

## Report of Independent Auditors

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**The Board of Directors and the Stockholders**  
**Rizal Commercial Banking Corporation**  
Yuchengco Tower, RCBC Plaza  
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Makati City

### Report on the Audit of the Financial Statements

#### Opinion

We have audited the financial statements of Rizal Commercial Banking Corporation and subsidiaries (together hereinafter referred to as the Group) and of Rizal Commercial Banking Corporation (the Parent Company), which comprise the statements of financial position as at December 31, 2017 and 2016, and the statements of profit or loss, statements of comprehensive income, statements of changes in equity and statements of cash flows for each of the three years in the period ended December 31, 2017, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Group and of the Parent Company as at December 31, 2017 and 2016, and their financial performance and their cash flows for each of the three years in the period ended December 31, 2017 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 Consolidated Financial Statements* section of our report. We are independent of the Group 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.

## Key Audit Matters

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

### Key audit matters identified in our audit of the financial statements of the Group and of the Parent Company:

#### (a) *Impairment of Loans and Receivables*

##### *Description of the Matter*

As of December 31, 2017, the Group's loans and receivables amounted to P354,243 million, net of allowance for impairment of P7,993 million, while the Parent Company's loans and receivables amounted to P265,791 million, net of allowance for impairment of P4,942 million, which details are disclosed in Note 11 to the financial statements. Loans and receivables are the most significant resources of the Group and the Parent Company which represented 64% and 60% of the total resources, respectively. Both the Group's and the Parent Company's management exercise significant judgment and use subjective estimates in determining when loans and receivables are impaired and how much impairment loss are required to be recognized in the financial statements. These judgment and estimates are set out in the Group's and the Parent Company's accounting policies in Note 2 to the financial statements, which describes the following impairment assessments:

- Loans and receivables are assessed for impairment on an individual basis if there is objective evidence of impairment that exists (or a loss event) as of the end of the reporting period. Management considers the following in determining that a loss event occurred, among others, a significant financial difficulty of the issuer or obligor; a breach of contract, such as a default or delinquency in interest or principal payments; and, it becoming probable that the borrower will enter bankruptcy or other financial reorganizations. Loss events are assessed by management and are assigned to individually impaired loan and receivable according to the following credit grades: substandard, doubtful and loss, depending on the level of credit risk.
- Collective assessments are made on a portfolio basis where loans and receivables are grouped on the basis of similar credit risk characteristics (i.e., on the basis of management's grading process that considers asset type, industry, geographical location, collateral type, past due status and other relevant factors). The methodology utilized by management in collective impairment assessment uses significant assumptions such as default rate and loss given default, which are applied to each portfolio belonging to a particular group and credit grade.

Because of the significance of the amounts involved and subjectivity of management's judgment and estimates used, we identified the inadequacy of the allowance for impairment on loans and receivables as a significant risk of material misstatement in the financial statements.



*How the Matter was Addressed in the Audit*

We established reliance on the Group's and the Parent Company's internal control by testing the design and operating effectiveness of key activities-level controls over the assessment and approval of customer credit; the capturing of information relevant to calculation of the amount of allowance for impairment (e.g., risk grades, default rates and loss given defaults); and, the calculation and recognition of impairment loss.

In addition, we performed substantive audit procedures, which included, among others:

- checking and evaluating the methodology used by management whether it was in accordance with the individual and collective impairment assessments prescribed by Philippine Accounting Standard (PAS) 39, *Financial Instruments: Recognition and Measurement*;
- on selected loan accounts, checking whether the loans identified for individual impairment assessment were appropriately classified according to credit grades and recalculating the net present values of expected future cash inflows using the effective interest rates applicable to each loan, which were compared to the outstanding balances of the loans; and,
- evaluating management's judgment applied in determining the significant assumptions and inputs used in computing the impairment loss for collective assessment such as default rates and loss given defaults by reviewing payment history for selected loans per economic activity or industry classification and credit grade.

**(b) Fair Value Measurement of Unquoted Security Classified at Fair Value Through Profit or Loss**

*Description of the Matter*

The Group and the Parent Company has significant investment in an unquoted equity security classified at fair value through profit or loss (FVPL) amounting to P543 million as of December 31, 2017, on which management recognized P43 million fair value loss in profit or loss in 2017. The valuation of such financial instrument involves a complex valuation technique (i.e., price-to-book value method) and significant estimation which are highly dependent on underlying assumptions and inputs such as price-to-book ratios of comparable listed entities and application of a certain haircut rate. These inputs are considered Level 3 unobservable inputs in the fair value hierarchy under PFRS 13, *Fair Value Measurement*, as discussed in Notes 3 and 7 to the financial statements. Accordingly, the valuation of such security was considered significant to our audit.

*How the Matter was Addressed in the Audit*

Our work included evaluating the appropriateness of management's valuation methodology in accordance with PFRS 13. We used our own internal valuation expert to assess and challenge the valuation assumptions used, including the identification of comparable listed entities and the related financial information such as net book value per share and quoted prices of those listed entities. In testing the reasonableness of the haircut rate used, we reviewed available non-financial information relevant to the assessment of the potential marketability of the subject security, and the consistency of the application of the haircut rate used in prior period in light of the current industry and economic circumstances.

**(c) Appropriateness of Disposals of Investment Securities at Amortized Cost**

*Description of the Matter*

As of December 31, 2017, the Parent Company carries in its financial statements investment securities held under its hold-to-collect (HTC) business model, which are measured at amortized amounting to P48,141 million. In 2017, it disposed of a portion of its US dollar-denominated HTC securities with face value of US\$449 million (P22,466 million) and carrying amount of P22,279 million. The disposal was made in anticipation to the possible impact on the Parent Company's qualifying capital in connection with the adoption of PFRS 9 (2014), *Financial Instruments*, in 2018 which would require recognition of additional allowance for impairment on certain financial assets under the expected credit loss model; and as a result, would diminish the Parent Company's existing level of qualifying capital. The disposal aims for the Parent Company to ensure its continuing regulatory compliance with the required minimum Common Equity Tier 1 ratio by the BSP.

Management assessed that such disposal remains to be consistent with the Parent Company's HTC business model for the portfolio with the objective of collecting contractual cash flows. The assessment to determine whether the disposal of the HTC securities is consistent with the Parent Company's HTC business model is significant to our audit because the assessments involve significant judgment and would impact the measurement of the investment securities in the affected portfolios. The disclosures in relation to these matters are included in Note 10 while the disclosures of the Parent Company's assessment of the business model applied in managing financial instruments are presented in Note 2 to the financial statements.

*How the Matter was Addressed in the Audit*

We confirmed the appropriateness of the Parent Company's disposal of the US dollar denominated HTC securities by reviewing the documentation of the approval of the Parent Company's Executive Committee on June 28, 2017 as required by the BSP, which was ratified by the Parent Company's Board of Directors. We assessed whether the disposals are made consistent with the permitted sale events documented in the Parent Company's business model in managing financial assets manual and with the relevant requirements of both the financial reporting standard and the BSP. We also assessed the appropriateness and reasonableness of the underlying data used and the rationale documented by the Parent Company in the determination of the amount of HTC securities disposed of relative to the current and forecasted level of qualifying capital sufficient to ensure continuing compliance with the regulatory requirements of the BSP.

**(d) Recoverability of Deferred Tax Assets**

*Description of the Matter*

The Group's and the Parent Company's deferred tax assets amounted to P1,896 million and P942 million, respectively, as of December 31, 2017. The recognition of deferred tax assets is reviewed at the end of each reporting period and adjusted to the extent of the changes in probability that sufficient taxable profits will be available to allow all or part of such deferred tax assets to be utilized. Determining the probabilities of sufficiency of future taxable profits involves significant management judgment and high estimation uncertainty as it requires preparation of financial forecast and profitability projections which may result in different outcome scenarios; hence, may significantly affect the estimates made by management. Accordingly, we identified the recoverability of deferred tax assets as significant area of focus in our audit.



*How the Matter was Addressed in the Audit*

Our work included, among others, obtaining management's income projections based on its Internal Capital Adequacy Assessment Process document. Relative to this, we reviewed the appropriateness of management's assumptions underlying the recoverability of the deferred tax assets by comparing the forecasts to our expectations developed based on historical performance. We also considered the fact that the Group and the Parent Company have been utilizing the benefits of deferred tax assets since prior periods.

The relevant information relating to deferred tax assets are disclosed in Notes 2, 3 and 26 to the financial statements.

Key audit matter we identified in our audit of the consolidated financial statements of the Group:

**Assessment of Goodwill Impairment**

*Description of the Matter*

As of December 31, 2017, the balance of goodwill amounted to P268 million, which is included as part of the Other Resources account in the Group's statement of financial position. Under PFRS, goodwill, having indefinite useful life, is not subject to amortization but is required to be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the carrying value of goodwill may be impaired. This annual impairment test was significant to our audit because management's assessment process is complex and highly judgmental, and is based on significant assumptions, specifically on the identification of cash generating units (CGUs) where the goodwill is allocated and the future cash flows of that particular CGUs, which are affected by expected future market or economic conditions. Relative to this, the Group engaged a third party valuation specialist to assist them in assessing any impairment on the recognized goodwill. Management's significant assumptions include:

- RCBC Savings Bank, Inc. (RSB), the identified CGU on which the goodwill is allocated, will continue as a going concern;
- RSB will have sufficient financial resources to finance its working capital requirements to achieve its projected forecast and to support the business needs; and,
- RSB's performance forecasts for the next five years.

The Group's accounting policy on impairment of and disclosures about goodwill are included in Notes 2 and 15, respectively, to the financial statements.

*How the Matter was Addressed in the Audit*

Our audit procedures included, among others, evaluating the assumptions and methodologies used by management and its valuation specialist, particularly those relating to the forecasted revenue growth and profit margins of RSB by considering historical trends. In addition, our audit on the financial statements of RSB as of and for the year ended December 31, 2017 did not identify event or conditions that may cast significant doubt on RSB's ability to continue as a going concern.

### **Other Information**

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

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

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

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

Management is responsible for the preparation and fair presentation of the financial statements in accordance with 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 Group's and the Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group and the Parent Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's and the Parent Company'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 Group's and the Parent Company'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 Group's and the Parent Company'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 Group and the Parent Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

### **Report on 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 discussed in Note 26 to the financial statements, the Parent Company presented the supplementary information required by the Bureau of Internal Revenue under Revenue Regulations (RR) 15-2010 and RR 19-2011 in a supplementary schedule filed separately from the basic financial statements. RR 15-2010 and RR 19-2011 require the supplementary information to be presented in the notes to 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 neither a required disclosure under the Securities Regulation Code Rule 68, as amended, of the SEC.



The engagement partner on the audits resulting in this independent auditors' report is Maria Isabel E. Comedia.

**PUNONGBAYAN & ARAULLO**

**By: Maria Isabel E. Comedia**  
Partner

CPA Reg. No. 0092966

TIN 189-477-563

PTR No. 6616005, January 3, 2018, Makati City

SEC Group A Accreditation

Partner - No. 0629-AR-3 (until Dec. 22, 2019)

Firm - No. 0002-FR-4 (until Apr. 30, 2018)

BIR AN 08-002511-21-2016 (until Oct. 3, 2019)

Firm's BOA/PRC Cert. of Reg. No. 0002 (until Dec. 31, 2018)

February 26, 2018





The engagement partner on the audits resulting in this independent auditors' report is Maria Isabel E. Comedia.

**PUNONGBAYAN & ARAULLO**

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February 26, 2018

**RIZAL COMMERCIAL BANKING CORPORATION AND SUBSIDIARIES**  
**STATEMENTS OF FINANCIAL POSITION**  
**DECEMBER 31, 2017 AND 2016**  
*(Amounts in Millions of Philippine Pesos)*

	Notes	GROUP		PARENT COMPANY	
		2017	2016	2017	2016
<b>RESOURCES</b>					
CASH AND OTHER CASH ITEMS	9	P 14,693	P 15,176	P 10,415	P 11,000
DUE FROM BANGKO SENTRAL NG PILIPINAS	9	58,801	66,520	47,186	50,871
DUE FROM OTHER BANKS	9	19,818	25,293	18,368	24,109
LOANS ARISING FROM REVERSE REPURCHASE AGREEMENT	9	9,831	7,889	7,435	4,931
TRADING AND INVESTMENT SECURITIES - Net	10	72,932	75,622	58,133	65,652
LOANS AND RECEIVABLES - Net	11	354,243	306,167	265,791	228,432
INVESTMENTS IN SUBSIDIARIES AND ASSOCIATES - Net	12	417	383	19,018	17,178
BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT - Net	13	8,946	8,876	5,197	5,192
INVESTMENT PROPERTIES - Net	14	3,399	3,229	2,785	2,816
DEFERRED TAX ASSETS	26	1,896	2,177	942	1,285
OTHER RESOURCES - Net	15	9,012	9,861	6,306	6,316
<b>TOTAL RESOURCES</b>		<b>P 553,988</b>	<b>P 521,193</b>	<b>P 441,576</b>	<b>P 417,782</b>

*See Notes to Financial Statements.*



	Notes	GROUP		PARENT COMPANY	
		2017	2016	2017	2016
<b><u>LIABILITIES AND EQUITY</u></b>					
DEPOSIT LIABILITIES	17	P 388,412	P 353,077	P 288,667	P 260,165
BILLS PAYABLE	18	43,967	37,643	36,600	31,712
BONDS PAYABLE	19	28,060	41,595	28,060	41,595
SUBORDINATED DEBT	20	9,968	9,952	9,968	9,952
ACCRUED INTEREST, TAXES AND OTHER EXPENSES	21	4,185	4,823	3,218	3,633
OTHER LIABILITIES	22	<u>12,369</u>	<u>11,970</u>	<u>8,134</u>	<u>8,688</u>
Total Liabilities		<u>486,961</u>	<u>459,060</u>	<u>374,647</u>	<u>355,745</u>
EQUITY	23				
Attributable to:					
Parent Company's Shareholders		66,999	62,107	66,929	62,037
Non-controlling Interests		<u>28</u>	<u>26</u>	<u>-</u>	<u>-</u>
		<u>67,027</u>	<u>62,133</u>	<u>66,929</u>	<u>62,037</u>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>P <u>553,988</u></b>	<b>P <u>521,193</u></b>	<b>P <u>441,576</u></b>	<b>P <u>417,782</u></b>

*See Notes to Financial Statements.*

**RIZAL COMMERCIAL BANKING CORPORATION AND SUBSIDIARIES**  
**STATEMENTS OF PROFIT OR LOSS**  
**FOR THE YEARS ENDED DECEMBER 31, 2017, 2016 AND 2015**  
*(Amounts in Millions of Philippine Pesos, Except Per Share Data)*

	Notes	GROUP			PARENT COMPANY		
		2017	2016	2015	2017	2016	2015
<b>INTEREST INCOME</b>							
Loans and receivables	11	P 21,956	P 19,442	P 17,462	P 15,081	P 13,219	P 12,163
Trading and investment securities	10	2,784	3,269	3,880	2,309	2,927	3,455
Others	9, 24	378	426	178	277	383	145
		<u>25,118</u>	<u>23,137</u>	<u>21,520</u>	<u>17,667</u>	<u>16,529</u>	<u>15,763</u>
<b>INTEREST EXPENSE</b>							
Deposit liabilities	17	3,959	3,269	2,992	2,389	2,021	2,006
Bills payable and other borrowings	18, 19, 20, 24	3,138	4,161	2,951	2,883	3,945	2,832
		<u>7,097</u>	<u>7,430</u>	<u>5,943</u>	<u>5,272</u>	<u>5,966</u>	<u>4,838</u>
<b>NET INTEREST INCOME</b>		<b>18,021</b>	<b>15,707</b>	<b>15,577</b>	<b>12,395</b>	<b>10,563</b>	<b>10,925</b>
<b>IMPAIRMENT LOSSES - Net</b>	16	<b>2,155</b>	<b>1,770</b>	<b>2,350</b>	<b>1,164</b>	<b>856</b>	<b>1,150</b>
<b>NET INTEREST INCOME AFTER IMPAIRMENT LOSSES</b>		<b>15,866</b>	<b>13,937</b>	<b>13,227</b>	<b>11,231</b>	<b>9,707</b>	<b>9,775</b>
<b>OTHER OPERATING INCOME</b>							
Service fees and commissions	2	3,138	3,196	3,473	1,985	1,762	1,793
Trading and securities gains - net	2, 10	900	1,619	1,327	664	1,663	1,232
Foreign exchange gains - net	2, 19	798	276	260	773	244	212
Trust fees	27	279	294	286	226	243	232
Share in net earnings of subsidiaries and associates	12	92	131	93	2,110	1,500	1,535
Miscellaneous - net	25	1,893	1,598	1,216	1,129	1,084	839
		<u>7,100</u>	<u>7,114</u>	<u>6,655</u>	<u>6,887</u>	<u>6,496</u>	<u>5,843</u>
<b>TOTAL OPERATING INCOME (Forward)</b>		<b>P 22,966</b>	<b>P 21,051</b>	<b>P 19,882</b>	<b>P 18,118</b>	<b>P 16,203</b>	<b>P 15,618</b>

*See Notes to Financial Statements.*



	Notes	GROUP			PARENT COMPANY		
		2017	2016	2015	2017	2016	2015
<b>TOTAL OPERATING INCOME</b>		<b>P 22,966</b>	P 21,051	P 19,882	<b>P 18,118</b>	P 16,203	P 15,618
<b>OTHER OPERATING EXPENSES</b>							
Employee benefits	24	6,037	5,408	4,731	4,211	3,666	3,190
Occupancy and equipment-related	28, 29	3,165	2,871	2,607	2,473	2,180	1,917
Depreciation and amortization	13, 14, 15	1,914	1,766	1,611	1,085	985	1,030
Taxes and licenses	14	1,821	1,840	1,437	1,289	1,287	938
Miscellaneous	25	4,878	5,470	4,675	4,055	4,556	3,396
		<u>17,815</u>	<u>17,355</u>	<u>15,061</u>	<u>13,113</u>	<u>12,674</u>	<u>10,471</u>
<b>PROFIT BEFORE TAX</b>		<b>5,151</b>	3,696	4,821	<b>5,005</b>	3,529	5,147
<b>TAX EXPENSE (INCOME)</b>	26	<u>841</u> (	<u>174</u> (	<u>307</u> )	<u>697</u> (	<u>339</u> )	<u>18</u>
<b>NET PROFIT</b>		<b>P 4,310</b>	P 3,870	P 5,128	<b>P 4,308</b>	P 3,868	P 5,129
<b>ATTRIBUTABLE TO:</b>							
<b>PARENT COMPANY'S SHAREHOLDERS</b>		<b>P 4,308</b>	P 3,868	P 5,129			
<b>NON-CONTROLLING INTERESTS</b>		<u>2</u>	<u>2</u> (	<u>1</u> )			
		<b>P 4,310</b>	P 3,870	P 5,128			
<b>Earnings Per Share</b>							
Basic and diluted	30	<u>P 3.08</u>	<u>P 2.76</u>	<u>P 3.07</u>			

*See Notes to Financial Statements.*

**RIZAL COMMERCIAL BANKING CORPORATION AND SUBSIDIARIES**  
**STATEMENTS OF COMPREHENSIVE INCOME**  
**FOR THE YEARS ENDED DECEMBER 31, 2017, 2016 AND 2015**  
*(Amounts in Millions of Philippine Pesos)*

	Notes	GROUP			PARENT COMPANY		
		2017	2016	2015	2017	2016	2015
<b>NET PROFIT</b>		<b>P 4,310</b>	<b>P 3,870</b>	<b>P 5,128</b>	<b>P 4,308</b>	<b>P 3,868</b>	<b>P 5,129</b>
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>							
<b>Items that will not be reclassified subsequently to profit or loss</b>							
Actuarial gains (losses) on defined benefit plan	24	1,510	( 325 )	( 1,045 )	1,491	( 349 )	( 987 )
Fair value gains (losses) on financial assets at fair value through other comprehensive income	10, 25	( 156 )	1,442	( 140 )	( 269 )	1,395	( 220 )
		<u>1,354</u>	<u>1,117</u>	<u>( 1,185 )</u>	<u>1,222</u>	<u>1,046</u>	<u>( 1,207 )</u>
<b>Share in other comprehensive income of the subsidiaries and associates:</b>							
Actuarial gains (losses) on defined benefit plan	12, 24	4	-	1	23	24	( 57 )
Fair value gains on financial assets at fair value through other comprehensive income	10, 12, 23	-	-	-	113	47	77
		<u>4</u>	<u>-</u>	<u>1</u>	<u>136</u>	<u>71</u>	<u>20</u>
		<u>1,358</u>	<u>1,117</u>	<u>( 1,184 )</u>	<u>1,358</u>	<u>1,117</u>	<u>( 1,187 )</u>
<b>Items that will be reclassified subsequently to profit or loss</b>							
Share in other comprehensive income (loss) of the subsidiaries - Translation adjustments on foreign operations	12, 23	( 1 )	25	( 10 )	( 1 )	25	( 10 )
<b>Total Other Comprehensive Income (Loss)</b>	25	<u>1,357</u>	<u>1,142</u>	<u>( 1,194 )</u>	<u>1,357</u>	<u>1,142</u>	<u>( 1,197 )</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		<b><u>P 5,667</u></b>	<b><u>P 5,012</u></b>	<b><u>P 3,934</u></b>	<b><u>P 5,665</u></b>	<b><u>P 5,010</u></b>	<b><u>P 3,932</u></b>
<b>ATTRIBUTABLE TO:</b>							
<b>PARENT COMPANY'S SHAREHOLDERS</b>		<b>P 5,665</b>	<b>P 5,010</b>	<b>P 3,932</b>			
<b>NON-CONTROLLING INTERESTS</b>		<u>2</u>	<u>2</u>	<u>2</u>			
		<b><u>P 5,667</u></b>	<b><u>P 5,012</u></b>	<b><u>P 3,934</u></b>			

*See Notes to Financial Statements.*



RIZAL COMMERCIAL BANKING CORPORATION AND SUBSIDIARIES  
STATEMENTS OF CHANGES IN EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2017, 2016 AND 2015  
(Amounts in Millions of Philippine Pesos)

