax	27,935,514	31,401,304
Other intangible assets	17,486,603	25,771,580
Total Tier 1 capital	5,055,235,478	5,291,394,576

C. Tier 2 Capital and Breakdown of Components

	2018	2017
General loan loss provision	45,341,760	70,856,519
Total Tier 2 capital	45,341,760	70,856,519

D. Computation of Qualifying Capital

	2018	2017
Tier 1 capital	5,100,657,595	5,348,567,460
Tier 2 capital	45,341,760	70,856,519
Gross qualifying capital	5,145,999,355	5,419,423,979
Less: Required deductions	45,422,118	57,172,884
Total qualifying capital	5,100,577,237	5,362,251,095

The regulatory qualifying capital of the Bank consists of Tier 1 (core) capital which includes paid-up common, surplus including current year profit, and surplus reserves, less deduction for deferred income tax and other intangible assets. The other component of regulatory capital is Tier 2 (supplementary) capital, which is the general loan loss provision.

E. Capital Conservation Buffer

	2018	2017
Common Equity Tier 1 Capital	5,055,235,478	5,291,394,576
Less: CET 1 requirement	1,652,312,809	1,649,192,003
Capital Conservation Buffer	3,402,922,669	3,642,202,573
Capital Conservation Buffer Ratio	12.36%	13.25%

F. Capital Requirements for Credit Risk

	2018	2017
On - Balance Sheet	18,144,035,316	18,689,409,249
Off - Balance Sheet	—	27,134,013
Counterparty (Trading Book)	3,763,465,311	3,205,865,034
Total	21,907,500,627	21,922,408,296
Capital Requirements	2,190,750,063	2,192,240,830

G. Capital Requirements for Market Risk

	2018	2017
Interest Rate Exposures	1,473,778,011	1,682,032,858
Foreign Exchange Exposures	528,047,965	534,700,187
Total	2,001,825,976	2,216,733,045
Capital Requirements	200,182,598	221,673,305

H. Capital Requirements for Operational Risk

	2018	2017
Basic Indicator	3,629,220,206	3,347,392,039
Total	3,629,220,206	3,347,392,039
Capital Requirements	362,922,021	334,739,204

I. Computation of Capital Adequacy Ratio - Total and Tier 1

	2018	2017
Total Qualifying Capital	5,100,577,237	5,362,251,095
Credit risk-weighted assets	21,907,500,627	21,922,408,296
Market risk-weighted assets	2,001,825,976	2,216,733,045
Operational risk-weighted assets	3,629,220,206	3,347,392,039
Risk weighted assets	27,538,546,808	27,486,533,380
Total capital ratio	18.52%	19.51%
Tier 1 capital ratio	18.36%	19.25%
CET 1 ratio	18.36%	19.25%

Full Reconciliation of all Regulatory Capital Elements back to the Balance Sheet in the Audited Financial Statements

	Per AFS	Adj - AFS to Regulatory	Regulatory Capital			
			CET 1	Tier 1	Tier 2	Qualifying
Common Stock	2,165,000,000		2,165,000,000	2,165,000,000		2,165,000,000
Surplus - Free/Reserve	3,276,824,721	(37,753,880)[a]	3,239,070,841	3,239,070,841		3,239,070,841
General Loan Loss Provisions	—	45,341,760[b]			45,341,760	45,341,760
Other Comprehensive Income						
Unrealized Fair Value G/L on AFS	(230,341,128)		(230,341,128)	(230,341,128)		(230,341,128)
Accumulated Actuarial G/L	(75,117,862)	2,045,745[c]	(73,072,117)	(73,072,117)		(73,072,117)
Cumulative Translation Adj						
	5,136,365,730	9,633,625	5,100,657,595	5,100,657,595	45,341,760	5,145,999,355
Regulatory Adjustments/ Deductions						
Deferred Income Tax		(27,935,514)	(27,935,514)	(27,935,514)		(27,935,514)
Other Intangible Assets		(17,486,603)	(17,486,603)	(17,486,603)		(17,486,603)
	5,136,365,730	(35,788,492)	5,055,235,478	5,055,235,478	45,341,760	5,100,577,238

(a)	Various audit adjustments	(388,528)
	Reclass from Reserve for GLLP to Tier 2 GLLP in CAR per Cir#1011	(37,365,352)
		(37,753,880)
(b)	General Loan Loss	7,976,408
	Reserve for GLLP	37,365,352
	Total Tier 2 GLLP	45,341,760
(c)	Various actuarial adjustments	2,045,745