Notes	GROUP										NON-CONTROLLING INTERESTS	TOTAL EQUITY
	COMMON STOCK	PREFERRED STOCK	CAPITAL PAID IN EXCESS OF PAR	HYBRID PERPETUAL DEBT/STOCK	RETALIATION RESERVE	RESERVE FOR TRUST BUSINESS	OTHER RESERVE	SURPLUS	TOTAL			
Balance at January 1, 2017	P 13,999	P 3	P 22,635	P -	P 821	P 413	( P 97)	P 26,311	P 62,937	P 26	P 62,963	
Transaction with owners	-	-	-	-	-	-	-	-	-	-	-	
Cash dividends	-	-	-	-	-	-	-	( 771)	( 771)	-	( 771)	
Total comprehensive income for the year	-	-	-	-	1,307	-	-	4,308	5,615	2	5,617	
Transfer of fair value gains on financial assets at fair value through other comprehensive income to surplus	16,14	-	-	-	( 4)	-	-	4	-	-	-	
Transfer from surplus to reserve for trust business	-	-	-	-	-	21	-	( 21)	-	-	-	
					1,303	21	-	4,291	4,995	2	4,998	
Balance at December 31, 2017	P 13,999	P 3	P 22,635	P -	P 1,304	P 434	( P 97)	P 26,409	P 66,999	P 28	P 67,027	
Balance at January 1, 2016	P 13,999	P 3	P 22,635	P -	( P 318)	P 388	( P 57)	P 21,695	P 56,195	P 24	P 56,179	
Transaction with owners	-	-	-	-	-	-	-	-	-	-	-	
Cash dividends	-	-	-	-	-	-	-	( 1,008)	( 1,008)	-	( 1,008)	
Total comprehensive income for the year	-	-	-	-	1,142	-	-	3,668	4,810	2	4,812	
Transfer of fair value gains on financial assets at fair value through other comprehensive income to surplus	16,14	-	-	-	( 3)	-	-	3	-	-	-	
Transfer from surplus to reserve for trust business	-	-	-	-	-	21	-	( 21)	-	-	-	
					1,139	21	-	3,650	4,810	2	4,809	
Balance at December 31, 2016	P 13,999	P 3	P 22,635	P -	P 65	P 403	( P 97)	P 24,581	P 62,181	P 26	P 62,207	
Balance at January 1, 2015	P 12,737	P 5	P 16,148	P 4,883	P 682	P 366	( P 97)	P 18,567	P 51,196	P 22	P 51,218	
Transaction with owners	-	-	-	-	-	-	-	-	-	-	-	
Issuance of common shares during the year	1,242	-	6,467	-	-	-	-	-	1,726	-	7,709	
Redemption of hybrid perpetual securities	-	-	-	( 4,883)	-	-	-	-	( 725)	-	( 5,608)	
Cash dividends	-	-	-	-	-	-	-	( 1,088)	( 1,088)	-	( 1,088)	
Total transaction with owners	1,242	-	6,467	( 4,883)	-	-	-	( 1,788)	1,064	-	1,064	
Total comprehensive income (loss) for the year	-	-	-	-	( 1,397)	-	-	4,129	3,032	2	3,834	
Transfer of fair value gains on financial assets at fair value through other comprehensive income to surplus	16,14	-	-	-	( 3)	-	-	3	-	-	-	
Transfer from surplus to reserve for trust business	-	-	-	-	-	21	-	( 21)	-	-	-	
					( 1,240)	21	-	3,131	4,096	2	4,099	
Balance at December 31, 2015	P 13,999	P 5	P 22,635	P -	( P 318)	P 388	( P 97)	P 21,695	P 56,195	P 24	P 56,179	

See Notes to Financial Statements.

		PARENT COMPANY															
Notes	COMMON STOCK	PREFERRED STOCK	CAPITAL PAID IN EXCESS OF PAR	HYBRID PERPETUAL SECURITIES	REVALUATION RESERVES	RESERVE FOR TRUST BUSINESS	SURPLUS	TOTAL EQUITY									
Balance at January 1, 2017	P	13,999	P	3	P	22,635	p	-	P	621	P	378	P	24,401	P	62,037	
Transaction with owners	21																
Cash dividends		-	-	-	-	-	-	-	-	-	-	-	-	( 773 )	(	773 )	
Total comprehensive income for the year	21	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Transfer of fair value gains on financial assets at fair value through other comprehensive income to surplus	10, 21	-	-	-	-	-	-	4,357	-	-	-	-	-	4,357	-	5,665	
Transfer from surplus to reserve for trust business	21	-	-	-	-	-	-	( 4 )	-	36	-	-	-	( 36 )	-	-	
Balance at December 31, 2017		<u>P</u>	<u>13,999</u>	<u>P</u>	<u>3</u>	<u>P</u>	<u>22,635</u>	<u>p</u>	<u>-</u>	<u>P</u>	<u>1,974</u>	<u>P</u>	<u>394</u>	<u>P</u>	<u>27,924</u>	<u>P</u>	<u>66,929</u>
Balance at January 1, 2016		P	13,999	P	3	P	22,635	p	-	( P	518 )	P	356	P	21,560	P	58,033
Transaction with owners	21																
Cash dividends		-	-	-	-	-	-	-	-	-	-	-	-	( 1,008 )	(	1,008 )	
Total comprehensive income for the year	21	-	-	-	-	-	-	-	-	-	1,142	-	-	5,908	-	5,010	
Transfer of fair value gains on financial assets at fair value through other comprehensive income to surplus	10, 21	-	-	-	-	-	-	-	-	( 3 )	-	-	-	3	-	-	
Transfer from surplus to reserve for trust business	21	-	-	-	-	-	-	-	-	-	-	22	-	( 22 )	-	-	
Balance at December 31, 2016		<u>P</u>	<u>13,999</u>	<u>P</u>	<u>3</u>	<u>P</u>	<u>22,635</u>	<u>p</u>	<u>-</u>	<u>P</u>	<u>621</u>	<u>P</u>	<u>378</u>	<u>P</u>	<u>24,401</u>	<u>P</u>	<u>62,037</u>
Balance at January 1, 2015		P	12,757	P	3	P	16,148	p	4,805	P	482	P	341	P	18,225	P	53,039
Transactions with owners	21																
Issuance of common shares during the year		1,242	-	6,487	-	-	-	-	-	-	-	-	-	-	-	7,729	
Redemption of hybrid perpetual securities		-	-	-	-	-	-	( 4,883 )	-	-	-	-	-	( 725 )	(	5,606 )	
Cash dividends		-	-	-	-	-	-	-	-	-	-	-	-	( 1,059 )	(	1,059 )	
Total transactions with owners		<u>1,242</u>	<u>-</u>	<u>6,487</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>( 4,883 )</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>( 1,784 )</u>	<u>(</u>	<u>1,064</u>	
Total comprehensive income (loss) for the year	21	-	-	-	-	-	-	-	-	( 1,197 )	-	-	-	3,129	-	3,932	
Transfer of fair value gains on financial assets at fair value through other comprehensive income to surplus	10, 21	-	-	-	-	-	-	-	-	( 3 )	-	-	-	3	-	-	
Transfer from surplus to reserve for trust business	21	-	-	-	-	-	-	-	-	-	-	15	-	( 15 )	-	-	
Balance at December 31, 2015		<u>P</u>	<u>13,999</u>	<u>P</u>	<u>3</u>	<u>P</u>	<u>22,635</u>	<u>p</u>	<u>-</u>	<u>( P</u>	<u>518 )</u>	<u>P</u>	<u>356</u>	<u>P</u>	<u>21,560</u>	<u>P</u>	<u>58,035</u>

See Notes to Financial Statements.

**RIZAL COMMERCIAL BANKING CORPORATION AND SUBSIDIARIES**  
**STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2017, 2016 AND 2015**  
*(Amounts in Millions of Philippine Pesos)*

	Notes	GROUP			PARENT COMPANY		
		2017	2016	2015	2017	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>							
Profit before tax		P 3,181	P 3,096	P 4,821	P 5,005	P 3,529	P 5,147
Adjustments for:							
Interest income		( 25,118 )	( 23,137 )	( 21,520 )	( 17,667 )	( 16,529 )	( 15,763 )
Interest received		24,889	25,570	21,349	17,536	16,962	15,593
Interest paid		( 7,240 )	( 7,255 )	( 5,861 )	( 5,887 )	( 5,889 )	( 4,721 )
Interest expense		7,097	7,430	5,345	5,272	5,966	4,038
Impairment losses - net	14	2,355	1,770	2,350	1,164	856	1,130
Depreciation and amortization	11, 14, 15	1,594	1,766	1,611	1,885	985	1,030
Dividend income	25	( 234 )	( 449 )	( 277 )	( 196 )	( 307 )	( 87 )
Share in net earnings of subsidiaries and associates	12	( 92 )	( 131 )	( 93 )	( 2,312 )	( 1,500 )	( 1,335 )
Gains on assets sold	14, 25	( 441 )	( 120 )	( 281 )	( 378 )	( 139 )	( 162 )
Operating profit before working capital changes		8,003	7,142	7,882	4,622	3,034	3,491
Decrease (increase) in financial assets at fair value through profit and loss		10,488	( 12,967 )	11,346	8,522	( 13,882 )	11,969
Decrease (increase) in financial assets at fair value through other comprehensive income		386	( 1,471 )	( 405 )	139	48	( 339 )
Decrease (increase) in loans and receivables		( 58,172 )	( 6,748 )	( 39,325 )	( 38,690 )	( 4,666 )	( 27,179 )
Decrease (increase) in investment properties		( 635 )	( 212 )	( 1,502 )	( 12 )	15	408
Decrease (increase) in other resources		1,693	( 328 )	( 1,469 )	285	554	( 96 )
Increase (decrease) in deposit liabilities		35,335	10,715	26,601	28,582	( 3,305 )	16,048
Increase (decrease) in accrued interest, taxes and other expenses		( 993 )	( 338 )	( 89 )	( 292 )	( 179 )	( 15 )
Increase (decrease) in other liabilities		1,391	( 256 )	( 232 )	958	( 1,385 )	( 93 )
Cash generated from (used in) operations		6,364	( 3,987 )	6,189	6,026	( 9,176 )	5,294
Cash paid for taxes		( 605 )	( 574 )	( 602 )	( 477 )	( 501 )	( 540 )
Net Cash From (Used in) Operating Activities		5,759	( 4,561 )	5,587	5,549	( 9,677 )	4,754
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>							
Proceeds from disposal and maturity of securities at amortized cost		25,296	61,288	42,563	24,251	57,887	42,732
Additional investments in securities at amortized cost		( 33,570 )	( 11,271 )	( 63,991 )	( 27,549 )	( 10,473 )	( 63,072 )
Acquisitions of bank premises, furniture, fixtures, and equipment	13	( 1,521 )	( 2,782 )	( 1,961 )	( 899 )	( 1,129 )	( 1,411 )
Acquisitions of intangible assets	15	( 304 )	( 294 )	( 1,548 )	( 267 )	( 270 )	( 1,243 )
Cash dividends received	13, 26	296	560	315	600	307	766
Proceeds from disposals of bank premises, furniture, fixtures and equipment	13	283	854	461	102	344	242
Additional investments in subsidiaries and associates	13	-	-	-	-	-	( 750 )
Net Cash From (Used in) Investing Activities		( 9,600 )	48,335	( 23,961 )	( 3,762 )	45,866	( 23,596 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>							
Proceeds from avancements of bills payable	18, 32	28,561	35,668	47,068	15,477	31,325	46,442
Payments of bills payable	18, 32	( 34,472 )	( 45,429 )	( 37,463 )	( 10,788 )	( 45,429 )	( 37,463 )
Redemption of bonds payable	18, 32	( 13,687 )	-	-	( 13,687 )	-	-
Dividends paid	23	( 773 )	( 1,008 )	( 1,059 )	( 773 )	( 1,808 )	( 1,059 )
Issuance of bonds payable	18, 32	-	-	15,878	-	-	15,878
Issuance of common stock		-	-	7,729	-	-	7,729
Redemption of hybrid perpetual securities		-	-	( 5,173 )	-	-	( 5,173 )
Net Cash From (Used in) Financing Activities		( 8,371 )	( 12,769 )	26,988	( 9,771 )	( 15,112 )	26,354
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS (Forward)</b>		( P 12,212 )	P 31,005	P 8,604	( P 7,984 )	P 21,077	P 7,512

*See Notes to Financial Statements.*

Note	GROUP			PARENT COMPANY		
	2017	2016	2015	2017	2016	2015
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>( P 12,202 )</b>	<b>P 31,005</b>	<b>P 8,604</b>	<b>( P 7,084 )</b>	<b>P 31,077</b>	<b>P 7,512</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>						
Cash and other cash items	18,376	14,070	15,085	11,000	10,127	9,539
Due from Bangko Sentral ng Pilipinas	66,520	50,617	46,059	50,871	42,026	37,763
Due from other banks	25,293	19,701	16,600	24,109	18,196	15,555
Loans arising from reverse repurchase agreement	7,889	-	-	4,931	-	-
Interbank loans receivable	515	-	-	515	-	-
	<u>115,383</u>	<u>84,388</u>	<u>75,744</u>	<u>91,426</u>	<u>70,349</u>	<u>62,857</u>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>						
Cash and other cash items	14,693	15,376	14,070	10,415	11,000	10,127
Due from Bangko Sentral ng Pilipinas	66,801	66,520	50,617	47,386	50,871	42,026
Due from other banks	19,838	25,293	19,701	18,368	24,109	18,196
Loans arising from reverse repurchase agreement	9,431	7,889	-	7,435	4,951	-
Interbank loans receivable	38	515	-	38	515	-
	<u>P 105,381</u>	<u>P 115,395</u>	<u>P 84,388</u>	<u>P 83,442</u>	<u>P 91,426</u>	<u>P 70,349</u>

See Notes to Financial Statements.



**RIZAL COMMERCIAL BANKING CORPORATION AND SUBSIDIARIES**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2017, 2016 AND 2015**  
*(Amounts in Millions of Philippine Pesos, Except Share and Per Share Data or As Indicated)*

**1. CORPORATE MATTERS**

**1.1 Incorporation and Operations**

Rizal Commercial Banking Corporation (the Parent Company, the Bank or RCBC), a universal bank engaged in all aspects of banking, was originally incorporated on September 23, 1960. The Bank renewed its corporate existence on December 10, 2009. It provides products and services related to traditional loans and deposits, trade finance, domestic and foreign fund transfers or remittance, cash management, treasury, and trust and custodianship services. Under relevant authority granted by the Bangko Sentral ng Pilipinas (BSP), the Bank is also licensed to deal in different types of derivatives products such as, but not limited, to foreign currency forwards, interest rate swaps and cross currency swaps. The Parent Company and its subsidiaries (together hereinafter referred to as the Group) are engaged in all aspects of traditional banking, investment banking, retail financing (credit cards, auto loans, mortgage/housing and microfinance loans), remittance, leasing and stock brokering.

As a banking institution, the Group's operations are regulated and supervised by the BSP. As such, the Group is required to comply with banking rules and regulations 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 Group's activities are subject to the provisions of Republic Act (RA) No. 8791, the *General Banking Law of 2000*, and other related banking laws.

The Parent Company's common shares are listed in the Philippine Stock Exchange (PSE).

The Group's and the Parent Company's banking network within and outside the Philippines as of December 31 follows:

	Group		Parent Company	
	2017	2016	2017	2016
Automated teller machines (ATMs)	1,562	1,488	1,103	1,047
Branches	473	446	306	281
Extension offices	35	35	25	25

RCBC is 42.45% owned subsidiary of Pan Malayan Management and Investment Corporation (PMMIC), a company incorporated and domiciled in the Philippines. PMMIC is the holding company of the flagship institutions of the Yuchengco Group of Companies (YGC), with registered business address located at 48<sup>th</sup> Floor, Yuchengco Tower, RCBC Plaza, 6819 Ayala Avenue cor. Sen. Gil Puyat Avenue, Makati City.

The Parent Company's registered address, which is also its principal office, is located at Yuchengco Tower, RCBC Plaza, 6819 Ayala Avenue cor. Sen. Gil Puyat Avenue, Makati City.

## 1.2 Subsidiaries and Associates

The Parent Company holds ownership interests in the following subsidiaries and associates:

Subsidiaries/Associates	Line of Business	Explanatory Notes	Effective Percentage of Ownership	
			2017	2016
Subsidiaries:				
RCBC Savings Bank, Inc. (RSB)	Consumer and retail banking		100.00	100.00
RCBC Forex Brokers Corporation (RCBC Forex)	Foreign exchange dealing		100.00	100.00
RCBC Telemoney Europe (RCBC Telemoney)	Remittance		100.00	100.00
RCBC North America, Inc. (RCBC North America)	Remittance	(a)	100.00	100.00
RCBC International Finance Limited (RCBC IFL)	Remittance		100.00	100.00
RCBC Investment Ltd.	Remittance	(b)	100.00	100.00
RCBC Capital Corporation (RCBC Capital)	Investment house		99.96	99.96
RCBC Securities, Inc. (RSI)	Securities brokerage and dealing	(c)	99.96	99.96
RCBC Bankard Services Corporation (RBSC)	Credit card management	(c)	99.96	99.96
RCBC-JPL Holding Company, Inc. (RCBC JPL)	Property holding		99.41	99.39
Merchants Savings and Loan Association, Inc. (Rizal Microbank)	Thrift banking and microfinance		98.03	98.03
RCBC Leasing and Finance Corporation (RCBC LFC)	Financial leasing		97.79	97.79
RCBC Rental Corporation	Property leasing	(d)	97.79	97.79
Special Purpose Companies (SPCs):				
Best Value Property and Development Corporation (Best Value)	Real estate buying and selling	(e)	100.00	100.00
Cajel Realty Corporation (Cajel)			100.00	100.00
Crescent Park Property and Development Corporation (Crescent Park)			100.00	100.00
Crestview Properties Development Corporation (Crestview)			100.00	100.00
Eight Hills Property and Development Corporation (Eight Hills)			100.00	100.00
Gold Place Properties Development Corporation (Gold Place)			100.00	100.00
Goldpath Properties Development Corporation (Goldpath)			100.00	100.00
Greatwings Properties Development Corporation (Greatwings)			100.00	100.00
Lifeway Property and Development Corporation (Lifeway)			100.00	100.00
Niceview Property and Development Corporation (Niceview)			100.00	100.00
Niyog Property Holdings, Inc. (NPHI)		(f)	100.00	100.00
Princeway Properties Development Corporation (Princeway)			100.00	100.00
Top Place Properties Development Corporation (Top Place)			100.00	100.00

<u>Subsidiaries/Associates</u>	<u>Line of Business</u>	<u>Effective Percentage of Ownership</u>	
		<u>2017</u>	<u>2016</u>
Associates:			
YGC Corporate Services, Inc. (YCS)	Support services for YGC	40.00	40.00
Luisita Industrial Park Co. (LIPC)	Real estate buying, developing, selling and rental	35.00	35.00
Honda Cars Phils., Inc. (HCPI)	Sale of motor vehicles	12.88	12.88

Except for RCBC Telemoney (Italy), RCBC North America (USA), RCBC IFL (Hongkong) and RCBC Investment Ltd. (Hongkong), all other subsidiaries and associates are incorporated and conducting their businesses in the Philippines. RCBC Telemoney and RCBC North America were operational only until March 1, 2016 and March 31, 2014, respectively.

Explanatory Notes:

- (a) The Parent Company has 83.97% direct ownership interest and 16.03% indirect ownership interest through RCBC IFL.
- (b) A wholly-owned subsidiary of RCBC IFL.
- (c) Wholly-owned subsidiaries of RCBC Capital.
- (d) A wholly-owned subsidiary of RCBC LFC.
- (e) Except for NPFI, the SPCs are wholly-owned subsidiaries of RSB; the SPCs, except for NPFI and Cajel, will be liquidated in pursuant to BSP recommendation and upon receipt of necessary regulatory clearance (see Note 15.1).
- (f) The Parent Company has 48.11% direct ownership interest and 51.89% indirect ownership interest through RSB.

### ***1.3 Approval of Financial Statements***

The consolidated financial statements of RCBC and subsidiaries and the separate financial statements of RCBC as of and for the year ended December 31, 2017 (including the comparatives as of December 31, 2016 and for the years ended December 31, 2016 and 2015) were approved and authorized for issue by the Board of Directors (BOD) of the Parent Company on February 26, 2018.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies that have been used in the preparation of these financial statements are summarized below. The 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 consolidated financial statements of the Group and the separate financial statements of the Parent Company 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 (IASB), and approved by Philippine Board of Accountancy.

These financial statements have been prepared using the measurement bases specified by PFRS for each type of resource, 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 Standards (PAS) 1, *Presentation of Financial Statements*. The Group presents all items of income and expenses in two statements: a “statement of profit or loss” and a “statement of comprehensive income.”

The Group 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 have 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.

The Group and the Parent Company made a retrospective reclassification in their statements of profit or loss for the year ended December 31, 2016 by transferring P32 services fees reported within Other Operating Income, from Miscellaneous account to Service Fees and Commissions account, to conform with the current presentation.

#### (c) *Functional and Presentation Currency*

These financial statements are presented in Philippine pesos, the Group’s functional and presentation currency (see Note 2.18). All amounts are in millions, except per share data or when otherwise indicated.

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



## 2.2 Adoption of New and Amended PFRS

### (a) Effective in 2017 that are Relevant to the Group

The Group adopted for the first time all the amendments and annual improvements to PFRS, which are mandatorily effective for annual periods beginning on or after January 1, 2017 as follows:

PAS 7 (Amendments)	:	Statement of Cash Flows – Disclosure Initiative
PAS 12 (Amendments)	:	Income Taxes – Recognition of Deferred Tax Assets for Unrealized Losses
Annual Improvements to PFRS (2014 - 2016 Cycle)	:	
PFRS 12	:	Disclosure of Interest in Other Entities – Scope Clarification on Disclosure of Summarized Financial Information for Interests Classified as Held for Sale

Discussed below are the relevant information about these amendments and improvements.