Comprehensive Explanations of How Ratios Involving Components for Regulatory Capital are Calculated

	Regulatory Capital Ratios		
	CET 1	Tier 1	Qualifying
Components of Regulatory Ratios			
Regulatory Capital	5,055,235,478	5,055,235,478	5,100,577,238
Risk Weighted Assets	27,538,546,808	27,538,546,808	27,538,546,808
Computation of Regulatory Ratios			
Qualifying Capital / Risk Weighted Assets			18.52%
Tier 1 Capital / Risk Weighted Assets		18.36%	
CET 1 Capital / Risk Weighted Assets	18.36%		

On Credit Risk Exposures

On-Balance Sheet (BS) Assets

	2018								
			RISK WEIGHTS						
Type of Exposures	Principal Amount	Exposures After CRM	0%	20%	50%	75%	100%	150%	Total
Cash on Hand									—
Checks and Other Cash Items									—
Due from Bangko Sentral ng Pilipinas	4,425,182,127	4,425,182,127	4,425,182,127						4,425,182,127
Due from Other Banks	3,044,898,940	3,044,898,940		508,158,888	1,996,062,369		540,677,683		3,044,898,940
Financial Assets Designated at FVTPL	—	—							—
Available for Sale Securities	11,430,066,625	11,430,066,625	2,875,974,670	566,144,982	4,063,110,222		3,924,836,751		11,430,066,625
Held to Maturity	19,492,612,463	19,492,612,463	10,994,230,446	1,225,856,521	7,272,525,496		—		19,492,612,463
Unquoted Debt Securities Classified as Loans	—	—							—
Loans and Receivables	4,313,757,446	4,313,757,446					4,313,757,446		4,313,757,446
Loans and Receivables Arising from Repurchase Agreements, Certificates of Assignment/ Participation with Recourse, and Securities Lending and Borrowing Transactions	—	—							—
Sales Contract Receivable	—	—							—
Real and Other Properties Acquired	—	—							—
Other Assets	2,189,854,485	2,189,854,485					2,189,854,485		2,189,854,485
Total Exposures	44,896,372,087	44,896,372,087	18,295,387,243	2,300,160,392	13,331,698,087	—	10,969,126,365	—	44,896,372,087
Total Risk-weighted On-BS Assets Not Covered by CRM			18,295,387,243	2,300,160,392	13,331,698,087	—	10,969,126,365		44,896,372,087
Total Risk-weighted On-BS Assets Covered by CRM*			67,650,620		98,055,659				165,706,278
Total Risk-weighted On-BS Assets			18,363,037,862	2,300,160,392	13,429,753,746	—	10,969,126,365	—	45,062,078,365
Computed Risk Weight/Capital Charge			—	*460,032,078*	*6,714,876,873*	—	*10,969,126,365*	—	*18,144,035,316*

** The types of eligible credit risk mitigants used on On Balance Sheet Assets are GS, ROP and Deposits*

On-Balance Sheet (BS) Assets

Type of Exposures	2017 Principal Amount	Exposures After CRM	RISK WEIGHTS 0%	20%	50%	75%	100%	150%	Total
Cash on Hand									—
Checks and Other Cash Items									—
Due from Bangko Sentral ng Pilipinas	11,977,051,895	11,977,051,895	11,977,051,895						11,977,051,895
Due from Other Banks	8,586,596,044	8,586,596,044		1,915,660,455	6,026,683,028		644,252,561		8,586,596,044
Financial Assets Designated at FVTPL	—	—							—
Available for Sale Securities	14,401,488,433	14,401,488,433	6,001,612,130	809,972,880	3,456,810,200		4,133,093,223		14,401,488,433
Held to Maturity	12,967,762,271	12,967,762,271	10,388,434,582	556,207,141	2,023,120,548		—		12,967,762,271
Unquoted Debt Securities Classified as Loans	3,479,250,283	3,479,250,283			3,479,250,283				3,479,250,283
Loans and Receivables	4,422,230,292	4,422,230,292					4,422,230,292		4,422,230,292
Loans and Receivables Arising from Repurchase Agreements, Certificates of Assignment/ Participation with Recourse, and Securities Lending and Borrowing Transactions	3,387,574,515	3,387,574,515	3,387,574,515						3,387,574,515
Sales Contract Receivable	—	—							—
Real and Other Properties Acquired	—	—							—
Other Assets	1,304,054,964	1,304,054,964					1,304,054,964		1,304,054,964
Total Exposures	60,526,008,697	60,526,008,697	31,754,673,122	3,281,840,476	14,985,864,060	—	10,503,631,039	—	60,526,008,697
Total Risk-weighted On-BS Assets Not Covered by CRM			31,754,673,122	3,281,840,476	14,985,864,060	—	10,503,631,039	—	60,526,008,697
Total Risk-weighted On-BS Assets Covered by CRM			201,955,141		72,956,170				274,911,311
Total Risk-weighted On-BS Assets			31,956,628,263	3,281,840,476	15,058,820,230	—	10,503,631,039	—	60,800,920,008
Computed Risk Weight/Capital Charge			*—*	*656,368,095*	*7,529,410,115*	*—*	*10,503,631,039*	*—*	*18,689,409,249*

Off-Balance Sheet (BS) Assets

		2018						
		Risk Weights						
Type of Exposures	**Credit Equivalent**	**0%**	**20%**	**50%**	**75%**	**100%**	**150%**	**Total**
Guarantees Issued	—					—		—
Transaction-related contingencies	—					—		—
Commitments with an original maturity of up to one (1) year	—					—		
	—					—		—
	—	—	—	—	—	—	—	—
Computed Risk Weight/Capital Charge		—	—	—	—	—	—	—

Off-Balance Sheet (BS) Assets

		2017						
		Risk Weights						
Type of Exposures	**Credit Equivalent**	**0%**	**20%**	**50%**	**75%**	**100%**	**150%**	**Total**
Guarantees Issued	12,667,050					12,667,050		12,667,050
Transaction-related contingencies	—					—		—
Commitments with an original maturity of up to one (1) year	—					—		
	14,466,963					14,466,963		14,466,963
	27,134,013	—	—	—	—	27,134,013	—	27,134,013
Computed Risk Weight/Capital Charge		—	—	—	—	*27,134,013*	—	*27,134,013*

On External Credit Assessments

Standardized credit risk weights were used in the credit assessment of asset exposures. Third party credit assessments were based on ratings of Standard and Poor's, Moody's, Fitch and PhilRatings on exposures to sovereigns, MDBs, LGUs, Government Corporations and Corporates.

On Interest Rate Risk in the Banking Books

For interest rate risks in the banking book (IRRBB), please refer to NFS Section 4.1.2. Earnings-at-Risk (EaR) is calculated using a 1-year holding period and is measured on a monthly basis.

Disclosure Statements on the ff:

Eligible Credit Risk Mitigants including Credit Derivatives
Credit Protection Given by the Bank
Structured Products
Hedging and Continuing Effectiveness of Hedges
Securitization Structures

Risk-weighted on balance sheet assets covered by credit risk mitigants are mostly exposures covered by deposits, government and corporate issued securities. There are no securitization exposures, no exposures covered by credit derivatives, no outstanding credit protection provided by the Bank through credit derivatives, and no outstanding investments in structured products. Moreover, the Bank has no outstanding accounting hedges. In case there are accounting hedges, the Bank performs both prospective and retrospective hedge effectiveness tests to monitor the continuing effectiveness of accounting hedges as a matter of policy.

On Basel III Leverage Ratio

A. Calculation of BASEL III Leverage Ratio

	2018	2017
Capital Measure	5,055,235,478	5,291,394,576
Total On-balance sheet exposures[1/]	45,583,292,465	58,696,729,450
Total Derivatives Exposures	4,143,563,908	3,780,894,630
Total Securities Financing Transactions	—	3,386,897,136
Off-balance Sheet Exposures	52,808,481	46,879,621
Total Exposure Measure	49,779,664,854	65,911,400,837
BASEL III Leverage Ratio	10.16%	8.03%

[1/] *Gross of general loan loss provision (GLLP) and excluding derivatives and SFTs and deductions from BASEL III Tier1 capital are excluded from the leverage ratio exposure measure*

B. Summary Comparison Table

	2018	2017
Total consolidated assets as per published financial statements[1/]	48,846,615,422	64,495,101,440
Adjustments for derivatives financial instruments	917,686,660	1,355,736,141
Adjustments for securities financial transactions	—	—
Adjustments for off-balance sheet items	52,808,481	46,879,621
Other adjustments	(37,445,710)	13,683,635
Leverage ratio exposure	49,779,664,854	65,911,400,837