- (i) PAS 7 (Amendments), *Statement of Cash Flows – Disclosure Initiative*. The amendments are designed to improve the quality of information provided to users of financial statements about changes in an entity's debt and related cash flows and non-cash changes. They require an entity to provide disclosures that enable users to evaluate changes in liabilities arising from financing activities and to apply its judgment when determining the exact form and content of the disclosures needed to satisfy this requirement. Moreover, they suggest a number of specific disclosures that may be necessary in order to satisfy the above requirement, including: (a) changes in liabilities arising from financing activities caused by changes in financing cash flows, foreign exchange rates or fair values, or obtaining or losing control of subsidiaries or other businesses; and, (b) a reconciliation of the opening and closing balances of liabilities arising from financing activities in the statement of financial position including those changes identified immediately above.

Management has applied these amendments in the current year and has not disclosed comparative figures as allowed by the transitional provisions.

The Group's liabilities arising from financing activities include bills payable, bonds payable and subordinated debt. The reconciliation between the opening and closing balances of these liabilities arising from financing activities are disclosed in Note 32.

- (ii) PAS 12 (Amendments), *Income Taxes – Recognition of Deferred Tax Assets for Unrealized Losses*. The focus of the amendments is to clarify how to account for deferred tax assets related to debt instruments measured at fair value, particularly where changes in the market interest rate decrease the fair value of a debt instrument below its cost. The amendments provide guidance in the following areas where diversity in practice previously existed: (a) existence of a deductible temporary difference; (b) recovering an asset for more than its carrying amount; (c) probable future taxable profit against which deductible temporary differences are assessed for utilization; and, (d) combined versus separate assessment of deferred tax asset recognition for each deductible temporary difference. The application of these amendments has no impact on the Group's financial statements as the Group already assesses the sufficiency of future taxable profit in a way that is consistent with these amendments.
- (iii) Annual improvements to PFRS (2014 - 2016 Cycle) on PFRS 12, *Disclosure of Interests in Other Entities – Scope Clarification on Disclosure of Summarized Financial Information for Interests Classified as Held for Sale*. The amendment clarifies that the disclosure requirements of PFRS 12 applies to interest in other entities classified as held for sale with practical concession in the presentation of summarized financial information. The amendment states that an entity need not present summarized financial information for interests in subsidiaries, associates, or joint ventures that are classified as held for sale. The Group has interests in certain SPCs with carrying amount of the net investments presented and classified as assets held-for-sale and disposal group (see Note 15). The Group has not been presenting summarized financial information of these SPCs which is consistent with the amendments.

(b) *Effective Subsequent to 2017 but not Adopted Early*

There are new PFRS, amendments and annual improvements to existing standards effective for annual periods subsequent to 2017, which are adopted by the FRSC. Management will adopt the following relevant pronouncements in accordance with their transitional provisions; and, unless otherwise stated, none of these are expected to have significant impact on the Group's financial statements:

- (i) PAS 40 (Amendments), *Investment Property – Transfers of Investment Property* (effective from January 1, 2018). 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 also provided a non-exhaustive list of examples constituting change in use.

(ii) PFRS 9 (2014), *Financial Instruments* (effective from January 1, 2018). This new standard on financial instruments will eventually replace PAS 39, *Financial Instruments: Recognition and Measurement*, and PFRS 9 (2009, 2010 and 2013 versions – herein referred to as PFRS 9). In addition to the principal classification categories for financial assets and financial liabilities, which were early adopted by the Group on January 1, 2014, PFRS 9 (2014) includes the following major provisions:

- limited amendments to the classification and measurement requirements for financial assets introducing a fair value measurement for eligible debt securities; and,
- an expected credit loss (ECL) model in determining impairment of all financial assets that are not measured at fair value through profit or loss (FVPL), which generally depends on whether there has been a significant increase in credit risk since initial recognition of a financial asset.

Based on an assessment and comprehensive study of the Group's financial assets and financial liabilities as at December 31, 2017, which has been limited to the facts and circumstances existing at that date, management determined the significant impact of PFRS 9 (2014) on the financial statements as follows:

- Debt securities held for both collecting contractual cash flows solely for payment of principal and interest (SPPI) and selling are designated by the Group to be classified at as fair value through other comprehensive income (FVOCI). Financial asset at FVOCI are measured at fair value, with fair value changes and realized gain or loss on sale directly recognized in other comprehensive income. Upon derecognition of debt securities under FVOCI, the cumulative gains or losses previously recognized in other comprehensive income shall be reclassified from equity to profit or loss. The Group has initially assessed that the application of the standard would result in reclassification of certain financial assets at FVPL to financial assets at FVOCI; hence, will affect the balance of the reported retained earnings and other comprehensive income at transition date.
- In applying the ECL methodology of PFRS 9 (2014), the Group initially assessed to use the loan loss provision methodology as allowed by the standard and as prescribed by the BSP. On the other hand, ECL on government bonds and corporate bonds currently classified as financial asset at amortized cost shall be measured using the 12-month ECL as these financial assets are assessed to have low credit risk, considering their respective credit ratings. Management has assessed that the application of the ECL model will result in an increase in the required allowance for impairment of certain financial instruments as at the beginning of the next reporting period and in impairment losses in that period as compared with the amount that would have been recognized under the impairment provisions of PAS 39.

- (iii) PFRS 10 (Amendments), *Consolidated Financial Statements*, and PAS 28 (Amendments), *Investments in Associates and Joint Ventures – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (effective date deferred indefinitely). The amendments to PFRS 10 require full recognition in the investor's financial statements of gains or losses arising on the sale or contribution of assets that constitute a business as defined in PFRS 3, *Business Combinations*, between an investor and its associate or joint venture. Accordingly, the partial recognition of gains or losses (i.e., to the extent of the unrelated investor's interests in an associate or joint venture) only applies to those sale or contribution of assets that do not constitute a business. Corresponding amendments have been made to PAS 28 to reflect these changes. In addition, PAS 28 has been amended to clarify that when determining whether assets that are sold or contributed constitute a business, an entity shall consider whether the sale or contribution of those assets is part of multiple arrangements that should be accounted for as a single transaction.
- (iv) PFRS 15, *Revenue from Contracts with Customers*. This standard will replace PAS 18, *Revenue*, and PAS 11, *Construction Contracts*, the related Interpretations on revenue recognition: International Financial Reporting Interpretations Committee (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*, effective January 1, 2018. This new standard establishes a comprehensive framework for determining when to recognize revenue and how much revenue to recognize. The core principle in this standard 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. Based on an assessment of the Group's revenue streams as at December 31, 2017, which has been limited to the facts and circumstances existing at that date, management determined that its significant sources of revenues pertain to its lending activities which generate interest income, service charges, and fees. Except for certain service charges and fees, substantial amount of the Bank's revenues are generated from financial instruments which are outside the scope of PFRS 15.
- (v) Annual Improvements to PFRS 2014 - 2016 Cycle. Among the improvements, PAS 28 (Amendments), *Investments in Associates and Joint Ventures – Measuring an Associate or Joint Venture at Fair Value* (effective from January 1, 2018) is relevant to the Group. The amendments clarify that the option for venture capital organization, mutual funds and other similar entities to elect the fair value through profit or loss classification in measuring investments in associates and joint ventures shall be made at initial recognition, separately for each associate or joint venture.
- (vi) IFRIC 22, *Foreign Currency Transactions and Advance Consideration* (effective from January 1, 2018). 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.



- (vii) PAS 28 (Amendments), *Investment in Associates – Long-term Interests in Associates and Joint Ventures* (effective from January 1, 2019). The amendments clarify that the scope exclusion in PFRS 9 (2014) applies only to ownership interests accounted for using the equity method. Thus, the amendments further clarify that long term interests in an associate or joint venture – to which the equity method is not applied – must be accounted for under PFRS 9 (2014), which shall also include long term interests that, in substance, form part of the entity’s net investment in an associate or joint venture. Management is currently assessing the impact of these new amendments in its financial statements.
- (viii) 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 SPPI test. As such, the financial assets containing prepayment features with negative compensation may still be classified at amortized cost or at fair value through other comprehensive income. Management is currently assessing the impact of these amendments in its financial statements.
- (ix) PFRS 16, *Leases* (effective from January 1, 2019). The new standard will eventually replace PAS 17, *Leases*.

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 similarly to a purchased asset subject to depreciation or amortization. The lease liability is accounted for similarly to a financial liability 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 expense 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 with those applied in PAS 17. 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, treatment of initial direct costs and lessor disclosures.

Management is currently assessing the impact of this new standard in its financial statements.

- (x) 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 Group to consider the probability of the tax treatment being accepted by the tax 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 Group 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 in its financial statements.
- (xi) Annual Improvements to PFRS 2015 - 2017 Cycle. Among the improvements effective January 1, 2019, the following are relevant to the Group but were initially assessed by management to have no material impact on the Group'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 when a specific borrowing remains outstanding after the related qualifying asset is ready for its intended purpose, such borrowing will then form part of an entity's general borrowings used in calculating the capitalization rate for capitalization purposes.
  - PFRS 3 (Amendments), *Business Combinations* and PFRS 11 (Amendments), *Joint Arrangements – Remeasurement of Previously Held Interests in a Joint Operation*. The amendments clarify that previously held interest in a joint operation shall be remeasured when the Group obtains control of the business. On the other hand, previously held interests in a joint operation shall not be remeasured when the Group obtains joint control of the business.

### ***2.3 Basis of Consolidation and Accounting for Investments in Subsidiaries and Associates in the Separate Financial Statements***

The Group's consolidated financial statements comprise the accounts of the Parent Company and its subsidiaries as enumerated in Note 1.2, after the elimination of material intercompany transactions. All intercompany resources and liabilities, equity, income, expenses and cash flows relating to transactions with subsidiaries are eliminated in full. Unrealized profits and losses from intercompany transactions that are recognized in assets are also eliminated in full. Intercompany losses that indicate impairment are recognized in the consolidated financial statements.

The financial statements of the subsidiaries are prepared in the same reporting period as the Parent Company, using consistent accounting policies.

The Parent Company accounts for its investments in subsidiaries, associates, interests in jointly controlled operations and non-controlling interests as follows:

(a) *Investments in Subsidiaries*

Subsidiaries are entities (including structured entities) over which the Group has control. The Group controls an entity when it has the power over the entity; it is exposed, or has rights to, variable returns from its involvement with the entity; and, it has the ability to affect those returns through its power over the entity. Subsidiaries are consolidated from the date the Group obtains control.

The Parent Company's investments in subsidiaries are initially recognized at cost and subsequently accounted for in its separate financial statements using the equity method. Under the equity method, all subsequent changes to the ownership interest in the equity of the subsidiaries are recognized in the Parent Company's carrying amount of the investments. Changes resulting from the profit or loss generated by the subsidiaries are credited or charged against the Share in Net Earnings of Subsidiaries and Associates account in the statement of profit or loss. These changes include subsequent depreciation, amortization, impairment and fair value adjustments of assets and liabilities. Dividends received are accounted for as reduction in the carrying value of the investment.

Changes resulting from other comprehensive income of the subsidiaries or items that have been directly recognized in the subsidiaries' equity are recognized in other comprehensive income or equity of the Parent Company as applicable. However, when the Parent Company's share in losses of subsidiaries equals or exceeds its interest in the subsidiary, including any other unsecured receivables, the Parent Company does not recognize further losses, unless it has incurred obligations or made payments on behalf of the subsidiary. If the subsidiary subsequently reports profits, the investor resumes recognizing its share of those profits only after its share of the profits exceeds the accumulated share of losses that has not been recognized previously.

Unrealized gains on transactions between the Parent Company and its subsidiaries are eliminated to the extent of the Parent Company's interest in the subsidiaries. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the assets that were transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Parent Company.

The Parent Company reassesses whether or not it controls an entity if facts and circumstances indicate that there are changes to one or more of the three elements of controls. Accordingly, entities are deconsolidated from the date that control ceases.

Acquired subsidiaries are subject to either of the following relevant policies:

- (i) *Purchase method* – involves the revaluation at fair value of all identifiable assets and liabilities, including contingent liabilities of a subsidiary, at the acquisition date, regardless of whether or not they were recorded in the financial statements of a subsidiary prior to acquisition. On initial recognition, the assets and liabilities of a subsidiary are included in the consolidated statement of financial position at their revalued amounts, which are also used as the bases for subsequent measurement in accordance with the Group's accounting policies.

Goodwill represents the excess of acquisition cost over the fair value of the Group's share of the identifiable net assets of the acquired subsidiary at the date of acquisition. On the other hand, negative goodwill represents the excess of the Group's share in the fair value of identifiable net assets of the subsidiary at the date of acquisition over acquisition cost and is recognized directly in profit or loss.

(ii) *Pooling of interest method* – is applicable for business combinations involving entities under common control. On initial recognition, the assets and liabilities of a subsidiary are included in the consolidated statement of financial position at their book values. Adjustments, if any, are recorded to achieve uniform accounting policies. The combining entities' results and financial positions are presented in the consolidated financial statements as if they had always been combined.

No goodwill or negative goodwill is recognized. Any difference between the cost of the investment and the subsidiary's identifiable net assets is recognized on consolidation in a separate reserve account under equity.

(b) *Investments in Associates*

Associates are those entities over which the Group is able to exert significant influence but which are neither subsidiaries nor interests in joint venture. In the consolidated financial statements, investments in associates are initially recognized at cost and subsequently accounted for using the equity method. Under the equity method, the Group recognizes in profit or loss its share in the net earnings or losses of the associates. The cost of the investment is increased or decreased by the Group's equity in net earnings or losses of the associates since the date of acquisition. Dividends received are accounted for as reduction in the carrying value of the investment.

Acquired investments in associates are subject to purchase method of accounting as described in Note 2.3(a)(i). However, any goodwill that represents the excess of identifiable net assets of the acquiree at the date of acquisition or fair value adjustment attributable to the Group's share in the associate is included in the amount recognized as investments in associates. All subsequent changes to the ownership of interest in the equity of the associate are recognized in the Group's carrying amount of the investment. Changes resulting from the profit or loss generated by the associate are credited against Share in Net Earnings of Subsidiaries and Associates account in the Group's statement of profit or loss. These changes include subsequent depreciation, amortization, impairment, and fair value adjustments of assets and liabilities.

Changes resulting from other comprehensive income of the associate or items that have been directly recognized in the associate's equity are recognized in other comprehensive income or equity of the Group as applicable. However, when the Group's share in losses of an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognizing its share of those profits only after its share of the profits exceeds the accumulated share of losses that has not been recognized previously.

Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the assets that were transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

The Group reassesses whether or not an entity qualifies as an associate in the occurrence of changes to facts and circumstances surrounding its ability to exert significant influence.

(c) *Interest in Jointly Controlled Operations*

For interests in jointly controlled operations, the Group recognizes in its financial statements the assets that it controls, the liabilities and the expenses that it incurs and its share in the income from the sale of goods or services by the joint venture. The amounts of these related accounts are presented as part of the regular asset and liability accounts and income and expense accounts of the Group.

No adjustment or other consolidation procedures are required for the assets, liabilities, income and expenses of the joint venture that are recognized in the separate financial statements of the venturers.

(d) *Transactions with Non-controlling Interests*

Non-controlling interests (NCI) represent the portion of the net assets and profit or loss not attributable to the Group. The Group applies a policy of treating transactions with NCI as transactions with parties external to the Group. Disposals to NCI result in gains and losses for the Group that are recorded in profit or loss. Purchases of equity shares from NCI may result in goodwill, being the difference between any consideration paid and the relevant share acquired in the carrying value of the net assets of a subsidiary.

In the consolidated financial statements, the NCI component is shown as part of the consolidated statement of changes in equity.

In the Parent Company's financial statements, impairment loss is provided when there is objective evidence that the investments in subsidiaries and associates will not be recovered (see Note 2.19).

## **2.4 Segment Reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is a segment engaged in providing products or services within a particular economic environment that is subject to risks and returns that are different from those of segments operating in other economic environments.

The Group's operations are structured according to the nature of the services provided (primary segment) and different geographical markets served (secondary segment). Financial information on business segments is presented in Note 8.



## 2.5 *Financial Assets*

Financial assets are recognized when the Group becomes a party to the contractual terms of the financial instrument. For purposes of classifying financial assets, an instrument is considered as an equity instrument if it is non-derivative and meets the definition of equity for the issuer in accordance with the criteria under PAS 32, *Financial Instruments: Presentation*. All other non-derivative financial instruments are treated as debt instruments.

### (a) *Classification, Measurement and Reclassification of Financial Assets*

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.

#### (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 Group's business model whose objective is to hold financial assets in order to collect contractual cash flows; 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.

The Group's financial assets at amortized cost are presented in the statement of financial position as Cash and Other Cash Items, Due from BSP, Due from Other Banks, Loans Arising from Reverse Repurchase Agreement, Investment securities at amortized cost under Trading and Investment Securities, Loans and Receivables and certain Other Resources accounts.

For purposes of cash flows reporting and presentation, cash and cash equivalents comprise of accounts with original maturities of three months or less, including cash and other cash items and non-restricted balances of Due from BSP, Due from Other Banks, Loans Arising from Reverse Repurchase Agreement, and Interbank loans receivables (part of Loans and Receivables). These generally include cash on hand, demand deposits and short-term, highly liquid investments readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value.

The Group may irrevocably elect at initial recognition to classify a financial asset that meets the amortized cost criteria above as at FVPL if that designation eliminates or significantly reduces an accounting mismatch had the financial asset been measured at amortized cost. In 2017 and 2016, the Group has not made such designation.

*(ii) Financial Assets at Fair Value Through Profit or Loss*

Debt instruments that do not meet the amortized cost criteria, or that meet the criteria but the Group has chosen to designate as at FVPL at initial recognition, are measured at FVPL. Equity investments are classified as financial assets at FVPL, unless the Group designates an equity investment that is not held for trading as at FVOCI at initial recognition. The Group's financial assets at FVPL include government securities, corporate bonds, equity securities, which are held for trading purposes or designated as at FVPL.

A financial asset is considered as held for trading if:

- it has been acquired principally for the purpose of selling it in the near term;
- on initial recognition, it is part of a portfolio of identified financial instruments that the Group manages together and has evidence of a recent actual pattern of short-term profit-taking; or,
- it is a derivative that is not designated and effective as a hedging instrument or financial guarantee.

Financial assets at FVPL are measured at fair value. Related transaction costs are recognized directly as expense in profit or loss. Unrealized gains and losses arising from changes (mark-to-market) in the fair value of the financial assets at FVPL category and realized gains or losses arising from disposals of these instruments are included in Trading and Securities Gains under Other Operating Income account in the statement of profit or loss.

Interest earned on these investments is reported in profit or loss under Interest Income account while dividend income is reported in profit or loss under Miscellaneous included in Other Operating Income account when the right of payment has been established.

*(iii) Financial Assets at Fair Value Through Other Comprehensive Income*

At initial recognition, the Group 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 Group for trading. The Group has designated certain equity instruments as at FVOCI 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 account.

Any dividends earned on holding these equity instruments are recognized in profit or loss as part of Miscellaneous under Other Operating Income account, when the Group's right to receive dividends is established in accordance with PAS 18 unless the dividends clearly represent recovery of a part of the cost of the investment.

The Group can only reclassify financial assets if the objective of its business model for managing those financial assets changes. Accordingly, the Group is required to reclassify financial assets: (i) from amortized cost to FVPL, if the objective of the business model changes so that the amortized cost criteria are no longer met; and, (ii) from FVPL 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 Group's business model will be effected only at the beginning of the next reporting period following the change in the business model.

(b) *Impairment of Financial Assets*

The Group 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 (or events) has an impact on the estimated future cash flows of the financial assets 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 Group about the following loss events:

- (i) significant financial difficulty of the issuer or obligor;
- (ii) a breach of contract, such as a default or delinquency in interest or principal payments;
- (iii) the Group granting the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
- (iv) it becoming probable that the borrower will enter bankruptcy or other financial reorganization;
- (v) the disappearance of an active market for that financial asset because of financial difficulties; or,
- (vi) 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, although the decrease cannot yet be identified with the individual financial assets in the group, including: adverse changes in the payment status of borrowers in the group, or national or local economic conditions that correlate with defaults on the assets in the group.

The Group recognizes impairment loss based on the category of financial assets as follows:

(i) *Financial Assets Carried at Amortized Cost*

For financial assets classified and measured at amortized cost, the Group 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 Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. 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 for individually assessed financial assets 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 financial asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group 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 foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

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

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 in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

When possible, the Group seeks to restructure loans rather than to take possession of the collateral. This may involve extending the payment arrangement and agreement for new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews restructured loans to ensure that all criteria evidencing the good quality of the loan are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate. The difference between the recorded sale of the original loan and the present value of the restructured cash flows, discounted at the original effective interest rate, is recognized as part of Impairment Losses account in profit or loss.

When a loan or receivable is determined to be uncollectible, it is written-off against the related allowance for impairment. Such loan or receivable is written-off after all the prescribed procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written-off are charged against the amount of impairment losses in profit or loss.

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 amount of the reversal is recognized in the statement of profit or loss.

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

For securities classified as FVOCI, the Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired.

In the case of equity investments, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for equity investments, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in profit or loss – is reclassified from Revaluation Reserves and recognized in profit or loss. Impairment losses recognized in profit or loss on equity instruments are not reversed through profit or loss.

In the case of debt instruments, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued based on the rate of interest used to discount future cash flows for the purpose of measuring impairment loss. Such accrual is recorded as part of interest income in profit or loss. If, in a subsequent period, the fair value of such debt instruments increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through profit or loss.



(c) *Derecognition of Financial Assets*

A financial asset (or where applicable, a part of a financial asset or part of a group of financial assets) is 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 Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

**2.6 *Derivative Financial Instruments and Hedge Accounting***

The Group is a party to various foreign currency forward contracts, cross currency swaps, futures, interest rate swaps, debt warrants, options and credit default swap. These contracts are entered into as a service to customers and as a means of reducing or managing the Group's foreign exchange and interest rate exposures as well as for trading purposes. Amounts contracted are recorded as contingent accounts and are not included in the statement of financial position.

Derivatives are categorized as Financial Assets at FVPL which are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently measured at their fair value. Fair values are obtained from active markets for listed or traded securities or determined using valuation techniques if quoted prices are not available, including discounted cash flow models and option pricing models, as appropriate. The change in fair value of derivative financial instruments is recognized in profit or loss, except when their effects qualify as a hedging instrument. 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 Group recognizes a gain or loss at initial recognition.