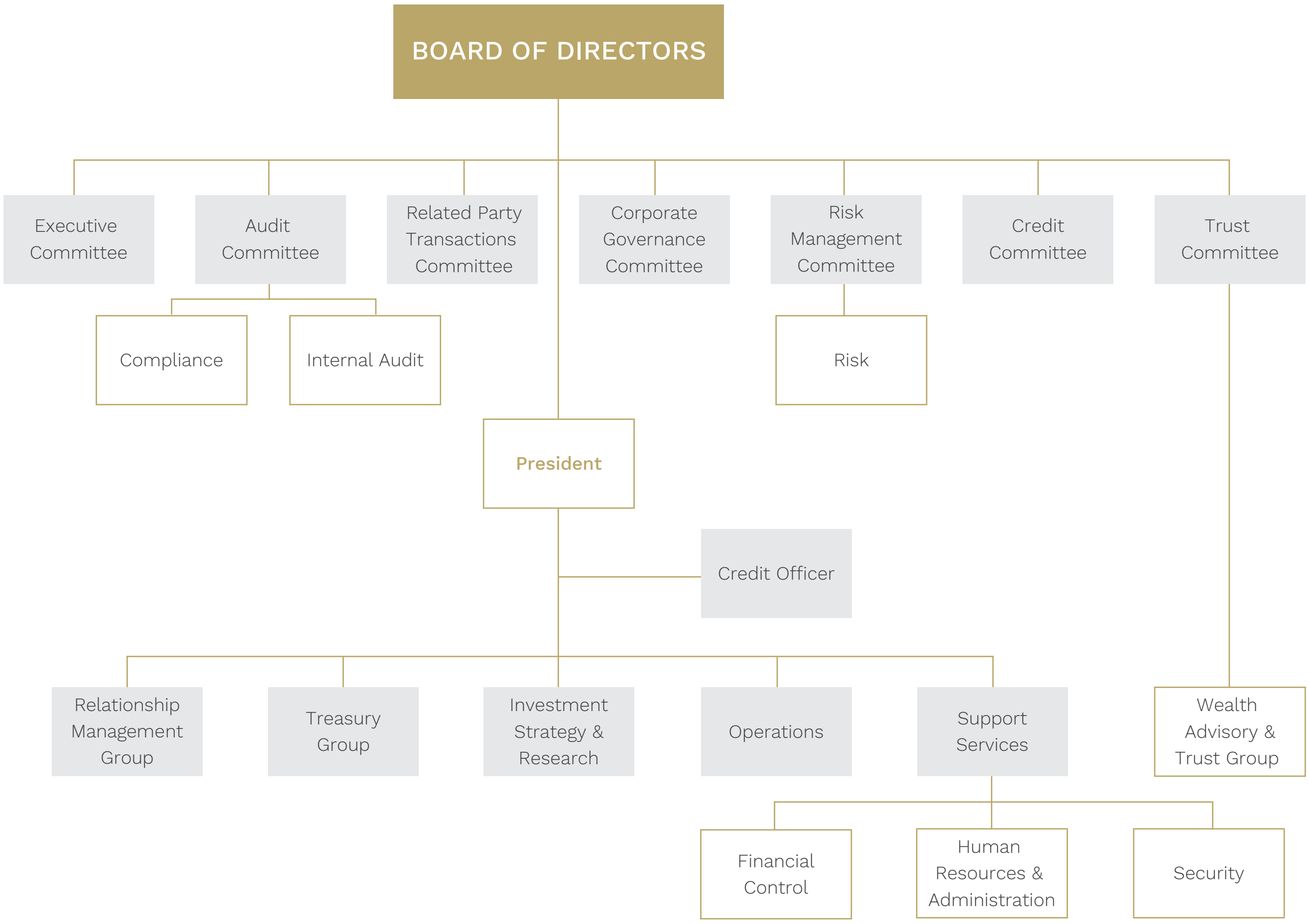
[1/] *Refers to total on-balance sheet assets per quarterly published balance sheet*

C. Common Disclosure Table

	2018	2017
On-balance sheet items[1/]	45,628,714,582	58,753,902,334
Asset amounts deducted in determining BASEL III Tier 1 Capital	(45,422,118)	(57,172,884)
Total on-balance sheet exposures (excluding derivatives & SFTs)	45,583,292,465	58,696,729,450
Replacement cost associated with all derivatives transactions	3,225,877,247	2,425,158,490
Add-on amounts for Potential Future Exposure associated with all derivative transactions	917,686,660	1,355,736,141
Total derivative exposures	4,143,563,908	3,780,894,630
Gross SFT assets	—	3,386,897,136
Total securities financing transaction exposures	—	3,386,897,136
Off-balance sheet exposure at gross notional amount	528,084,814	282,457,945
Off-balance sheet items	52,808,481	46,879,621
Tier 1 capital	5,055,235,478	5,291,394,576
Total exposures	49,779,664,854	65,911,400,837
Basel III leverage ratio	10.16%	8.03%

[1/] *Gross of general loan loss provision (GLLP) and excluding derivatives and SFTs*

Organizational Structure



Management Directory

As of December 31, 2018

Albert S. Yeo
President and Director

OFFICE OF THE PRESIDENT

Vice President
Marilou M. Espiritu

TREASURY

First Vice President and Treasurer
Gerardo Clemente C. Rivera

Senior Assistant Vice President
Ryan Paul G. Marbella

Assistant Vice President
Christopher Mari M. Topacio

RELATIONSHIP MANAGEMENT

Executive Vice President
Stella L. Cabalatungan

Senior Vice Presidents
Jonathan T. Cua
Sonia Maribel D. Go

First Vice Presidents
Jose Rene C. Carlos
Cheryll B. Gaviño
Judy L. Go
Francis Jay F. Nacino
Arlene Marie H. Uson
Beatriz Y. Zalazar

Vice Presidents
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Catherine S. Choa
Patricia Ann F. Gonzalez
Michele Y. Lao
Christy K. Ortega
Charisse B. Recto
Ma. Elena I. Rigor
Belinda Rose S. Yap
Avery U. Yu

Senior Assistant Vice Presidents
Maria Katrina G. Datoc
Anna Patricia A. Dee
Joy Kerwin U. Dela Cruz
Christopher John S. Jorge
Jonalyn T. See
Donna Marie C. Uy

Assistant Vice Presidents
Gina Camille G. Barrica
Theresita G. Herrera
Pinky Marissa Y. Tan

INVESTMENT STRATEGY & ECONOMIC RESEARCH

Senior Vice Presidents
Richard Emil R. Grau
Jose Noel M. Mendoza

WEALTH ADVISORY & TRUST

Senior Vice President and Trust Officer
Juan Sabino P. Lizares

First Vice Presidents
Pollyanna B. Diokno
Evelyn K. Sy
Steven C. Te
Frederick N. Tiu
Edlyn L. Quiroz
Blandina Uvyhilda B. Vicente

Vice Presidents
Patricia Lei S. Alvarillo
Lilli Ann D.S. Bautista
Candy U. Dy
Maria Vilma D. Fabian
Michael Geronimo G. Martin
Dalisay S. Molas

Senior Assistant Vice Presidents
Jones Mark L. Chan
Andrei Ian D. Chua
Julian Raphael B. Favila

Assistant Vice Presidents
John Naphtali D. Cabuyao
Marie Therese T. Chan
Martin Antonio L. Español
Jovi H. Gotamco
Jose Lis L. Leagogo
Manuel P. Mallari, Jr.
Marie Christine Z. Morillo
Jaime T. Reyes, II

FINANCIAL CONTROL

Vice President
Maria Lourdes M. Sevilla

Assistant Vice President
Rosalia G. Bautista

OPERATIONS

First Vice President
Wendeline Therese M. Tumolva

Vice President
Norberto Robert S. Cabañero

Senior Assistant Vice President
Rowena Remedios I. Estrella

COMPLIANCE

Vice President
Benjamin V. Teodoro

Assistant Vice President
Maria Arleli Rose B. Malonzo

RISK MANAGEMENT

First Vice President
Brenda S. Taruc

HUMAN RESOURCES & ADMINISTRATION

Assistant Vice President
Annaliza G. Valmonte

Products and Services

PRODUCTS

Peso and Foreign Currency Settlement Accounts

Multi-Currency Deposits

Foreign Exchange

Multi-Currency Fixed Income/Equity Securities

Derivatives

WEALTH ADVISORY SERVICES

Financial Planning

Strategic Investment Advisory

Investment Management
(Asset Allocation, Portfolio Construction, Investment Selection)

TRUST SERVICES

Estate Planning Advisory

Personal and Management Trust

- Bespoke and Special Needs Trust
- Irrevocable Trust
- Real Estate Trust

Life Insurance Trust

Employee Benefit Trust

Investment Management
(Directional and Discretionary Mandate)

Family Office

BDO Private Bank Lounges

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GREENHILLS

Mezzanine Floor
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Greenhills, San Juan City
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CEBU

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Cebu Business Park
Mindanao Avenue corner Bohol Avenue
Cebu City
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BDO Private Bank