**2.7 *Offsetting Financial Instruments***

Financial assets and 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 there is a legally enforceable right to offset 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.

## **2.8 Bank Premises, Furniture, Fixtures and Equipment**

Land is stated at cost less impairment losses, if any. As no finite useful life for land can be determined, the related carrying amounts are not depreciated. All other bank premises, furniture, fixtures and equipment are carried at cost less accumulated depreciation, amortization and any impairment in value.

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

Depreciation is computed using the straight-line method over the estimated useful lives of the depreciable assets as follows:

Buildings	20-50 years
Furniture, fixtures and equipment	3-15 years

Leasehold rights and improvements are amortized over the term of the lease or the estimated useful lives of the improvements, 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 2.19).

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

An item of bank premises, furniture, fixtures and equipment, including the related accumulated depreciation, amortization and any 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 on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in profit or loss in the year the item is derecognized.

## **2.9 Investment Properties**

Investment properties pertain to land, buildings or condominium units acquired by the Group, in settlement of loans from defaulting borrowers through foreclosure or dacion in payment which are neither held by the Group for sale in the next 12 months nor used in the rendering of services or for administrative purposes. This also includes properties held for rental.

Investment properties are stated at cost, less accumulated depreciation and any impairment losses (see Note 2.19). The cost of an investment property comprises its purchase price and directly attributable costs incurred such as legal fees, transfer taxes and other transaction costs.

Transfers from other accounts (such as bank premises, furniture, fixtures and equipment) are made to investment properties when and only when, there is a change in use, evidenced by ending of owner-occupation or commencement of an operating lease to another party or holding the property for capital appreciation, while transfers from investment properties are made when, and only when, there is a change in use, evidenced by commencement of owner-occupation or commencement of development with a view to sell.

Depreciation and impairment loss are recognized in the same manner as in bank premises, furniture, fixtures and equipment.

Direct operating expenses related to investment properties, such as repairs and maintenance, and real estate taxes are normally charged against current operations in the period in which these costs are incurred.

Investment properties, including the related accumulated depreciation and any impairment losses, are derecognized upon disposal or when permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gain or loss on the retirement or disposal of investment properties is recognized in Miscellaneous Income under Other Operating Income account in the year of retirement or disposal.

### ***2.10 Assets Held-for-Sale and Disposal Group***

Assets held-for-sale and disposal group, which are presented as part of Other Resources account, include real and other properties acquired through repossession, foreclosure or purchase that the Group intends to sell within one year from the date of classification as held-for-sale and for which the Group is committed to immediately dispose through an active marketing plan. The Group classifies an asset (or disposal group) as held-for-sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. In the event that the sale of the asset is extended beyond one year, the extension of the period required to complete the sale does not preclude an asset from being classified as held-for-sale if the delay is caused by events or circumstances beyond the Group's control and there is sufficient evidence that the Group remains committed to its plan to sell the asset.

Assets classified as held-for-sale are measured at the lower of their carrying amounts, immediately prior to their classification as held-for-sale and their fair value less costs to sell.

Assets classified as held-for-sale are not subject to depreciation or amortization. Asset that ceases to be classified as held-for-sale is measured at the lower of: (a) its carrying amount before the asset was classified as held-for-sale, adjusted for any depreciation, amortization or revaluations that would have been recognized had the asset not been classified as held-for-sale; and, (b) its recoverable amount at the date of the subsequent decision not to sell. Any adjustment to the carrying amount of an asset that ceases to be classified as held-for-sale resulting in either a gain or loss, is recognized in profit or loss. The Group recognizes an impairment loss for any initial or subsequent write-down of the assets held-for-sale to fair value less cost to sell, to the extent that it has not been previously recognized in profit or loss. On the other hand, any gain from any subsequent increase in fair value less to costs to sell of an asset up to the extent of the cumulative impairment loss that has been previously recognized is recognized in profit or loss.

The gains or losses arising from the sale or remeasurement of assets held-for-sale is recognized in Miscellaneous Income (Expenses) under the Other Operating Income (Expenses) account in the statement of profit or loss.

### ***2.11 Intangible Assets***

Intangible assets include goodwill, branch licenses, trading right, and computer software licenses which are accounted for under cost model and are reported under Other Resources account in the statement of financial position. The cost of the asset is the amount of cash and cash equivalents paid or the fair value of the other considerations given to acquire an asset at the time of acquisition.

Goodwill represents the excess of the cost of acquisition over the fair value of the identifiable net assets acquired at the date of acquisition (see Note 2.3).

Branch licenses represent the rights given by the BSP to the Group to establish a certain number of branches in various areas in the country.

Goodwill and branch licenses are classified as intangible assets with indefinite useful life and, thus, not subject to amortization but would require an annual test for impairment (see Note 2.19). Goodwill and branch licenses are subsequently carried at cost less accumulated impairment losses. Goodwill is allocated to cash-generating units for the purpose of impairment testing. Each of those generating units is represented by each primary reporting segment.

Trading right, included as part of Miscellaneous under Other Resources account, represents the right given to RSI, a subsidiary engaged in stock brokerage, to preserve its access to the trading facilities and to transact business at the PSE. Trading right is assessed as having an indefinite useful life. It is carried at the amount allocated from the original cost of the exchange membership seat (after a corresponding allocation was made to the value of the PSE shares) less allowance for impairment, if any. The trading right is tested annually for any impairment in value (see Note 2.19).

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortized on a straight line basis over the expected useful lives of the software of three to ten years.

Costs associated with developing or maintaining computer software programs are recognized as expense as incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognized as intangible assets. Direct costs include employee costs incurred on software development and an appropriate portion of relevant overhead costs.

Computer software development costs recognized as assets are amortized using the straight-line method over their useful lives (not exceeding ten years).

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.

### ***2.12 Other Resources***

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

### ***2.13 Financial Liabilities***

Financial liabilities which include deposit liabilities, bills payable, bonds payable, subordinated debt, accrued interest and other expenses, and other liabilities (except tax-related payables, post-employment defined benefit obligation and deferred income) are recognized when the Group becomes a party to the contractual terms of the instrument.

Financial liabilities are recognized initially at their fair value and subsequently measured at amortized cost using the effective interest method, for those with maturities beyond one year, less settlement payments. All interest-related charges incurred on financial liabilities are recognized as an expense in the statement of profit or loss under the caption Interest Expense.

Deposit liabilities are stated at amounts in which they are to be paid. Interest is accrued periodically and recognized in a separate liability account before recognizing as part of deposit liabilities.

Bills payable, bonds payable and subordinated debt are recognized initially at fair value, which is the issue proceeds (fair value of consideration received), net of direct issue costs. These are subsequently measured at amortized cost; any difference between the proceeds net of transaction costs and the redemption value is recognized in profit or loss over the period of the borrowings using the effective interest method.

Derivative financial liabilities represent the cumulative changes in the net fair value losses arising from the Group's currency forward transactions and interest rate swaps.

Financial liabilities are derecognized from the statement of financial position only when the obligations are extinguished either through discharge, cancellation or expiration. 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.

#### ***2.14 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 obligation that has resulted from past events (e.g., legal dispute or onerous contracts).

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 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 Group 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 Group 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.

The Parent Company offers monetized rewards to active cardholders in relation to its credit card business' rewards program. Provisions for rewards are recognized at a certain rate of cardholders' credit card availments, determined by management based on redeemable amounts.

### **2.15 Equity**

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

Capital paid in excess of par includes any premiums received on the issuance of capital stock. Any transaction costs associated with the issuance of shares of stock are deducted from capital paid in excess of par, net of any related income tax benefits.

Hybrid perpetual securities reflect the net proceeds from the issuance of non-cumulative step-up callable perpetual securities.

Revaluation reserves consist of:

- (a) Net unrealized fair value gains or losses arising from remeasurements of financial assets at FVOCI;
- (b) Reserves on remeasurements of post-employment defined benefit plan comprising of net accumulated actuarial gains or losses arising from experience adjustments and other changes in actuarial assumptions, and actual return on plan assets (excluding account included in net interest);
- (c) Accumulated translation adjustments related to the cumulative gains from the translation of the financial statements of foreign subsidiaries whose functional currency is different from that of the Parent Company; and,
- (d) Share in other comprehensive income or loss of subsidiaries and associates.

Reserve for trust business representing the accumulated amount set aside by the Group under existing regulations requiring the Parent Company and a subsidiary to carry to surplus 10% of its net profits accruing from their trust business until the surplus shall amount to 20% of the regulatory capital. The reserve shall not be paid out in dividends, but losses accruing in the course of the trust business may be charged against this account.

Other reserves refer to the amount attributable to the Parent Company arising from the changes in the ownership of the NCI in the Group and the result of the redemption of the preferred stocks of RSB's subsidiaries. This also includes the excess of cost of investment over the net identifiable assets of an acquired subsidiary under the pooling of interest method.

Surplus represents all current and prior period results of operations as disclosed in the statement of profit or loss, reduced by the amount of dividends declared.

NCI represents the portion of the net assets and profit or loss not attributable to the Group and are presented separately in the consolidated statement of profit or loss and comprehensive income and within equity in the consolidated statement of financial position and changes in equity.

### ***2.16 Revenue and Expense Recognition***

Revenue is recognized to the extent that the revenue can be reliably measured; it is probable that the economic benefits will flow to the Group; and, the costs incurred or to be incurred can be measured reliably.

The following specific recognition criteria must also be met before a revenue or expense is recognized:

*(a) Interest Income and Expenses*

These are recognized in the statement of profit or loss for all financial instruments measured at amortized cost and interest-bearing financial assets using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the group estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses.

The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

*(b) Trading and Securities Gains (Losses)*

These are recognized when the ownership of the securities is transferred to the buyer and is computed as the difference between the selling price and the carrying amount of the securities disposed of. These also include trading gains as a result of the mark-to-market valuation of investment securities classified as FVPL.

*(c) Service Fees and Commissions*

These are recognized as follows:

*(i) Finance charges* – are recognized on credit card revolving accounts, other than those accounts classified as installment, as income as long as those outstanding account balances are not 90 days and over past due. Finance charges on installment accounts, and first year and renewal membership fees are recognized as income when billed to cardholders. Purchases by cardholders which are collected on installment are recorded at the cost of the items purchased.

- (ii) *Discounts earned, net of interchange costs* – are recognized as income upon presentation by member establishments of charges arising from RCBC Bankard and non-RCBC Bankard (associated with MasterCard, JCB, VISA and China UnionPay labels) credit card availments passing through the Point of Sale (POS) terminals of the Parent Company. These discounts are computed based on agreed rates and are deducted from the amounts remitted to member establishments. Interchange costs pertain to the other credit card companies' share in RCBC Bankard's merchant discounts whenever their issued credit cards transact in the Parent Company's POS terminal.
- (iii) *Late payment fees* – are billed on delinquent credit card receivable balances which are at most 179 days past due. These late payment fees are recognized as income upon collection.
- (iv) *Loan syndication fees* – are recognized upon completion of all syndication activities and where there are no further obligations to perform under the syndication agreement.
- (v) *Service charges and penalties* – are recognized only upon collection or accrued where there is a reasonable degree of certainty as to its collectibility.
- (vi) *Underwriting fees and commissions* – are recorded when services for underwriting, arranging or brokering has been rendered.

(d) *Gains on Assets Sold*

Gains on assets sold arise from the disposals of bank premises, furniture, fixtures and equipment, investment properties, real estate properties for sale, and assets held-for-sale, and are recognized when the risks and rewards of ownership of the assets are transferred to the buyer, when the Group does not retain either continuing managerial involvement to the degree usually associated with ownership, or effective control over the assets sold, and when the collectibility of the entire sales price is reasonably assured. Gains on assets sold are included as part of Miscellaneous income under Other Operating Income account in the statement of profit or loss.

Costs and expenses are recognized in profit or loss upon utilization of the assets and/or services or at the date those are incurred. All finance costs are reported in profit or loss on accrual basis, except capitalized borrowing costs which are included as part of the cost of the related qualifying asset, if any (see Note 2.21).

## **2.17 Leases**

The Group accounts for its leases as follows:

(a) *Group as Lessee*

Leases which do not transfer to the Group 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 repairs and maintenance and insurance, are expensed as incurred.

(b) *Group as Lessor*

Leases which transfer to the lessee all risks and benefits incidental to ownership of the leased item are classified as finance leases and are presented at an amount equal to the Group's net investment in the lease. Finance income is recognized based on the pattern reflecting a constant periodic rate of return on the Group's net investment outstanding in respect of the finance lease, and is included as part of Interest Income on loans and receivables.

Leases which do not transfer to the lessee substantially all the risks and benefits of ownership of the asset are classified as operating leases. Lease income from operating leases is recognized in profit or loss on a straight-line basis over the lease term. These are recognized as part of Miscellaneous income under Other Operating Income account in the statement of profit or loss.

The Group 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. A reassessment is made after inception of the lease, only if one of the following applies:

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

**2.18 Foreign Currency Transactions and Translations**

(a) *Transactions and Balances*

Except for the foreign subsidiaries and accounts of the Group's foreign currency deposit unit (FCDU), the accounting records of the Group are maintained in Philippine pesos. Foreign currency transactions during the period are translated into the functional currency at exchange rates which approximate those prevailing at transaction dates. Resources and liabilities denominated in foreign currencies are translated to Philippine pesos at the prevailing Philippine Dealing System closing rates (PDSCR) at the end of the reporting period.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit or loss, except when recognized in other comprehensive income and deferred in equity as qualifying cash flow hedges and qualifying net investment hedges. Translation differences on non-monetary items, such as equity securities classified as at FVPL, are reported as part of fair value gain or loss.

For financial reporting purposes, the accounts of the FCDU are translated into their equivalents in Philippine pesos based on the PDSCR prevailing at the end of each reporting period (for resources and liabilities) and at the average PDSCR for the period (for income and expenses). Any foreign exchange difference is recognized in profit or loss.

Changes in the fair value of monetary financial assets denominated in foreign currency classified as financial assets at FVPL and financial assets at FVOCI 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 as gains and losses in other comprehensive income.

*(b) Translation of Financial Statements of Foreign Subsidiaries*

The results of operations and financial position of all the Group's foreign subsidiaries (none of which has the currency dependency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (i)* Assets and liabilities at the end of each reporting period as presented in the statement of financial position are translated at the closing rate at the date of that statement of financial position;
- (ii)* Income and expenses are translated at average exchange rates during the period (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transactions' dates, in which case income and expenses are translated at the dates of the transactions); and,
- (iii)* All resulting exchange differences are recognized as a component of equity.

In consolidation, exchange differences arising from the translation of the net investment in foreign entities are recognized in other comprehensive income which form part of Revaluation Reserves account in equity. When a foreign operation is sold, the accumulated translation and exchange differences are recognized in profit or loss as part of the gain or loss on sale.

The translation of the financial statements into Philippine peso should not be construed as a representation that the amounts stated in currencies other than the Philippine peso could be converted in Philippine peso amounts at the translation rates or at any other rates of exchange.

***2.19 Impairment of Non-financial Assets***

Investments in subsidiaries and associates, bank premises, furniture, fixtures and equipment, investment properties, and other resources (including intangible assets) and other non-financial assets are subject to impairment testing. Intangible assets with an indefinite useful life or those not yet available for use and goodwill are tested for impairment at least annually.



For purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows [cash-generating units (CGU)]. As a result, some assets are tested for impairment either individually or at the CGU level.

Except for intangible assets with an indefinite useful life (i.e., goodwill, branch licenses and trading rights) or those not yet available for use, individual assets or CGU are tested for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable.

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined for goodwill by assessing the recoverable amount of the CGU (or group of CGUs) to which the goodwill relates. Where the recoverable amount of the CGU (or group of CGUs) is less than the carrying amount of the CGU (or group of CGUs) to which goodwill has been allocated, an impairment loss is recognized immediately in profit or loss. Impairment losses relating to goodwill cannot be reversed for subsequent increases in its recoverable amount in future periods.

Impairment loss is recognized in profit or loss for the amount by which the asset's or CGU's carrying amount exceeds its recoverable amount which is the higher of its fair value less costs to sell and its value in use. In determining value in use, management estimates the expected future cash flows from each CGU and determines the suitable interest rate in order to calculate the present value of those cash flows. The data used for impairment testing procedures are directly linked to the Group's latest approved budget, adjusted as necessary to exclude the effects of asset enhancements. Discount factors are determined individually for each CGU and reflect management's assessment of respective risk profiles, such as market and asset-specific risk factors.

All assets, except for intangible assets with indefinite useful life and goodwill, are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist. An impairment loss is reversed if the asset's or CGU's recoverable amount exceeds its carrying amount.

## **2.20 Employee Benefits**

Entities under the Group provide respective post-employment benefits to employees through a defined benefit plan and defined contribution plan, as well as other benefits, which are recognized and measured 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 Group, 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 Group's post-employment defined benefit plan covers all regular full-time employees. The pension plan is tax-qualified, non-contributory and administered by trustees.

The liability recognized in the statement of financial position for defined benefit post-employment 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 zero-coupon government bonds as published by the Philippine Dealing & Exchange Corp. (PDEX), 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.

Remeasurements, comprising of actuarial gains and losses arising from experience adjustments and other changes in actuarial assumptions, effect of the changes to the asset ceiling, if any, and actual 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. Remeasurements are not reclassified to profit or loss in the subsequent periods.

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 Other Interest Income or Expense account in the statement of profit or loss.

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 post-employment plan under which the Group pays fixed contributions into an independent entity such as the Social Security System. The Group 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.

(c) *Termination Benefits*

Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognizes termination benefits at the earlier of: (i) when it can no longer withdraw the offer of such benefits, and, (ii) 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 end of the reporting period are discounted to their present value.

(d) *Bonus Plans*

The Group recognizes a liability and an expense for bonuses, based on a fixed formula. The Group 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 the reporting period. They are included in the Accrued Interest, Taxes and Other Expenses account in the statement of financial position at the undiscounted amount that the Group expects to pay as a result of the unused entitlement.

**2.21 *Borrowing Costs***

Borrowing costs are recognized as expense in the period in which they are incurred, except to the extent that they are capitalized. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (i.e., an asset that takes a substantial period of time to get ready for its intended use or sale) are capitalized as part of the cost of such asset. The capitalization of borrowing costs commences when expenditures for the asset and borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalization ceases when substantially all such activities are completed.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization.

**2.22 *Income Taxes***

Tax expense recognized in profit or loss comprises the sum of current tax and deferred 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, tax authorities relating to the current or prior reporting period, that are unpaid at the end of the reporting period. They are calculated according to the tax rates and tax laws applicable to the 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 the statement of profit or loss.

Deferred tax is provided using the liability method, on temporary differences at the end of the reporting period between the tax bases 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 assets can be utilized. Deferred tax assets are reassessed at the end of each reporting period. Previously unrecognized deferred tax assets 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 liabilities are measured at the tax rates that are expected to apply in the period when the asset is realized or the liability is settled provided such tax rates have been enacted or substantively enacted at the end of the 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 assets to be utilized.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of the 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 recognized by the entities under the Group are offset if they have 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.

### ***2.23 Related Party Relationships and Transactions***

Related party transactions are transfers of resources, services or obligations between the Group and its related parties, regardless of 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 Group; (b) associates; (c) individuals owning, directly or indirectly, an interest in the voting power of the Group that gives them significant influence over the Group and close members of the family of any such individual; and, (d) the funded retirement plan of each of the entities under the Group.

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

### ***2.24 Earnings and Dilutive Earning Per Share***

Basic earnings per share (EPS) is determined by dividing the adjusted net profit for the year attributable to common shareholders by the weighted average number of common stocks outstanding during the period, after giving retroactive effect to any stock dividends declared in the current period.

Diluted EPS is also computed by dividing net profit by the weighted average number of common stocks subscribed and issued during the period. However, net profit attributable to common stocks and the weighted average number of common stocks outstanding are adjusted to reflect the effects of potentially dilutive convertible preferred stocks. Convertible preferred stocks are deemed to have been converted into common stocks at the issuance of preferred stocks.

In cases of redemption of preference shares, the net income used in the computation of basic and diluted EPS is decreased by the excess of the fair value of consideration paid to holders of the instruments over the carrying amount of such repurchased the instruments.

### ***2.25 Trust and Fiduciary Activities***

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

### ***2.26 Events After the End of the Reporting Period***

Any post year-end event that provides additional information about the Group'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. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES**

The preparation of the Group's financial statements in accordance with PFRS requires 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 ultimately vary from these estimates.

### ***3.1 Critical Management Judgments in Applying Accounting Policies***

In the process of applying the Group'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) Evaluation of Business Model Applied in Managing Financial Instruments***

The Group 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 Group developed business models which reflect how it manages its portfolio of financial instruments. The Group'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 Group) 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 Group 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 Group (e.g., held-for-trading, generating accrual income, direct matching to a specific liability) as those relate to the Group's investment, trading and lending strategies.

(b) *Testing the Cash Flow Characteristics of Financial Assets and Continuing Evaluation of the Business Model*

In determining the classification of financial assets under PFRS 9, the Group assesses whether the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest 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 Group 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 Group 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 Group 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 Group can explain the reasons for those sales and why those sales do not reflect a change in the Group's objective for the business model.

(c) *Evaluation of Impairment of Financial Assets at FVOCI*

The determination when a financial asset at FVOCI is other-than-temporarily impaired requires the Group to make judgment. In making this judgment with respect to the Group's outstanding financial assets at FVOCI as of December 31, 2017 (see Note 10.2), the Group has evaluated, among other factors, the duration and extent to which the fair value of an investment is less than its cost, 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. For investments issued by counterparty under bankruptcy, the Group determines permanent impairment based on the price of the most recent transaction and on latest indications obtained from reputable counterparties (which regularly quotes prices for distressed securities) since current bid prices are no longer available.

(d) *Distinction Between Investment Properties and Owner-occupied Properties*

The Group determines whether a property qualifies as an investment property. In making its judgment, the Group considers whether the property generates cash flows largely independent of the other assets held by the Group. Owner-occupied properties generate cash flows that are attributable not only to property but also to other assets used in the production, supply process, and in the Group's banking operation.

Some properties comprise a portion that is held to earn rental or for capital appreciation and another portion that is held for use for administrative purposes. If these portions can be sold separately (or leased out separately under finance lease) then these portions can be accounted for separately. If the portions cannot be sold separately, the property is accounted for as investment property only if an insignificant portion is held for use in operations or for administrative purposes. Judgment is applied in determining whether ancillary services are so significant that a property does not qualify as investment property.

As of the end of the reporting period, the Group has certain building which comprise a portion that is held for rental and other portion is used for operations which were classified by the Group as Investment Property or as part of Bank Premises, Furniture, Fixtures and Equipment according to its current use.

(e) *Distinction Between Operating and Finance Leases*

The Group has entered into various lease agreements either as a lessor or a lessee. 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 judgment will result in either overstatement or understatement of assets or liabilities. As of December 31, 2017 and 2016, most of the Group's lease arrangements qualify as operating leases except for the various lease agreements of RCBC LFC which are accounted for under finance lease.

(f) *Classification and Determination of Fair Value of Acquired Properties*

The Group classifies its acquired properties as Bank Premises, Furniture, Fixtures and Equipment if used in operations, as Assets Held-for-Sale and Disposal Group classified under Other Resources if the Group expects that the properties will be recovered through sale rather than use, as Investment Properties if held for rental or for currently undetermined future use and is regarded as held for capital appreciation, or as financial assets in accordance with PFRS 9. At initial recognition, the Group determines the fair value of acquired properties through internal and external appraisal depending on the Group's threshold policy. The appraised value is determined based on the current economic and market conditions, as well as the physical condition of the property. The Group's methodology in determining the fair value of acquired properties are further discussed in Note 7.4.



(g) *Assessment of Significant Influence on HCPI in which the Group and Parent Company Holds Less than 20% Ownership*

The management considers that the Group and the Parent Company has significant influence on HCPI even though it holds less than 20% of the ordinary shares in the latter. In making this judgment, management considered the Group's and the Parent Company's rights to commit and undertake to vote, and to regulate the conduct of voting and the relationship between them with respect to their exercise of their voting rights (see Note 12.2).

(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 2.14 and relevant disclosures are presented in Note 29. In dealing with the Group's various legal proceedings, the Group's estimate of the probable costs that may arise from claims and contingencies has been developed in consultation and coordination with the Group's internal and outside counsels acting in defense for the Group's and the Parent Company's legal cases and are based upon the analysis of probable results. Although the Group does not believe that its on-going proceedings as disclosed in Note 29 will have material adverse effect on the Group's financial position, it is possible that future results of operations could be materially affected by changes in the estimates or in the effectiveness of the strategies conducted relating to those proceedings.

### **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 each reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next reporting period:

(a) *Estimation of Impairment Losses on Loans and Receivables and Investment Securities at Amortized Cost*

The Group reviews its loans and receivables portfolio to assess impairment at least on a semi-annual basis. In determining whether an impairment loss should be recognized in profit or loss, the Group 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.

Moreover, the Group holds debt securities measured at amortized cost as of December 31, 2017 and 2016. The determination when an investment is other-than-temporarily impaired requires significant judgment. In making this judgment, the Group has evaluated, among other factors, the duration and extent to which the fair value of an investment is less than its cost, 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 flows. Management uses 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.

The carrying value of the Group's and the Parent Company's loans and receivables and the analysis of the allowance for impairment on such financial assets are shown in Note 11 while the information about the debt securities measured at amortized cost is disclosed in Note 10.

(b) *Determination of Fair Value Measurement for Financial Assets at FVPL and FVOCI*

The Group carries certain financial assets at fair value which requires the extensive use of accounting estimates and judgment. In cases when active market quotes are not available, fair value is determined by reference to the current market value of another financial instrument which is substantially the same or is calculated based on the expected cash flows of the underlying net base of the instrument (see Note 7.2).

The amount of changes in fair value would differ if the Group had utilized different valuation methods and assumptions. Any change in fair value of the financial assets and financial liabilities would affect profit or loss and other comprehensive income.

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 (see Note 7.2).

The carrying values of the Group's and the Parent Company's trading and investment securities and the amounts of fair value changes recognized on those financial assets are disclosed in Note 10.

(c) *Estimation of Useful Lives of Bank Premises, Furniture, Fixtures and Equipment, Investment Properties, Computer Software, Branch Licenses and Trading Rights*

The Group estimates the useful lives of bank premises, furniture, fixtures and equipment, investment properties and computer software based on the period over which the assets are expected to be available for use. The estimated useful lives of these assets 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.

The Group's branch licenses and trading rights were regarded as having an indefinite useful lives considering there is no foreseeable limit to the period over which such assets are expected to generate net cash inflows for the Group. The assessment of having indefinite useful lives is reviewed periodically and is updated whether events and circumstances such as the period of control over these assets and legal or similar limits on the use of these assets continue to support such assessment.

The carrying amounts of bank premises, furniture, fixtures and equipment, investment properties and computer software are analyzed in Notes 13, 14 and 15, respectively, while the carrying amounts of goodwill and branch licenses are analyzed in Note 15. Based on management's assessment as of December 31, 2017 and 2016, there are no changes in the useful lives of these assets. Actual results, however, may vary due to changes in estimates brought about by changes in factors mentioned above.

(d) *Determination of Realizable Amount of Deferred Tax Assets*

The Group 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. The carrying values of recognized and unrecognized deferred tax assets as of December 31, 2017 and 2016 are disclosed in Note 26.1.

(e) *Estimation of Impairment Losses of Non-financial Assets*

Except for intangible assets with indefinite useful lives, PFRS requires that an impairment review be performed when certain impairment indications are present. The Group's policy on estimating the impairment of non-financial assets is discussed in detail in Note 2.19. Though management believes that the assumptions used in the estimation of fair values of non-financial assets are appropriate and reasonable, significant changes in these 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.

(f) *Determination of Fair Value of Investment Properties*

The Group's investment properties are composed of parcels of land, buildings and condominium units which are held for capital appreciation or held-for-lease, and are measured using cost model. The estimated fair value of investment properties disclosed in Note 7.4 is determined on the basis of the appraisals conducted by professional appraiser applying the relevant valuation methodologies as discussed therein.

For investment properties with appraisal conducted prior to the end of the current reporting period, management determines whether there are significant circumstances during the intervening period that may require adjustments or changes in the disclosure of fair value of those properties.

A significant change in key inputs and sources of information used in the determination of the fair value disclosed for those assets may result in adjustment in the carrying amount of the assets reported in the financial statements if their fair value will indicate evidence of impairment.

(g) *Valuation of Post-employment Defined Benefits*

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

The amounts of post-employment benefit obligation and related income or expense, and an analysis of the movements in the estimated present value of post-employment benefit obligation, as well as the significant assumptions used in estimating such obligation, are presented in Note 24.2.

#### **4. RISK MANAGEMENT POLICIES AND OBJECTIVES**

The Group is exposed to risks in relation to its operating, investing, and financing activities, and the business environment in which it operates. The Group's objectives in risk management are to ensure that it identifies, measures, monitors, and controls the various risks that arise from its business activities, and that it adheres strictly to the policies, procedures, and control systems which are established to address these risks.

A committee system is a fundamental part of the Group's process of managing risk. The following four committees of the Parent Company's BOD are relevant in this context:

- The Executive Committee, which meets weekly, has the power to act and pass upon such matters as the Board may entrust to it for action in between Board meetings. It may also consider and approve loans and other credit related matters, investments, purchase of stocks, bonds, securities and other commercial papers for the Bank's portfolio. The Executive Committee also has the power to review an asset or loan to ensure timely resolution and recognition of losses of impaired assets.
- The Risk Oversight Committee (ROC), which meets monthly, carries out the BOD's oversight responsibility for Group's capital adequacy and risk management strategy and actions covering credit, market and operational risks under Pillar 1 of the Basel framework; as well as the management of other material risks determined under Pillar II and the Internal Capital Adequacy Assessment Process (ICAAP) (see Note 5.2). Risk limits are reviewed and approved by the ROC.
- The Audit Committee, which meets monthly, reviews the results of the Internal Audit examinations and recommends remedial actions to the BOD as appropriate.
- The Related Party Transactions (RPT) Committee, which meets monthly and as necessary, reviews proposed RPT within the materiality threshold to determine whether or not the transaction is on terms no less favorable to the Parent Company than terms available to any unconnected third party under the same or similar circumstances. On favorable review, the RPT Committee endorses transactions to the BOD for approval.
- The Anti-Money Laundering (AML) Board Committee, which meets monthly, oversees the implementation of the Bank's Money Laundering and Terrorist Financing Prevention Program (MLPP) and ensures compliance thereof. The Committee also ensures that infractions are immediately corrected, issues are addressed and AML training of officers and staff are conducted.

Four senior management committees also provide a regular forum to take up risk issues.

- The Credit and Collection Committee (CRECOL), chaired by the Chief Executive Officer (CEO) and composed of the heads of credit risk-taking business units and the head of credit management group, meets weekly to review and approve credit exposures within its authority. It also reviews plans and progress on the resolution of problem loan accounts.
- The Asset/Liability Committee (ALCO), chaired by the Treasurer of the Parent Company and with the participation of the CEO and key business and support unit heads including the President of the major subsidiary, RSB, meets weekly to appraise market trends, and economic and political developments. It provides direction in the management of interest rate risk, liquidity risk, foreign currency risk, and trading and investment portfolio decisions. It sets prices or rates for various asset and liability and trading products, in light of funding costs and competitive and other market conditions. It receives confirmation that market risk limits (as described in the succeeding pages) are not breached; or if breached, it provides guidance on the handling of the relevant risk exposure in between ROC meetings.

- The Related Party Transactions Management Committee (RPT ManCom), composed of the Group Heads of the business units as specified in the charter or their respective designates. It meets monthly to review and approve proposed RPT below the materiality threshold for the purpose of determining whether or not the transaction is on terms no less favorable to the Bank than terms available to any unconnected third party under the same or similar circumstances unless the transaction requires board approval. On favorable review, the RPT ManCom endorses the transaction for BOD confirmation.
- The Anti-Money Laundering Management Committee (AMLCom) was created through an order of the Senior Management Committee on June 24, 2002, for the evaluation of the suspicious transaction reports (STR) reported by different units before submission to the Anti-Money Laundering Council (AMLC). The AMLCom assists the BOD in implementing the Group's MLPP in order to ensure compliance with BSP rules and regulations relating to the prevention of money laundering and terrorist financing.

The AMLCom is composed of the Chief Compliance Officer as the Chairperson and Presiding Officer and the Heads of Operations Group, Retail Banking Group, Controllershship Group, Legal Affairs Group, Operational Risk Management Group, Legal Affairs Division as members, and AML Division as the Rapporteur. The AML Division, through the Chief Compliance Officer, reports to the Audit and Compliance Committee and to the AML Board Committee its monthly activities including the AMLCom meetings.

The Parent Company established a Corporate Risk Management Services (CRISMS) Group, headed by the Chief Risk Officer, to ensure that consistent implementation of the objectives of risk identification, measurement and/or assessment, mitigation, and monitoring are pursued via practices commensurate with the group-wide risk profile. In 2016, CRISMS was divided into two sub-groups, the Business Risk Group (BRG) and the Operational Risk Management Group (ORMG), for a more focused and dedicated management of risks. CRISMS is independent of all risk-taking business segments and reports directly to the BOD's ROC. It participates in the CRECOL and ALCO meetings.

In addition to established risk management systems and controls, the Group holds capital commensurate with the levels of risk it undertakes (see Note 5), in accordance with regulatory capital standards and internal benchmarks set by the Parent Company's BOD.

#### ***4.1 Group's Strategy in Using Financial Instruments***

It is the Group's intent to generate returns mainly from the traditional financial intermediation and service-provision activities, augmented by returns from positions based on views on the financial markets. The main source of risk, therefore, remains to be that arising from credit risk exposures. Nevertheless, within BSP regulatory constraints, and subject to limits and parameters established by the BOD and/or the ROC, the Group is exposed to liquidity risk and interest rate risk inherent in the Group's operations, and other market risks, which include foreign exchange risk.

In the course of performing financial intermediation function, the Group accepts deposits from customers at fixed and floating rates, and for various periods, and seeks to earn interest margins by investing these funds in high-quality assets. The conventional strategy to enhance net interest margin is the investment of short-term funds in longer-term assets, such as fixed-income securities. While, in doing so, the Group maintains liquidity at prudent levels to meet all claims that fall due, the Group fully recognizes the consequent interest rate risk exposure.

The Group's investment portfolio is composed mainly of marketable, sovereign and corporate debt instruments.

The Parent Company was granted by the BSP additional derivatives authorities effective January 2011. Products approved under the Limited Dealer Authority (Type 2) are foreign currency forwards, non-deliverable forwards, interest rate and cross currency swaps while credit-linked notes (CLNs) and bond options were approved under the Limited User Authority (Type 3). In February 2012, bond forwards, non-deliverable swaps and foreign exchange options have been included under the same Limited User Authority (Type 3). In June 2013, the Parent Company was granted a Type 2 license non-deliverable swaps, foreign currency options, bond and interest rate options, and asset swaps. During the same period, additional Type 3 licenses for foreign exchange-option and bond-option linked notes were likewise approved. The Parent Company's derivatives portfolio consists mostly of short-term currency forward contracts and swaps.

#### **4.2 Liquidity Risk**

Liquidity risk is the potential insufficiency of funds available to meet the demands of the Group's customers to repay maturing liabilities. The Group manages liquidity risk by limiting the maturity mismatch between assets and liabilities, and by holding sufficient liquid assets of appropriate quality and marketability.

The Group recognizes the liquidity risk inherent in its activities, and identifies, measures, monitors and controls the liquidity risk inherent to the members of the Group which are financial intermediaries.

The Group's liquidity policy is to manage its operations to ensure that funds available are more than adequate to meet demands of its customers and to enable deposits to be repaid on maturity. The Group's liquidity policies and procedures are set out in its funding and liquidity plan which contains certain funding requirements based on assumptions and uses resources and liability maturity gap analysis.

The gap analyses as of December 31, 2017 and 2016 are presented below.

	<b>Group</b>					
	<b>2017</b>					
	<b>One to Three Months</b>	<b>Three Months to One Year</b>	<b>One to Five Years</b>	<b>More than Five Years</b>	<b>Non-maturity</b>	<b>Total</b>
<b>Resources:</b>						
Cash and cash equivalents	P 40,867	P 691	P 1,676	P 581	P 59,366	P 103,181
Investments - net	17,506	1,969	14,818	32,915	6,141	73,349
Loans and receivables - net	33,508	62,507	105,486	83,195	69,509	354,205
Other resources - net	<u>9,027</u>	<u>566</u>	<u>512</u>	<u>38</u>	<u>13,110</u>	<u>23,253</u>
Total resources	<u>100,908</u>	<u>65,733</u>	<u>122,492</u>	<u>116,729</u>	<u>148,126</u>	<u>553,988</u>
<b>Liabilities:</b>						
Deposit liabilities	62,028	9,867	11,234	2,505	302,778	388,412
Bills payable	18,538	15,303	6,379	1,499	2,248	43,967
Bonds payable	-	-	28,060	-	-	28,060
Subordinated debt	-	-	9,968	-	-	9,968
Other liabilities	<u>9,370</u>	<u>69</u>	<u>-</u>	<u>-</u>	<u>7,115</u>	<u>16,554</u>
Total liabilities	89,936	25,239	55,641	4,004	312,141	486,961
<b>Equity</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>67,027</u>	<u>67,027</u>
Total liabilities and equity	<u>89,936</u>	<u>25,239</u>	<u>55,641</u>	<u>4,004</u>	<u>379,168</u>	<u>553,988</u>
<b>On-book gap</b>	<u>10,972</u>	<u>40,494</u>	<u>66,851</u>	<u>112,725</u>	<u>(231,042)</u>	<u>-</u>
<b>Cumulative on-book gap</b>	<u>10,972</u>	<u>51,466</u>	<u>118,317</u>	<u>231,042</u>	<u>-</u>	<u>-</u>
Contingent resources	9,969	-	-	-	-	9,969
Contingent liabilities	<u>10,175</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>10,175</u>
<b>Off-book gap</b>	<u>(206)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(206)</u>
<b>Cumulative off-book gap</b>	<u>(206)</u>	<u>(206)</u>	<u>(206)</u>	<u>(206)</u>	<u>(206)</u>	<u>-</u>
<b>Periodic gap</b>	<u>10,766</u>	<u>40,494</u>	<u>66,851</u>	<u>112,725</u>	<u>(231,042)</u>	<u>(206)</u>
<b>Cumulative total gap</b>	<u><b>P 10,766</b></u>	<u><b>P 51,260</b></u>	<u><b>P 118,111</b></u>	<u><b>P 230,836</b></u>	<u><b>(P 206)</b></u>	<u><b>P -</b></u>



		Group					
		2016					
		One to Three Months	Three Months to One Year	One to Five Years	More than Five Years	Non-maturity	Total
<u>Resources:</u>							
Cash and cash equivalents	P	47,381	P -	P -	P -	P 68,012	P 115,393
Investments - net		18,729	4,683	9,699	37,347	5,547	76,005
Loans and receivables - net		26,063	52,035	83,224	88,427	55,903	305,652
Other resources - net		7,305	232	1,063	34	15,509	24,143
<b>Total resources</b>		<b>99,478</b>	<b>56,950</b>	<b>93,986</b>	<b>125,808</b>	<b>144,971</b>	<b>521,193</b>
<u>Liabilities:</u>							
Deposit liabilities		51,586	15,147	10,523	-	275,821	353,077
Bills payable		9,552	5,628	20,970	1,493	-	37,643
Bonds payable		13,673	-	27,922	-	-	41,595
Subordinated debt		-	-	9,952	-	-	9,952
Other liabilities		8,260	24	-	-	8,509	16,793
<b>Total liabilities</b>		<b>83,071</b>	<b>20,799</b>	<b>69,367</b>	<b>1,493</b>	<b>284,330</b>	<b>459,060</b>
<u>Equity</u>		-	-	-	-	62,133	62,133
<b>Total liabilities and equity</b>		<b>83,071</b>	<b>20,799</b>	<b>69,367</b>	<b>1,493</b>	<b>346,463</b>	<b>521,193</b>
On-book gap		16,407	36,151	24,619	124,315	(201,492)	-
Cumulative on-book gap		16,407	52,558	77,177	201,492	-	-
Contingent resources		14,727	2,032	2,138	-	-	18,897
Contingent liabilities		21,275	2,032	2,138	-	-	25,445
Off-book gap	(	6,548)	-	-	-	-	(6,548)
Cumulative off-book gap	(	6,548)	(6,548)	(6,548)	(6,548)	(6,548)	-
Periodic gap		9,859	36,151	24,618	124,315	(201,492)	(6,548)
Cumulative total gap	<b>P</b>	<b>9,859</b>	<b>46,010</b>	<b>70,629</b>	<b>194,944</b>	<b>(6,548)</b>	<b>P -</b>

<b>Parent Company</b>						
<b>2017</b>						
	<b>One to Three Months</b>	<b>Three Months to One Year</b>	<b>One to Five Years</b>	<b>More than Five Years</b>	<b>Non-maturity</b>	<b>Total</b>
<b>Resources:</b>						
Cash and cash equivalents	P 34,050	P 673	P 1,441	P 501	P 46,777	P 83,442
Investments - net	14,288	507	11,903	46,207	4,246	77,151
Loans and receivables - net	24,958	46,996	62,684	74,279	56,836	265,753
Other resources - net	<u>5,340</u>	<u>346</u>	<u>32</u>	<u>12</u>	<u>9,500</u>	<u>15,230</u>
Total resources	<u>78,636</u>	<u>48,522</u>	<u>76,060</u>	<u>120,999</u>	<u>117,359</u>	<u>441,576</u>
<b>Liabilities:</b>						
Deposit liabilities	49,147	4,402	10,041	2,505	222,572	288,667
Bills payable	16,009	13,906	5,185	1,500	-	36,600
Bonds payable	-	-	28,060	-	-	28,060
Subordinated debt	-	-	9,968	-	-	9,968
Other liabilities	<u>5,109</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,243</u>	<u>11,352</u>
Total liabilities	70,265	18,308	53,254	4,005	228,815	374,647
<b>Equity</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>66,929</u>	<u>66,929</u>
Total liabilities and equity	<u>70,265</u>	<u>18,308</u>	<u>53,254</u>	<u>4,005</u>	<u>295,744</u>	<u>441,576</u>
<b>On-book gap</b>	<u>8,371</u>	<u>30,214</u>	<u>22,806</u>	<u>116,994</u>	<u>( 178,385 )</u>	<u>-</u>
<b>Cumulative on-book gap</b>	<u>8,371</u>	<u>38,585</u>	<u>61,391</u>	<u>178,385</u>	<u>-</u>	<u>-</u>
Contingent resources	9,824	-	-	-	-	9,824
Contingent liabilities	<u>9,824</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>9,824</u>
<b>Off-book gap</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Cumulative off-book gap</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Periodic gap</b>	<u>8,371</u>	<u>30,214</u>	<u>22,806</u>	<u>116,994</u>	<u>( 178,385 )</u>	<u>-</u>
<b>Cumulative total gap</b>	<u><b>P 8,371</b></u>	<u><b>P 38,585</b></u>	<u><b>P 61,391</b></u>	<u><b>P 178,385</b></u>	<u><b>P -</b></u>	<u><b>P -</b></u>

		Parent Company					
		2016					
		One to Three Months	Three Months to One Year	One to Five Years	More than Five Years	Non-maturity	Total
<u>Resources:</u>							
Cash and cash equivalents	P	42,154	P -	P -	P -	P 49,272	P 91,426
Investments - net		16,044	3,378	8,099	33,477	21,832	82,830
Loans and receivables - net		14,756	38,062	47,400	77,804	49,895	227,917
Other resources - net		3,440	5	497	6	11,661	15,609
<b>Total resources</b>		<b>76,394</b>	<b>41,445</b>	<b>55,996</b>	<b>111,287</b>	<b>132,660</b>	<b>417,782</b>
<u>Liabilities:</u>							
Deposit liabilities		40,186	10,418	9,786	-	199,775	260,165
Bills payable		9,552	1,197	19,470	1,493	-	31,712
Bonds payable		13,673	-	27,922	-	-	41,595
Subordinated debt		-	-	9,952	-	-	9,952
Other liabilities		4,698	-	-	-	7,623	12,321
<b>Total liabilities</b>		<b>68,109</b>	<b>11,615</b>	<b>67,130</b>	<b>1,493</b>	<b>207,398</b>	<b>355,745</b>
<b>Equity</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>62,037</b>	<b>62,037</b>
<b>Total liabilities and equity</b>		<b>68,109</b>	<b>11,615</b>	<b>67,130</b>	<b>1,493</b>	<b>269,435</b>	<b>417,782</b>
On-book gap		8,285	29,830	(11,134)	109,794	(136,775)	-
Cumulative on-book gap		8,285	38,115	26,981	136,775	-	-
Contingent resources		14,557	2,032	2,138	-	-	18,727
Contingent liabilities		20,911	2,032	2,138	-	-	25,081
Off-book gap	(	6,354)	-	-	-	-	(6,354)
Cumulative off-book gap	(	6,354)	(6,354)	(6,354)	(6,354)	(6,354)	-
Periodic gap		1,931	29,830	(11,135)	109,794	(136,775)	(6,354)
Cumulative total gap	<b>P</b>	<b>1,931</b>	<b>P 31,761</b>	<b>P 20,627</b>	<b>P 130,421</b>	<b>(P 6,354)</b>	<b>P -</b>

Pursuant to applicable BSP regulations, the Group is required to maintain reserves against deposit liabilities which are based on certain percentages of deposits. The required reserves against deposit liabilities shall be kept in the form of deposits placed in the Group's demand deposit accounts with the BSP. The BSP also requires the Parent Company and RSB to maintain asset cover of 100% for foreign currency denominated liabilities of their respective FCDUs, of which 30% must be in liquid assets.

#### 4.2.1 Foreign Currency Liquidity Management

The liquidity risk management policies and objectives described also apply to the management of any foreign currency to which the Group maintains significant exposure. Specifically, the Group ensures that its measurement, monitoring, and control systems account for these exposures as well. The Group sets and regularly reviews limits on the size of the cash flow mismatches for each significant individual currency and in aggregate over appropriate time horizons. The Group also assesses its access to foreign exchange markets when setting up its risk limits.

Following BSP Circular No. 639 on ICAAP, the Group likewise calculates and maintains a level of capital needed to support unexpected losses attributable to liquidity risk (see Note 5.2).

#### **4.2.2 Liquidity Risk Stress**

To augment the effectiveness of the Group's gap analysis, the Group regularly assesses liquidity risk based on behavioral and hypothetical assumptions under stress conditions. The results of these liquidity stress simulations are reported monthly to the ROC.

#### **4.3 Market Risk**

The Group's exposure to market risk is the potential diminution of earnings arising from the movement of market interest rates as well as the potential loss of market value, primarily of its holdings of debt securities and derivatives, due to price fluctuation.

The market risks of the Group are: (a) foreign exchange risk, (b) interest rate risk and (c) equity price risk. The Group manages these risks via a process of identifying, analyzing, measuring and controlling relevant market risk factors, and establishing appropriate limits for the various exposures. The market risk metrics in use, each of which has a corresponding limit, include the following:

- Nominal Position – an open risk position that is held as of any point in time expressed in terms of the nominal amount of the exposure.
- Dollar Value of 01 (DV01) – an estimate of the price impact due to a one-basis point change in the yield of fixed income securities. It effectively captures both the nominal size of the portfolio as well as its duration. A given DV01 limit accommodates various combinations of portfolio nominal size and duration, thus providing a degree of flexibility to the trading/risk taking function, but at the same time represents a ceiling to the rate sensitivity of the exposure according to the Group's risk appetite.
- Value-at-Risk (VaR) – an estimate of the amount of loss that a given risk exposure is unlikely to exceed during a given time period, at a given level of statistical confidence. Analytically, VaR is the product of: (a) the sensitivity of the market value of the position to movements of the relevant market risk factors, and (b) the volatility of the market risk factor for the given time horizon at a specified level of statistical confidence. Typically, the Group uses a 99% confidence level for this measurement. VaR is used as a risk measure for trading positions, which are marked-to-market (as opposed to exposures resulting from banking, or accrual, book resources and liabilities). Foreign Exchange Position VaR uses a one-day holding period, while Fixed Income VaR uses a defeasance period assessed periodically as appropriate to allow an orderly unwinding of the position. VaR models are back-tested to ensure that results remain consistent with the expectations based on the chosen statistical confidence level. While the Parent Company and RSB use VaR as an important tool for measuring market risk, they are cognizant of its limitations, notably the following:
  - 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.

- VaR is based on historical volatility. Future volatility may be different due to either random, one-time events or structural changes (including changes in correlation). VaR may be unable to capture volatility due to either of these.
  - The holding period assumption may not be valid in all cases, such as during periods of extremely stressed market liquidity.
  - VaR is, by definition, an estimate at a specified level of confidence. Losses may occur beyond VaR. A 99% VaR implies that losses can exceed VaR 1% of the time.
  - In cases where a parametric distribution is assumed to calculate VaR, the assumed distribution may not fit the actual distribution well.
  - VaR assumes a static position over the holding period. In reality, trading positions change, even during the trading day.
- Net Interest Income (NII)-at-Risk – more specifically, in its current implementation, refers to the impact on net interest income for a 12-month horizon of adverse movements in interest rates. For this purpose, the Group employs a gap analysis to measure the interest rate sensitivity of its financial position (local and foreign currencies). As of a given reporting date, the interest rate gap analysis (see Note 4.3.2) measures mismatches between the amounts of interest-earning assets and interest-bearing liabilities re-pricing within “time buckets” going forward from the end of the reporting period. A positive gap means net asset sensitivity, which implies that an increase in the interest rates would have a positive effect on the Group’s net interest income. Conversely, a negative gap means net liability sensitivity, implying that an increase in the interest rates would have a negative effect on the Group’s net interest income. The rate movements assumed for measuring NII-at-Risk are consistent with a 99% confidence level with respect to historical rate volatility, assuming a one-year holding period. The Group considers the sum of NII-at-risk and the VaR of the FVPL and HTC portfolios as the Earnings-at-Risk (EaR) estimate.
  - Capital-at-Risk (CaR) – BSP Circular No. 544 refers to the estimation of the effect of interest rate changes as not only with respect to earnings, but also on the Group’s economic value. The estimate, therefore, must consider the fair valuation effect of rate changes on non-trading positions. This includes both those positions with fair value changes against profit or loss, as well as those with fair value changes recognized directly in equity. Adding this to the EaR determined using the procedure described above provides a measure of capital subject to interest rate risk. The Group sets its CaR limit as a percentage of the equity in the statement of financial position.

In addition to the limits corresponding to the above measurements, the following are also in place:

- Loss Limit – represents a ceiling on accumulated month-to-date and year-to-date losses. For trading positions, a Management Action Trigger (MAT) is also usually defined to be at 50% of the Loss Limit. When MAT is breached, the risk-taking unit must consult with ALCO for approval of a course of action moving forward.
- Product Limit – the nominal position exposure for certain specific financial instruments is established.

Stress Testing, which uses more severe rate/price volatility and/or holding period assumptions, (relative to those used for VaR) is applied to marked-to-market positions to arrive at “worst case” loss estimates. This supplements the VaR measure, in recognition of its limitations mentioned above.

A summary of the VaR position of the trading portfolios at December 31 is as follows:

		<u>Group</u>						
		<u>At December 31</u>	<u>Average</u>	<u>Maximum</u>	<u>Minimum</u>			
<b>2017:</b>								
Foreign currency risk	P	7	P	11	P	32	P	2
Interest rate risk		<u>363</u>		<u>287</u>		<u>501</u>		<u>154</u>
Overall		<u><b>P 370</b></u>		<u><b>P 298</b></u>		<u><b>P 533</b></u>		<u><b>P 156</b></u>
<b>2016:</b>								
Foreign currency risk	P	15	P	10	P	28	P	3
Interest rate risk		<u>201</u>		<u>232</u>		<u>425</u>		<u>166</u>
Overall		<u><b>P 216</b></u>		<u><b>P 242</b></u>		<u><b>P 453</b></u>		<u><b>P 169</b></u>
<b>2015:</b>								
Foreign currency risk	P	15	P	7	P	17	P	2
Interest rate risk		<u>279</u>		<u>245</u>		<u>360</u>		<u>167</u>
Overall		<u><b>P 294</b></u>		<u><b>P 252</b></u>		<u><b>P 377</b></u>		<u><b>P 169</b></u>
		<u>Parent Company</u>						
		<u>At December 31</u>	<u>Average</u>	<u>Maximum</u>	<u>Minimum</u>			
<b>2017:</b>								
Foreign currency risk	P	7	P	11	P	31	P	2
Interest rate risk		<u>147</u>		<u>125</u>		<u>277</u>		<u>40</u>
Overall		<u><b>P 154</b></u>		<u><b>P 136</b></u>		<u><b>P 308</b></u>		<u><b>P 42</b></u>
<b>2016:</b>								
Foreign currency risk	P	15	P	9	P	27	P	3
Interest rate risk		<u>83</u>		<u>102</u>		<u>217</u>		<u>70</u>
Overall		<u><b>P 98</b></u>		<u><b>P 111</b></u>		<u><b>P 244</b></u>		<u><b>P 73</b></u>
<b>2015:</b>								
Foreign currency risk	P	15	P	7	P	16	P	2
Interest rate risk		<u>118</u>		<u>114</u>		<u>190</u>		<u>64</u>
Overall		<u><b>P 133</b></u>		<u><b>P 121</b></u>		<u><b>P 206</b></u>		<u><b>P 66</b></u>

#### **4.3.1 Foreign Exchange Risk**

Foreign exchange risk is the risk to earnings or capital arising from changes in foreign exchange rates. The net foreign exchange exposure, or the difference between foreign currency denominated assets and foreign currency denominated liabilities, is capped by current BSP regulations. Compliance with this ceiling by the Group and the respective foreign currency positions of its subsidiaries are reported to the BSP on a daily basis as required. Beyond this constraint, the Group manages its foreign exchange exposure by limiting it within the conservative levels justifiable from a return/risk perspective. In addition, the Group regularly calculates VaR for each currency position, which is incorporated in the foregoing market risk management discussion.

The breakdown of the financial resources and financial liabilities as to foreign and Philippine peso-denominated balances, after elimination of intercompany accounts or transactions, as of December 31 follows:

	<b>Group</b>		
	<b>Foreign Currencies</b>	<b>Philippine Pesos</b>	<b>Total</b>
<b>2017:</b>			
<b><u>Resources:</u></b>			
Cash and other cash items	P 1,029	P 13,664	P 14,693
Due from BSP	-	58,801	58,801
Due from other banks	17,922	1,896	19,818
Loans arising from reverse repurchase agreement	37	9,794	9,831
Financial assets at FVPL	1,144	6,447	7,591
Financial assets at FVOCI	51	5,312	5,363
Investment securities at amortized cost	50,044	9,934	59,978
Loans and receivables - net	54,940	299,303	354,243
Other resources	<u>456</u>	<u>436</u>	<u>892</u>
	<b><u>P 125,623</u></b>	<b><u>P 405,587</u></b>	<b><u>P 531,210</u></b>
<b><u>Liabilities:</u></b>			
Deposit liabilities	P 116,080	P 272,332	P 388,412
Bills payable	36,598	7,369	43,967
Bonds payable	28,060	-	28,060
Subordinated debt	-	9,968	9,968
Accrued interest and other expenses	838	3,091	3,929
Other liabilities	<u>4,157</u>	<u>7,076</u>	<u>11,233</u>
	<b><u>P 185,773</u></b>	<b><u>P 299,836</u></b>	<b><u>P 485,569</u></b>
<b>2016:</b>			
<b><u>Resources:</u></b>			
Cash and other cash items	P 5,242	P 9,934	P 15,176
Due from BSP	-	66,520	66,520
Due from other banks	23,775	1,518	25,293
Loans arising from reverse repurchase agreement	-	7,889	7,889
Financial assets at FVPL	15,679	2,400	18,079
Financial assets at FVOCI	1,744	3,935	5,679
Investment securities at amortized cost	40,542	11,322	51,864
Loans and receivables - net	55,148	251,019	306,167
Other resources	<u>112</u>	<u>669</u>	<u>781</u>
	<b><u>P 142,242</u></b>	<b><u>P 355,206</u></b>	<b><u>P 497,448</u></b>

	Group		
	Foreign Currencies	Philippine Pesos	Total
2016:			
<b>Liabilities:</b>			
Deposit liabilities	P 92,284	P 260,793	P 353,077
Bills payable	31,709	5,934	37,643
Bonds payable	41,595	-	41,595
Subordinated debt	-	9,952	9,952
Accrued interest and other expenses	1,103	3,481	4,584
Other liabilities	<u>802</u>	<u>8,081</u>	<u>8,883</u>
	<u>P 167,493</u>	<u>P 288,241</u>	<u>P 455,734</u>
<b>Parent Company</b>			
	Foreign Currencies	Philippine Pesos	Total
2017:			
<b>Resources:</b>			
Cash and other cash items	P 868	P 9,547	P 10,415
Due from BSP	-	47,186	47,186
Due from other banks	17,839	529	18,368
Loans and receivables arising from reverse repurchase agreement	-	7,435	7,435
Financial assets at FVPL	1,145	5,408	6,553
Financial assets at FVOCI	15	3,424	3,439
Investment securities at amortized cost	45,507	2,634	48,141
Loans and receivables - net	54,845	210,946	265,791
Other resources	<u>109</u>	<u>70</u>	<u>179</u>
	<u><b>P 120,328</b></u>	<u><b>P 287,179</b></u>	<u><b>P 407,507</b></u>
<b>Liabilities:</b>			
Deposit liabilities	P 266,240	P 22,427	P 288,667
Bills payable	36,597	3	36,600
Bonds payable	28,060	-	28,060
Subordinated debt	-	9,968	9,968
Accrued interest and other expenses	796	2,213	3,009
Other liabilities	<u>695</u>	<u>5,561</u>	<u>6,256</u>
	<u><b>P 332,388</b></u>	<u><b>P 40,172</b></u>	<u><b>P 372,560</b></u>



	Parent Company		
	Foreign Currencies	Philippine Pesos	Total
2016:			
<u>Resources:</u>			
Cash and other cash items	P 1,066	P 9,934	P 11,000
Due from BSP	-	50,871	50,871
Due from other banks	23,561	548	24,109
Loans and receivables arising from reverse repurchase agreement	-	4,931	4,931
Financial assets at FVPL	14,675	2,400	17,075
Financial assets at FVOCI	1,744	1,991	3,735
Investment securities at amortized cost	40,542	4,300	44,842
Loans and receivables - net	55,148	173,284	228,432
Other resources	89	377	466
	<u>P 136,825</u>	<u>P 248,636</u>	<u>P 385,461</u>
<u>Liabilities:</u>			
Deposit liabilities	P 65,959	P 194,206	P 260,165
Bills payable	31,709	3	31,712
Bonds payable	41,595	-	41,595
Subordinated debt	-	9,952	9,952
Accrued interest and other expenses	750	2,765	3,515
Other liabilities	802	5,292	6,094
	<u>P 140,815</u>	<u>P 212,218</u>	<u>P 353,033</u>

#### **4.3.2 Interest Rate Risk**

The interest rate risk inherent in the Group's financial statements arises from re-pricing mismatches between assets and liabilities. The Group follows a policy on managing its assets and liabilities so as to ensure that exposure to fluctuations in interest rates are kept within acceptable limits. ALCO meets at least on a weekly basis to set rates for various assets and liabilities and trading products. ALCO employs interest rate gap analysis to measure the interest rate sensitivity of those financial instruments.

The interest rate gap analyses of assets and liabilities as of December 31 based on re-pricing maturities are shown below. It should be noted that such interest rate gap analyses are based on the following key assumptions:

- Loans and time deposits are subject to re-pricing on their contractual maturity dates. Non-performing loans, however, are not re-priced;
- Debt securities at amortized cost are bucketed based on their re-pricing profile;
- Held-for-trading securities and derivatives are considered as non-rate sensitive; and,
- For assets and liabilities with no definite re-pricing schedule or maturity, slotting is based on the Group's empirical assumptions.

<b>Group</b>						
<b>2017</b>						
	<b>One to Three Months</b>	<b>Three Months to One Year</b>	<b>One to Five Years</b>	<b>More than Five Years</b>	<b>Non-rate Sensitive</b>	<b>Total</b>
<b>Resources:</b>						
Cash and cash equivalents	P 31,016	P 261	P 484	P 80	P 71,340	P 103,181
Investments - net	9,712	1,969	14,818	32,915	13,935	73,349
Loans and receivables - net	163,355	40,828	87,289	31,778	30,955	354,205
Other resources - net	<u>2,657</u>	<u>374</u>	<u>239</u>	<u>517</u>	<u>19,466</u>	<u>23,253</u>
Total resources	<u>206,740</u>	<u>43,432</u>	<u>102,830</u>	<u>65,290</u>	<u>135,696</u>	<u>553,988</u>
<b>Liabilities:</b>						
Deposit liabilities	136,523	14,161	18,040	2,505	217,183	388,412
Bills payable	32,690	1,225	5,434	1,499	3,119	43,967
Bonds payable	-	-	28,060	-	-	28,060
Subordinated debt	-	-	9,968	-	-	9,968
Other liabilities	<u>1,006</u>	<u>69</u>	<u>-</u>	<u>-</u>	<u>15,479</u>	<u>16,554</u>
Total liabilities	170,219	15,455	61,502	4,004	235,781	486,961
<b>Equity</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>67,027</u>	<u>67,027</u>
Total liabilities and equity	<u>170,219</u>	<u>15,455</u>	<u>61,502</u>	<u>4,004</u>	<u>302,808</u>	<u>553,988</u>
<b>On-book gap</b>	<u>36,521</u>	<u>27,977</u>	<u>41,328</u>	<u>61,286</u>	<u>(167,112)</u>	<u>-</u>
<b>Cumulative on-book gap</b>	<u>36,521</u>	<u>64,498</u>	<u>105,826</u>	<u>167,112</u>	<u>-</u>	<u>-</u>
Contingent resources	9,969	-	-	-	-	9,969
Contingent liabilities	<u>9,977</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>198</u>	<u>10,175</u>
<b>Off-book gap</b>	<u>(8)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(198)</u>	<u>(206)</u>
<b>Cumulative off-book gap</b>	<u>(8)</u>	<u>(8)</u>	<u>(8)</u>	<u>(8)</u>	<u>(206)</u>	<u>-</u>
<b>Periodic gap</b>	<u>36,513</u>	<u>27,977</u>	<u>41,328</u>	<u>61,286</u>	<u>(167,310)</u>	<u>(206)</u>
<b>Cumulative total gap</b>	<u>P 36,513</u>	<u>P 64,490</u>	<u>P 105,818</u>	<u>P 167,104</u>	<u>(P 206)</u>	<u>P -</u>

		Group					
		2016					
		One to Three Months	Three Months to One Year	One to Five Years	More than Five Years	Non-rate Sensitive	Total
<u>Resources:</u>							
Cash and cash equivalents	P	42,381	P -	P -	P -	P 73,012	P 115,393
Investments - net		3,359	4,512	9,196	37,347	21,591	76,005
Loans and receivables - net		142,139	32,138	74,189	33,388	23,798	305,652
Other resources - net		<u>3,165</u>	<u>42</u>	<u>726</u>	<u>587</u>	<u>19,623</u>	<u>24,143</u>
Total resources		<u>191,044</u>	<u>36,692</u>	<u>84,111</u>	<u>71,322</u>	<u>138,024</u>	<u>521,193</u>
<u>Liabilities:</u>							
Deposit liabilities		106,462	27,579	14,055	1	204,980	353,077
Bills payable		17,650	3,933	16,060	-	-	37,643
Bonds payable		13,673	-	27,922	-	-	41,595
Subordinated debt		-	-	9,952	-	-	9,952
Other liabilities		<u>625</u>	<u>24</u>	<u>-</u>	<u>-</u>	<u>16,144</u>	<u>16,793</u>
Total liabilities		138,410	31,536	67,989	1	221,124	459,060
Equity		<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>62,133</u>	<u>62,133</u>
Total liabilities and equity		<u>138,410</u>	<u>31,536</u>	<u>67,989</u>	<u>1</u>	<u>283,257</u>	<u>521,193</u>
On-book gap		<u>52,634</u>	<u>5,156</u>	<u>16,122</u>	<u>71,321</u>	<u>(145,233)</u>	<u>-</u>
Cumulative on-book gap		<u>52,634</u>	<u>57,790</u>	<u>73,912</u>	<u>145,233</u>	<u>-</u>	<u>-</u>
Contingent resources		21,063	2,032	2,138	-	-	25,233
Contingent liabilities		<u>21,093</u>	<u>2,032</u>	<u>2,138</u>	<u>-</u>	<u>182</u>	<u>25,445</u>
Off-book gap	(	<u>30</u> )	<u>-</u>	<u>-</u>	<u>-</u>	<u>(182)</u>	<u>(212)</u>
Cumulative off-book gap	(	<u>30</u> )	<u>(30)</u>	<u>(30)</u>	<u>(30)</u>	<u>(212)</u>	<u>-</u>
Periodic gap		<u>52,604</u>	<u>5,156</u>	<u>16,122</u>	<u>71,321</u>	<u>(145,415)</u>	<u>(212)</u>
Cumulative total gap	P	<u>52,604</u>	<u>57,760</u>	<u>73,882</u>	<u>145,203</u>	<u>(P 212)</u>	<u>P -</u>

<b>Parent Company</b>						
<b>2017</b>						
	<b>One to Three Months</b>	<b>Three Months to One Year</b>	<b>One to Five Years</b>	<b>More than Five Years</b>	<b>Non-rate Sensitive</b>	<b>Total</b>
<b>Resources:</b>						
Cash and cash equivalents	P 26,031	P -	P -	P -	P 57,411	P 83,442
Investments - net	9,021	506	11,903	46,207	9,514	77,151
Loans and receivables - net	157,341	27,556	29,093	29,122	22,641	265,753
Other resources - net	7	346	32	12	14,833	15,230
<b>Total resources</b>	<b>192,400</b>	<b>28,408</b>	<b>41,028</b>	<b>75,341</b>	<b>104,399</b>	<b>441,576</b>
<b>Liabilities:</b>						
Deposit liabilities	88,232	5,873	10,041	2,505	182,016	288,667
Bills payable	30,913	-	4,187	1,500	-	36,600
Bonds payable	-	-	28,060	-	-	28,060
Subordinated debt	-	-	9,968	-	-	9,968
Other liabilities	880	-	-	-	10,472	11,352
<b>Total liabilities</b>	<b>120,025</b>	<b>5,873</b>	<b>52,256</b>	<b>4,005</b>	<b>192,488</b>	<b>374,647</b>
<b>Equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>66,929</b>	<b>66,929</b>
<b>Total liabilities and equity</b>	<b>120,025</b>	<b>5,873</b>	<b>52,256</b>	<b>4,005</b>	<b>259,417</b>	<b>441,576</b>
<b>On-book gap</b>	<b>72,375</b>	<b>22,535</b>	<b>(11,228)</b>	<b>71,336</b>	<b>(155,018)</b>	<b>-</b>
<b>Cumulative on-book gap</b>	<b>72,375</b>	<b>94,910</b>	<b>83,682</b>	<b>155,018</b>	<b>-</b>	<b>-</b>
Contingent resources	9,824	-	-	-	-	9,824
Contingent liabilities	9,824	-	-	-	-	9,824
<b>Off-book gap</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Cumulative off-book gap</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Periodic gap</b>	<b>72,375</b>	<b>22,535</b>	<b>(11,228)</b>	<b>71,336</b>	<b>(155,018)</b>	<b>-</b>
<b>Cumulative total gap</b>	<b>P 72,375</b>	<b>P 94,910</b>	<b>P 83,682</b>	<b>P 155,018</b>	<b>P -</b>	<b>P -</b>

		Parent Company					
		2016					
		One to Three Months	Three Months to One Year	One to Five Years	More than Five Years	Non-rate Sensitive	Total
<u>Resources:</u>							
Cash and cash equivalents	P	42,143	P -	P -	P -	P 49,283	P 91,426
Investments - net		674	3,207	7,596	33,477	37,876	82,830
Loans and receivables - net		131,872	21,221	22,475	30,813	21,536	227,917
Other resources - net		3	5	497	17	15,087	15,609
<b>Total resources</b>		<b>174,692</b>	<b>24,433</b>	<b>30,568</b>	<b>64,307</b>	<b>123,782</b>	<b>417,782</b>
<u>Liabilities:</u>							
Deposit liabilities		61,105	15,326	9,786	-	173,948	260,165
Bills payable		16,301	-	15,411	-	-	31,712
Bonds payable		13,673	-	27,922	-	-	41,595
Subordinated debt		-	-	9,952	-	-	9,952
Other liabilities		514	-	-	-	11,807	12,321
<b>Total liabilities</b>		<b>91,593</b>	<b>15,326</b>	<b>63,071</b>	<b>-</b>	<b>185,755</b>	<b>355,745</b>
<u>Equity</u>		<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>62,037</u>	<u>62,037</u>
<b>Total liabilities and equity</b>		<b>91,593</b>	<b>15,326</b>	<b>63,071</b>	<b>-</b>	<b>247,792</b>	<b>417,782</b>
On-book gap		83,099	9,107	(32,503)	64,307	(124,010)	-
Cumulative on-book gap		83,099	92,206	59,703	124,010	-	-
Contingent resources		14,557	2,032	2,138	-	-	18,727
Contingent liabilities		20,911	2,032	2,138	-	-	25,081
Off-book gap	(	6,354)	-	-	-	-	(6,354)
Cumulative off-book gap	(	6,354)	(6,354)	(6,354)	(6,354)	(6,354)	-
Periodic gap		76,745	9,107	(32,503)	64,307	(124,010)	(6,354)
Cumulative total gap	P	<u>76,745</u>	P <u>85,852</u>	P <u>53,349</u>	P <u>117,656</u>	(P <u>6,354</u> )	P <u>-</u>

The table below summarizes the potential impact on the Group's and the Parent Company's annual interest income of parallel rate shifts using the repricing profile shown in the previous pages.

Changes in Interest Rates (in basis points)			
- 100	- 200	+ 100	+ 200

December 31, 2017

Group	(P	586)	(P	1,172)	P	586	P	1,172
Parent Company	(	831)	(	1,661)		831		1,661

December 31, 2016

Group	(P	667)	(P	1,335)	P	667	P	1,335
Parent Company	(	906)	(	1,811)		906		1,811

### **4.3.3 Equity Price Risk**

The Group's exposure to price risk on equity securities held and classified in the statement of financial position as financial assets at FVPL or financial assets at FVOCI as of December 31, 2017 and 2016 is managed through diversification of portfolio and monitoring of changes in market prices. Diversification of the portfolio is done in accordance with the limits set by the Group.

Moreover, RCBC Capital and RSI, estimate the potential loss and determines the market and position risk requirement on equity securities at FVPL in the computation of the market and position risk requirement for all equity positions.

RCAP uses the delta-normal approach as its VaR model to estimate the daily potential loss that can be incurred from equity securities held for trading. VaR is a key measure in the management of market price 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. RCAP uses a 99% confidence level and a minimum 260-day observation period in VaR calculation. In addition, RSI computes its market and position risk for all equity positions, if any, in conjunction with the Risk Based Capital Adequacy ratio required to be maintained. Market and position risk requirement is calculated using position risk factor multiplied by mark-to-market value security.

### **4.4 Credit Risk**

Credit risk is the risk that the counterparty in a transaction may default, and arises from lending, trade finance, treasury, derivatives and other activities undertaken by the Group. The Group manages credit risk through a system of policies and authorities that govern the processes and practices of all credit-originating and borrowing relationship management units.

The Credit and Group Risk Division (CGRD) of CRISMS assists senior management: (a) in establishing risk concentration limits at the portfolio level; and (b) in the continuous monitoring of the actual credit risk portfolio from the perspective of those limits and other risk management objectives. The Credit Management Group (CMG), on the other hand, is responsible for: (a) the development of credit policies relating to account management; (b) the financial evaluation and credit risk rating of borrowers; and, (c) asset quality review.

At the individual borrower level, exposure to credit risk is managed via adherence to a set of policies, the most notable features of which, in this context, are: (a) credit approving authority, except as noted below, is not exercised by a single individual but rather, through a hierarchy of limits is effectively exercised collectively; (b) business center managers have limited approval authority only for credit exposure related to deposit-taking operations in the form of bills purchase, acceptance of second endorsed checks and 1:1 loan accommodations; (c) an independent credit risk assessment by the CMG of large corporate and middle-market borrowers, summarized into a borrower risk rating, is provided as input to the credit decision-making process; and, (d) borrower credit analysis is performed at origination and at least annually thereafter.

Impairment provisions are recognized for losses that have been incurred at the end of the reporting period. Significant changes in the economy, or in particular industry segments that represent a concentration in the Group's financial instrument portfolio could result in losses that are different from those provided for at the end of each reporting period. Management, therefore, carefully monitors the changes and adjusts the Group's exposure to such credit risk, as necessary.

Loans and receivables, regardless if the accounts have been fully paid, extended or renewed in subsequent year or period, are subjected to evaluation for possible losses. The Parent Company uses its internal credit risk rating system (ICRRS) to determine any evidence of impairment. The rating system classifies performing accounts from a scale of AAA indicating an extremely strong capacity of the counterparty to meet financial commitments down to ratings lower than CCC demonstrating weakness in the counterparty's economic and financial condition that could lead to payment default on financial commitments. Past due accounts, accounts identified for phase-out and those that exhibit the characteristics of classified loans shall be risk-rated following the guidelines on credit classification per BSP Manual of Regulations for Banks, i.e., Especially Mentioned, Substandard, Doubtful or Loss.

Only impaired accounts with significant amount are subject to specific impairment test. Impaired accounts refer to those accounts which were rated BB+ to lower than CCC and accounts rated as Especially Mentioned, Substandard, Doubtful and Loss. Significant amount is at least P0.5 for sales contract receivables and P15 for all other loan and receivable accounts.

In the process of applying the Parent Company's ICRRS in determining indications of impairment on individually significant items of loans and receivables, the Parent Company analyzes the credit quality of the borrowers and counterparties through a set of criteria and rating scale classified into the following:

<u>Risk Rating</u>	<u>Rating Description/Criteria</u>
AAA	Extremely strong capacity to meet financial commitments
AA*	Very strong capacity to meet financial commitments
A*	Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances
BBB*	Adequate capacity to meet financial commitments, but more subject to adverse economic conditions
BB*	Less vulnerable in the near-term but faces major ongoing uncertainties to adverse business, financial and economic conditions
B*	More vulnerable to adverse business, financial and economic conditions but currently has the capacity to meet financial commitments
CCC and below*	Not at risk of loss at the moment and the borrower has the financial capacity to meet its obligations but its exposure to adverse business, financial or economic conditions has weakened it and, unless present trends are reversed, could eventually lead to losses.
Especially Mentioned	Has potential weaknesses that deserve management's close attention and if left uncorrected, these weaknesses may affect the repayment of the loan.

<u>Risk Rating</u>	<u>Rating Description/Criteria</u>
Substandard	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.
Doubtful	Loans and credit accommodations that exhibit more severe weaknesses than those classified as “Substandard”, whose characteristics on the basis of currently known facts, conditions and values make collection or liquidation highly improbable.
Loss	Loans considered absolutely uncollectible or worthless

*\* Ratings from AA to CCC are modified by a plus (+) or minus (-) sign to show relative standing within the rating categories.*

The foregoing ICRRS is established by the Parent Company in congruence with and with reference to the credit risk rating methodology used by Standard & Poor’s (S&P) in measuring the creditworthiness of an individual debt issue which is still performing or current in status. The risk ratings determined by the Parent Company for its portfolio of loans and receivables at a given review date is updated to consider the possible shift in the economy or business environment or circumstances affecting the industry and the entity or borrower, in particular. Accordingly, a periodic assessment of credit quality may improve the borrower’s rating or it could lead to one or more rating downgrades over time.

Credit Risk Management Division (CRMD) of RSB is, in turn, tasked to measure, control and manage credit risk on the consumer loans business of RSB through the performance of regular monitoring, reporting and recommendation of risk mitigation measures of the actual credit risk portfolio to the Credit Committee and Risk Committee, as well as accomplishment of the corresponding review and development of credit policies and guidelines to sustain asset quality.

For consumer loans, risk assessment is performed on an individual borrower through the use of a credit application scorecard for Housing, Auto and Personal Loans while for Corporate Salary Loans, rule-based credit criteria on company accreditation and borrower evaluation has been established. The credit application scorecard makes use of customer, loan and collateral characteristics which have been assigned weights based on their predictive power in determining the propensity of an account to default or maintain a satisfactory credit performance. Credit decisions are based on recommended score cut-offs.

Asset quality of RSB is monitored through a regular portfolio performance review including customer segmentation and loan concentration risk assessment to identify sources of risk and to determine risk mitigation on segments that drive delinquency or manifests triggers for default. Likewise, close monitoring and review of industry performance, economic changes and market conditions that may affect the consumer loans business is also taken into consideration to establish a holistic risk assessment process.



#### 4.4.1 Exposure to Credit Risk

The carrying amount of financial resources recognized in the financial statements, net of any allowance for losses, which represents the maximum exposure to credit risk, without taking into account the value of any collateral obtained, as of December 31 follows:

	<b>Group</b>			
	<u>2017</u>		<u>2016</u>	
	<u>Loans and Receivables</u>	<u>Trading and Investment Securities</u>	<u>Loans and Receivables</u>	<u>Trading and Investment Securities</u>
<b>Individually Assessed for Impairment</b>				
B to B-	P -	P -	P -	P -
CCC+ and below	-	-	-	-
Especially mentioned	1,308	-	4,055	-
Sub-standard	4,181	-	1,318	-
Doubtful	250	-	59	-
Loss	<u>1,222</u>	<u>-</u>	<u>903</u>	<u>-</u>
Gross amount	6,961	-	6,335	-
Unearned interest and discount	( 46)	-	-	-
Allowance for impairment	<u>( 2,249)</u>	<u>-</u>	<u>( 1,373)</u>	<u>-</u>
Carrying amount	<u>4,666</u>	<u>-</u>	<u>4,962</u>	<u>-</u>
<b>Collectively Assessed for Impairment</b>				
Unrated	103,319	-	88,390	-
AAA to AA-	-	-	-	-
A+ to A-	-	-	-	-
BBB+ to BBB-	21,128	-	22,632	-
BB+ to BB	40,848	-	40,278	-
BB- to BB	76,321	-	62,455	-
B to B-	105,963	-	80,706	-
CCC+ and below	581	-	5,198	-
Especially mentioned	105	-	154	-
Sub-standard	678	-	794	-
Doubtful	726	-	668	-
Loss	<u>125</u>	<u>-</u>	<u>122</u>	<u>-</u>
Gross amount	349,794	-	301,397	-
Unearned interest and discount	( 771)	-	( 243)	-
Allowance for impairment	<u>( 4,451)</u>	<u>-</u>	<u>( 4,932)</u>	<u>-</u>
Carrying amount	<u>344,572</u>	<u>-</u>	<u>296,222</u>	<u>-</u>
Unquoted debt securities classified as loans	1,939	-	1,256	-
Other receivables	4,359	-	4,893	-
Allowance for impairment	<u>( 1,293)</u>	<u>-</u>	<u>( 1,106)</u>	<u>-</u>
Carrying amount	<u>5,005</u>	<u>-</u>	<u>5,043</u>	<u>-</u>
<b>Neither Past Due Nor Impaired</b>	<u>-</u>	<u>68,879</u>	<u>-</u>	<u>68,378</u>
<b>Total Carrying Amount</b>	<u><b>P 354,243</b></u>	<u><b>P 68,879</b></u>	<u><b>P 306,167</b></u>	<u><b>P 68,378</b></u>

	<b>Parent Company</b>			
	<u>2017</u>		<u>2016</u>	
	<u>Loans and Receivables</u>	<u>Trading and Investment Securities</u>	<u>Loans and Receivables</u>	<u>Trading and Investment Securities</u>
<b>Individually Assessed for Impairment</b>				
B to B-	P -	P -	P -	P -
CCC+ and below	-	-	-	-
Especially mentioned	-	-	-	-
Sub-standard	995	-	115	-
Doubtful	22	-	59	-
Loss	<u>159</u>	<u>-</u>	<u>310</u>	<u>-</u>
Gross amount	1,176	-	484	-
Allowance for impairment	( 276 )	-	( 384 )	-
Carrying amount	<u>900</u>	<u>-</u>	<u>100</u>	<u>-</u>
<b>Collectively Assessed for Impairment</b>				
Unrated	18,314	-	15,023	-
AAA to AA-	-	-	-	-
A+ to A-	-	-	-	-
BBB+ to BBB-	21,128	-	22,632	-
BB+ to BB	40,848	-	40,278	-
BB- to B+	76,321	-	62,455	-
B to B-	105,480	-	80,706	-
CCC+ and below	581	-	5,198	-
Especially mentioned	105	-	154	-
Sub-standard	678	-	794	-
Doubtful	656	-	668	-
Loss	<u>125</u>	<u>-</u>	<u>121</u>	<u>-</u>
Gross amount	264,236	-	228,030	-
Unearned interest and discount	( 332 )	-	( 226 )	-
Allowance for impairment	( 3,632 )	-	( 3,426 )	-
Carrying amount	<u>260,272</u>	<u>-</u>	<u>224,378</u>	<u>-</u>
<b>Unquoted debt securities</b>				
classified as loans	1,177	-	1,196	-
Other receivables	4,476	-	3,740	-
Allowance for impairment	( 1,034 )	-	( 982 )	-
Carrying amount	<u>4,619</u>	<u>-</u>	<u>3,954</u>	<u>-</u>
<b>Neither Past Due Nor Impaired</b>	<u>-</u>	<u>54,004</u>	<u>-</u>	<u>61,228</u>
<b>Total Carrying Amount</b>	<b><u>P 265,791</u></b>	<b><u>P 54,004</u></b>	<b><u>P 228,432</u></b>	<b><u>P 61,228</u></b>

The credit risk for cash and cash equivalents such as Due from BSP, Due from Other Banks and Loans Arising from Reverse Repurchase Agreement are considered negligible, since the counterparties are reputable banks with high quality external credit ratings.

#### 4.4.2 Collateral Held as Security and Other Credit Enhancements

The Group holds collateral against loans and advances to customers in the form of hold-out deposits, real estate mortgage, standby letters of credit or bank guaranty, government guaranty, chattel mortgage, assignment of receivables, pledge of equity securities, personal and corporate guaranty and other forms of security. Estimates of fair value are based on the value of collateral assessed at the time of borrowing and are generally updated annually.

Generally, collateral is not held over loans and advances to other banks, except when securities are held as part of reverse repurchase and securities borrowing arrangements. Collateral is not usually held against trading and investment securities, and no such collateral was held as of December 31, 2017 and 2016.

An estimate of the fair value of collateral and other security enhancements held against the loan portfolio as of December 31, 2017 and 2016 is shown below.

	<u>Group</u>	
	<u>2017</u>	<u>2016</u>
Against individually impaired		
Real property	<b>P 1,164</b>	P 129
Chattels	<b>207</b>	201
Against classified accounts but not impaired		
Real property	<b>54,256</b>	75,014
Chattels	<b>10,959</b>	11,385
Equity securities	<b>5,356</b>	55
Others	<b>630</b>	1,027
Against neither past due nor impaired		
Real property	<b>95,088</b>	82,599
Chattels	<b>55,026</b>	48,029
Hold-out deposits	<b>15,799</b>	16,379
Others	<b>28,017</b>	21,708
	<b><u>P 266,502</u></b>	<b><u>P 256,526</u></b>
	<u>Parent Company</u>	
	<u>2017</u>	<u>2016</u>
Against individually impaired		
Real property	<b>P 1,164</b>	P 129
Chattels	<b>-</b>	15
Against classified accounts but not impaired		
Real property	<b>42,594</b>	54,987
Equity securities	<b>5,356</b>	55
Chattels	<b>1,434</b>	2,993
Others	<b>270</b>	587
Against neither past due nor impaired		
Real property	<b>16,707</b>	12,503
Hold-out deposits	<b>14,380</b>	15,925
Others	<b>25,105</b>	19,638
	<b><u>P 107,010</u></b>	<b><u>P 106,832</u></b>

#### ***4.4.3 Concentrations of Credit Risk***

Credit risk concentration in the context of banking generally denotes the risk arising from an uneven distribution of counterparties in credit or in any other business relationships, or from a concentration in business sectors or geographic regions which is capable of generating losses large enough to jeopardize an institution's solvency.

The Group monitors concentrations of credit risk by sector. An analysis of concentrations of credit risk of the loan portfolio at the end of the reporting period is shown in Note 11.1.

In the course of the Group's implementation of ICAAP (see Note 5.2), it adopts a quantification of credit risk concentration following frameworks prescribed by some of the more advanced European central banks as well as established concentration metrics. Using sector distribution as a tool, the Group performs a straightforward application of the Herfindahl-Hirshman Index (HHI) to determine the existence of credit risk concentration. The Group supplements this methodology with the use of the Comprehensive Concentration Index (CCI) to monitor and analyze name concentration.

The Group, however, recognizes the inherent limitations of the use of HHI and CCI to assess credit concentration risk. To augment this measure and to appropriately manage said risk, the Group performs an in-depth analysis of its large borrowing groups. To ensure the independence of this process, the review and analysis are done in the context of ROC meetings.

#### ***4.4.4 Credit Risk Stress Test***

To enhance the assessment of credit risk, the Group adopted a credit risk stress testing framework using break-even sales and cash flow debt service to determine a borrower's vulnerability and ultimately impact to the Group's capital adequacy. The Parent Company adopts a portfolio credit risk testing framework that takes into consideration the causal relationships among industry sectors.

#### ***4.5 Operational Risk***

Operational risks are risks arising from the potential inadequate information systems and systems, operations or transactional problems (relating to service or product delivery), breaches in internal controls, fraud, or unforeseen catastrophes that may result in unexpected loss. Operational risks include the risk of loss arising from various types of human or technical error, settlement or payments failures, business interruption, administrative and legal risks, and the risk arising from systems not performing adequately.

The Operational Risk Management Group (ORMG) assists management in meeting its responsibility to understand and manage operational risk exposures and to ensure consistent application of operational risk management tools across the Group.

The ORMG applies a number of techniques to efficiently manage operational risks. Among these are as follows:

- Each major business line has an embedded operational risk management officer who acts as a point person for the implementation of various operational risk tools. The operational risk officers attend annual risk briefings conducted by the ORMG to keep them up-to-date with different operational risk issues, challenges and initiatives;
- With ORMG's bottom up self-assessment process, which is conducted at least annually, areas with high risk potential are highlighted and reported, and control measures are identified. The result of said self-assessment exercise also serves as one of the inputs in identifying specific key risk indicators (KRIs);
- KRIs are used to monitor the operational risk profile of the Group and of each business unit, and alert management of impending problems in a timely fashion;
- Internal loss information is collected, reported, and utilized to model operational risk; and,
- The ORMG reviews product and operating manuals, policies, procedures and circulars, thus allowing the embedding of desired operational risk management practices in all business units.

Operational Risk Management, as it relates to capital adequacy, is currently under Basic Indicator Approach (see Note 5.2).

The Group has also developed a Business Continuity Plan (BCP) based on several crisis severity levels which is tested at least annually and updated for any major changes in systems and procedures. Central to the Group's BCP is a disaster recovery plan to address the continued functioning of systems, recovery of critical data, and contingency processing requirements in the event of a disaster.

#### ***4.5.1 Reputation Risk***

Reputation risk is the risk to earnings or capital arising from negative public opinion. This affects the Group's ability to establish new relationships or services, or to continue servicing existing relationships. This risk can expose the Group to litigation, financial loss, or damage to its reputation. Reputation risk arises whenever technology-based banking products, services, delivery channels, or processes may generate adverse public opinion such that it seriously affects the Group's earnings or impairs its capital. This risk is present in activities such as asset management and regulatory compliance.

The Group adopted a reputation risk monitoring and reporting framework to manage public perception. Central to the said framework is the creation of the RCBC Public Relations Committee chaired by the head of the Parent Company's Public and Media Relations Division.

#### ***4.5.2 Legal Risk and Regulatory Risk Management***

Changes in laws and regulations and fiscal policies could adversely affect the Group's operations and financial reporting. In addition, the Group faces legal risks in enforcing its rights under its loan agreements, such as foreclosing of collateral. Legal risk is higher in new areas of business where the law remains untested by the courts. The Group uses a legal review process as the primary control mechanism for legal risk. Such a legal review aims to verify and validate the existence, genuineness and due execution of legal documents, and verify the capacity and authority of counterparties and customers to enter into transactions. In addition, the Group seeks to minimize its legal risk by using stringent legal documentation, imposing certain requirements designed to ensure that transactions are properly authorized, and consulting internal and external legal advisors.

Regulatory risk refers to the potential for the Group to suffer financial loss due to changes in the laws or monetary, tax or other governmental regulations of the country. The Group's Compliance Program, the design and implementation of which is overseen and coordinated by the Compliance Officer, is the primary control process for regulatory risk issues. The Compliance Office is committed to safeguard the integrity of the Group by maintaining a high level of regulatory compliance. It is responsible for communicating and disseminating new rules and regulations to all units, assessing and addressing identified compliance issues, performing periodic compliance testing on branches and head office units, and reporting compliance findings to the Audit Committee and the BOD.

#### ***4.6 Anti-Money Laundering Controls***

The AMLA or RA No. 9160 was passed in September 2001. It was subsequently amended by RA No. 9194, RA No. 10167, and RA No. 10365 in March 2003, June 2012 and February 2013, respectively. Together with the Terrorism Financing Prevention and Suppression Act (CFT) which was passed in June 2012 by virtue of RA No. 10168, these laws provide the regulatory framework for the Philippine Anti-Money Laundering and Terrorist Financing Prevention regulations.

Under the AMLA, as amended, the Group is required to submit Covered Transaction Reports (CTRs). CTRs involve single transactions in cash or other equivalent monetary instruments in excess of P0.5 within one banking day. The Group is also required to submit STRs to the AMLC in the event that there are reasonable grounds to believe that any amounts processed are the proceeds of money laundering or terrorist financing activities.

The AMLA requires the Group to safe keep, as long as the account exists, all the Know Your Customer (KYC) documents involving its clients, including official documents that establish and record their true and full identity. In addition, transactional documents are required to be maintained and stored for five years from the date of the transaction. In cases involving closed accounts, the KYC documents must be retained for five years after their closure. Meanwhile, all records of accounts with court cases must be preserved until resolved with finality.

On January 27, 2011, BSP Circular No. 706 (the Circular) was implemented superseding prior rules and regulations on AMLA. The Circular requires the Group to adopt a comprehensive and risk-based Money Laundering and Terrorist Financing Prevention Program (MLPP) designed according to the covered institution's corporate structure and risk profile. In compliance with the risk-based approach mandated by the Circular, the Group profiles its clients based on their level of risk, specifically, Low, Normal, or High. These risk levels have their corresponding level of due diligence, specifically, Reduced, Average or Enhanced. BSP Circular No. 706 was later amended by BSP Circular No. 950.

The Group's MLPP is revised annually to ensure that its KYC policies and guidelines are updated. Under the guidelines, each business unit is required to validate the true identity of a customer based on official or other reliable identifying documents or records prior to account opening. Decisions to enter into a business relationship with a high risk customer requires senior management approval, and in some cases such as a politically exposed person or a private individual holding a prominent position, a Group Head's approval is necessary.

The Group's Chief Compliance Officer, through the Anti-Money Laundering Division, monitors AML/CFT compliance by conducting regular compliance testing of the head office and business units. Results of its AML/CFT activities and compliance monitoring are regularly reported to the AMLCom, Senior Management Committee and the BOD to ensure that all AML/CFT matters are appropriately escalated.

In 2016, the Group instituted reforms aimed to reinforce its AML/CFT controls. The Group significantly lowered the thresholds for remittances, required more posting reviews during the day, and strengthened the process for escalation, fraud and unusual transactions. In addition, the Group has embarked on a re-engineering of its settlements and business center operations, and the consolidation and strengthening of its fraud management framework.

An essential aspect in the prevention of money laundering and terrorist financing is the training of Group's personnel. In the latter part of 2016 to the first quarter of 2017, the Group conducted a one-time bank-wide AML Certification training for all its employees with the aid of an external AML expert. Annual AML trainings, classroom and e-learning, are key features of the Group's regular training program.

In addition to the Group's existing transaction monitoring system, the Group has also subscribed to an international watchlist database in 2017 to further strengthen its screening capabilities for client on-boarding and cross-border transactions.

The Group continuously improved controls over Money Laundering risks and had implemented the necessary enhancements of the on-boarding procedures, risk profiling model, transaction processing and monitoring. Corresponding trainings were provided to equip personnel with the necessary skills to perform the enhanced procedures. On July 31, 2017, the AML Board Committee was created to meet on a monthly basis and provide oversight of AML related activities of the Bank.

## **5. CAPITAL MANAGEMENT**

### ***5.1 Regulatory Capital***

The Group's lead regulator, the BSP, sets and monitors the capital requirements of the Group.

In implementing the current capital requirements, the BSP requires the Group to maintain a prescribed ratio of qualifying regulatory capital to total risk-weighted assets including market risk and operational risk computed based on BSP-prescribed formula provided under its circulars.

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

The BSP has adopted the Basel III risk-based capital adequacy framework effective January 1, 2014, which requires the Group to maintain at all times the following:

- (a) Common Equity Tier 1 (CET1) of at least 6.0% 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 10.0% of risk-weighted assets; and,
- (d) Capital Conservation Buffer of 2.5% of risk weighted assets, comprised of CET1 Capital.

Under the relevant provisions of the current BSP regulations, the required minimum capitalization for the Parent Company, RSB, Rizal Microbank, RCBC Capital and RCBC LFC is P20,000, P2,000, P400, P300 and P300, respectively.

In computing for the capital adequacy ratio (CAR), the regulatory qualifying capital is analyzed into two tiers which are: (i) Tier 1 Capital comprised of CET1 and Additional Tier 1 (AT1) capital, and, (ii) Tier 2 Capital, defined as follows and are subject to deductions as defined in relevant regulations:

- (a) Common Equity Tier 1 Capital includes the following:
  - (i) paid-up common stock;
  - (ii) common stock dividends distributable;
  - (iii) additional paid-in capital;
  - (iv) deposit for common stock subscription;
  - (v) retained earnings;
  - (vi) undivided profits;
  - (vii) other comprehensive income from net unrealized gains or losses on financial assets at FVOCI and cumulative foreign currency translation; and,
  - (viii) minority interest in subsidiary banks which are less than wholly-owned, subject to regulatory conditions.
- (b) AT1 Capital includes:
  - (i) instruments that do not qualify as CET1, but meet the criteria set out in Annex B of BSP Circular 781;
  - (ii) financial liabilities meeting loss absorbency requirements set out in Annex E of BSP Circular 781;
  - (iii) financial liabilities bearing loss absorbency features at point of non-viability as set out in Annex F of BSP Circular 781;
  - (iv) additional paid-in capital resulting from issuance of AT1 capital;
  - (v) deposit for subscription to AT1 instruments; and,
  - (vi) minority interest in subsidiary banks which are less than wholly-owned, subject to regulatory conditions.



(c) Tier 2 Capital includes:

- (i) instruments issued that are not qualified as Tier 1 capital but meet the criteria set forth in Annex C of BSP Circular 781;
- (ii) financial liabilities bearing loss absorbency features at point of non-viability as set out in Annex F of BSP Circular 781;
- (iii) deposit for subscription of Tier 2 capital;
- (iv) appraisal increment reserve on bank premises, as authorized by the Monetary Board (MB);
- (v) general loan loss provisions; and,
- (vi) minority interest in subsidiary banks that are less than wholly-owned, subject to regulatory conditions.

In the calculation of Risk-based Capital Adequacy Ratio, the total Qualifying Capital is expressed as a percentage of Total Risk Weighted Assets based on book exposures, where Risk Weighted Assets is composed of Credit Risk, Market Risk and Operational Risk, net of specific provisions and exposures covered by credit risk mitigation (CRM).

Banking book exposures shall be risk-weighted based on third party credit assessment of the individual exposure given by eligible external credit institutions and the corresponding external credit assessment are mapped with the corresponding risk weights following the Standardized Credit Risk Weights table as provided under BSP Circular 538.

The Group's and Parent Company's regulatory capital position based on the Basel III risk-based capital adequacy framework as of December 31, 2017 and 2016 follows:

	<u>Group</u>	<u>Parent Company</u>
<b>2017:</b>		
Tier 1 Capital		
CET 1	<b>P 54,326</b>	<b>P 40,873</b>
AT1	<u>3</u>	<u>3</u>
	<b>54,329</b>	<b>40,876</b>
Tier 2 Capital	<u>13,115</u>	<u>12,456</u>
Total Qualifying Capital	<b><u>67,444</u></b>	<b><u>53,332</u></b>
Total Risk – Weighted Assets	<b><u>436,269</u></b>	<b><u>347,932</u></b>
Capital ratios:		
Total qualifying capital expressed as a percentage of total risk weighted assets	<b>15.46%</b>	<b>15.33%</b>
Tier 1 Capital Ratio	<b>12.45%</b>	<b>11.75%</b>
Total CET 1 Ratio	<b>12.45%</b>	<b>11.75%</b>

	<u>Group</u>	<u>Parent Company</u>
2016:		
Tier 1 Capital		
CET 1	P 49,842	P 37,659
AT1	<u>3</u>	<u>3</u>
	49,845	37,662
Tier 2 Capital	<u>12,622</u>	<u>12,048</u>
Total Qualifying Capital	<u>P 62,467</u>	<u>P 49,710</u>
Total Risk – Weighted Assets	<u>P 386,663</u>	<u>P 306,268</u>
Capital ratios:		
Total qualifying capital expressed as a percentage of total risk weighted assets	16.16%	16.23%
Tier 1 Capital Ratio	12.89%	12.30%
Total CET 1 Ratio	12.89%	12.30%

The foregoing capital ratios comply with the related BSP prescribed ratios.

## ***5.2 Internal Capital Adequacy Assessment and Pillar 2 Risk-Weighted Assets***

In January 2009, the BSP issued Circular No. 639 on the ICAAP and Supervisory Review Process covering universal and commercial banks on a group-wide basis. As a supplement to BSP Circular No. 538 on the Risk-Based Capital Adequacy Framework, ICAAP sets out the following principles:

- (a) Banks must have a process for assessing capital adequacy relative to their risk profile, operating environment, and strategic/business plans;
- (b) The Bank's ICAAP is the responsibility of the BOD, must be properly documented and approved and with policies and methodologies integrated into banking operations;
- (c) The Bank's ICAAP should address other material risks – Pillar 2 risks – in addition to those covered by Pillar 1, with risk measurement methodologies linked to the assessment of corresponding capital requirement both on a business-as-usual (BAU) and stressed scenario;
- (d) The minimum CAR prescribed by the BSP after accounting for Pillar 1 and other risks is retained at 10%; and,
- (e) The Bank's ICAAP document must be submitted to the BSP every January 31 of each year, beginning 2011.

The Group submitted its first ICAAP trial document in January 2009. Subsequent revisions to the trial document were made, and likewise submitted in February 2010 and May 2010 following regulatory review and the Group's own process enhancements. Complementing the ICAAP document submissions were dialogues between the BSP and the Group's representatives, the second of which transpired last November 2010 between a BSP panel chaired by the Deputy Governor for Supervision and Examination, and the members of the Parent Company's EXCOM. The Group submitted its final ICAAP document within the deadline set by the BSP. Henceforth up to 2014, the annual submission of an ICAAP document is due every January 31<sup>st</sup> and every March 31<sup>st</sup> starting in 2015, as prescribed by the BSP.

The Group identified the following Pillar 2 risks as material to its operations, and consequently set out methodologies to quantify the level of capital that it must hold.

- (a) *Credit Risk Concentration* – The Group has so far limited its analysis to credit risk concentration arising from the uneven sector distribution of the Group’s credit exposures. Aside from using a simplified application of the HHI, concentration is estimated using the Comprehensive Concentration Index (CCI). The capital charge is estimated by calculating the change in the Economic Capital (EC) requirement of the credit portfolio as an effect of credit deterioration in the largest industry exposure.
- (b) *Interest Rate Risk in the Banking Book (IRRBB)* – It is the current and prospective negative impact on earnings and capital arising from interest rate shifts. The Group estimates interest rate risk in the banking book as its NII-at-risk, and accordingly deducts the same from regulatory qualifying capital. Stressed IRRBB is calculated by applying the highest observed market volatilities over a determined timeframe.
- (c) *Liquidity Risk* – The Group estimates its liquidity risk under BAU scenario using standard gap analysis. Stressed liquidity risk on the other hand assumes a repeat of a historical liquidity stress, and estimates the impact if the Group were to partially defend its deposits and partially pay-off by drawing from its reserve of liquid assets.
- (d) *Information Technology Risk* – It is the current and prospective negative impact to earnings arising from failure of IT systems and realization of cyber security threats. The Group treats this risk as forming part of Operational Risk.
- (e) *Compliance Risk* – It is the current and prospective negative impact on earnings and capital arising from violation of laws, regulations, ethical standards, and the like. For Business-as-usual scenario, the Group estimates compliance risk charge from historical fines and penalties as the worst-case loss determined via a frequency-severity analysis of each penalty type. The resulting compliance risk charge calculation is likewise directly deducted from earnings.
- (f) *Strategic Business Risk* – It is the current and prospective negative impact on earnings and capital arising from adverse business decisions, improper implementation, and failure to respond to industry changes. The Group treats strategic business risk as a catch-all risk, and expresses its estimate as a cap on additional risk-weighted assets given other risks and the desired level of capital adequacy. The Group maintains that the assessment of strategic risk is embedded in the budget of the Group. Its capital impact therefore on a business-as-usual case is already expressed in the amount of risk projected to be taken on in the forecast years. However, the Group does recognize the need to set up processes that would enable to put a number to the risk incurred by going into specific strategies.
- (g) *Reputation Risk* – From the adoption of a theoretical measure, the Group amended its approach to reputation risk in 2011 by adopting instead a reputation risk monitoring and reporting process, run primarily by its Public Relations Committee. The measurement of reputation risk under stress is folded into the Group’s assessment of stressed liquidity risk.

## 6. CATEGORIES AND OFFSETTING OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

### 6.1 Carrying Amounts and Fair Values by Category

The following table summarizes the carrying amounts and corresponding fair values of those financial assets and financial liabilities presented in the statements of financial position.

	<b>Group</b>			
	<b>2017</b>		<b>2016</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Carrying Amount</b>	<b>Fair Value</b>
<b><i>Financial Assets</i></b>				
At amortized cost:				
Cash and cash equivalents	P 103,181	P 103,181	P 115,393	P 115,393
Investment securities	59,978	56,396	51,864	49,698
Loans and receivables - net	354,205	354,205	305,652	305,652
Other resources	1,138	1,138	873	873
	<u>518,502</u>	<u>514,920</u>	473,782	471,616
At FVPL	7,591	7,591	18,079	18,079
At FVOCI	<u>5,363</u>	<u>5,363</u>	<u>5,679</u>	<u>5,679</u>
	<u><b>P 531,456</b></u>	<u><b>P 527,874</b></u>	<u><b>P 497,540</b></u>	<u><b>P 495,374</b></u>
<b><i>Financial Liabilities</i></b>				
At amortized cost:				
Deposit liabilities	P 388,412	P 388,412	P 353,077	P 353,077
Bills payable	43,967	43,967	37,643	37,643
Bonds payable	28,060	29,465	41,595	44,175
Subordinated debt	9,968	15,178	9,952	20,570
Accrued interest and other expenses	3,929	3,929	4,584	4,584
Other liabilities	<u>11,233</u>	<u>11,233</u>	<u>8,883</u>	<u>8,883</u>
	485,569	492,184	455,734	468,932
Derivative financial liabilities	<u>483</u>	<u>483</u>	<u>385</u>	<u>385</u>
	<u><b>P 486,052</b></u>	<u><b>P 492,667</b></u>	<u><b>P 456,119</b></u>	<u><b>P 462,317</b></u>
<b>Parent Company</b>				
	<b>2017</b>		<b>2016</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Carrying Amount</b>	<b>Fair Value</b>
<b><i>Financial Assets</i></b>				
At amortized cost				
Cash and cash equivalents	P 83,442	P 83,442	P 91,426	P 91,426
Investment securities	48,141	47,784	44,842	43,931
Loans and receivables - net	265,753	265,753	227,917	227,917
Other resources	179	179	466	466
	<u>397,515</u>	<u>397,158</u>	364,651	363,740
At FVPL	6,553	6,553	17,075	17,075
At FVOCI	<u>3,439</u>	<u>3,439</u>	<u>3,735</u>	<u>3,735</u>
	<u><b>P 407,507</b></u>	<u><b>P 407,150</b></u>	<u><b>P 385,461</b></u>	<u><b>P 384,550</b></u>

	<b>Parent Company</b>			
	<b>2017</b>		<b>2016</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Carrying Amount</b>	<b>Fair Value</b>
<b><i>Financial Liabilities</i></b>				
At amortized cost:				
Deposit liabilities	P 288,667	P 288,667	P 260,165	P 260,165
Bills payable	36,600	36,600	31,712	31,712
Bonds payable	28,060	29,465	41,595	44,175
Subordinated debt	9,968	15,178	9,952	20,570
Accrued interest and other expenses	3,009	3,009	3,515	3,515
Other liabilities	<u>6,256</u>	<u>6,256</u>	<u>6,094</u>	<u>6,094</u>
	<b>372,560</b>	<b>379,175</b>	<b>353,033</b>	<b>366,231</b>
Derivative financial liabilities	<u>483</u>	<u>483</u>	<u>385</u>	<u>385</u>
	<b><u>P 373,043</u></b>	<b><u>P 379,658</u></b>	<b><u>P 353,418</u></b>	<b><u>P 366,616</u></b>

Except for investment securities at amortized cost, bonds payable and subordinated debt with fair value disclosed different from their carrying amounts, management considers that the carrying amounts of other financial assets and financial liabilities presented above which are measured at amortized cost, approximate the fair values either because those instruments are short-term in nature or the effect of discounting for those with maturities of more than one year is not material. The fair value information disclosed for the Group's and Parent Company's investment securities at amortized cost and other financial assets and liabilities measured at fair value on a recurring basis are determined based on the procedures and methodologies discussed in Note 7.2.

## 6.2 Offsetting Financial Assets and Financial Liabilities

The following financial assets presented in the statements of financial position at gross amounts are covered by enforceable master netting arrangements and similar arrangements:

	Notes	<b>Group</b>				
		<b>Gross amounts recognized in the statements of financial position</b>	<b>Related amounts not set off in the statements of financial position</b>			<b>Net amount</b>
			<b>Financial instruments</b>	<b>Cash received</b>		
<b><u>December 31, 2017</u></b>						
Loans and receivables – Receivable from customers	11	P 352,845	( P 15,799 )	P -	P 337,046	
Trading and investment securities – Investment securities at amortized cost	10	72,932	( 5,686 )	-	67,246	
Other resources – Margin deposits	15	23	-	( 23 )	-	
<b><u>December 31, 2016</u></b>						
Loans and receivables – Receivable from customers	11	P 305,659	( P 16,379 )	P -	P 289,280	
Trading and investment securities – Investment securities at amortized cost	10	75,622	( 6,859 )	-	68,763	
Other resources – Margin deposits	15	20	-	( 20 )	-	

<b>Parent Company</b>									
<u>Notes</u>			<u>Gross amounts recognized in the statements of financial position</u>	<u>Related amounts not set off in the statements of financial position</u>				<u>Net amount</u>	
				<u>Financial instruments</u>	<u>Cash received</u>				
<b>December 31, 2017</b>									
	Loans and receivables –								
	Receivable from customers	11	P 264,631	(P 14,380)	P -		P 250,251		
	Trading and investment securities – Investment securities at amortized cost	10	58,133	( 5,686)	-		52,447		
	Other resources – Margin deposits	15	23	-	( 23)		-		
<b>December 31, 2016</b>									
	Loans and receivables –								
	Receivable from customers	11	P 227,724	(P 15,925)	P -		P 211,799		
	Trading and investment securities – Investment securities at amortized cost	10	65,133	( 6,859)	-		58,274		
	Other resources – Margin deposits	15	20	-	( 20)		-		

The following financial liabilities presented in the statements of financial position at gross amounts are covered by enforceable master netting arrangements and similar agreements:

<b>Group</b>									
<u>Notes</u>			<u>Gross amounts recognized in the statements of financial position</u>	<u>Related amounts not set off in the statements of financial position</u>				<u>Net amount</u>	
				<u>Financial instruments</u>	<u>Cash received</u>				
<b>December 31, 2017</b>									
	Deposit liabilities	17	P 388,412	(P 15,799)	P -		P 372,613		
	Bills payable	18	43,967	( 5,686)	-		38,281		
	Other liabilities – Derivative financial liabilities	22	483	-	( 23)		460		
<b>December 31, 2016</b>									
	Deposit liabilities	17	P 353,077	(P 16,379)	P -		P 336,698		
	Bills payable	18	43,967	( 6,859)	-		37,108		
	Other liabilities – Derivative financial liabilities	22	385	-	( 20)		365		
<b>Parent Company</b>									
<u>Notes</u>			<u>Gross amounts recognized in the statements of financial position</u>	<u>Related amounts not set off in the statements of financial position</u>				<u>Net amount</u>	
				<u>Financial instruments</u>	<u>Cash received</u>				
<b>December 31, 2017</b>									
	Deposit liabilities	17	P 288,667	(P 14,380)	P -		P 274,287		
	Bills payable	18	43,967	( 5,686)	-		38,281		
	Other liabilities – Derivative financial liabilities	22	483	-	( 23)		460		
<b>December 31, 2016</b>									
	Deposit liabilities	17	P 260,165	(P 15,925)	P -		P 244,240		
	Bills payable	18	43,967	( 6,859)	-		37,108		
	Other liabilities – Derivative financial liabilities	22	385	-	( 20)		365		