



Independent Auditor's Report

To the Board of Directors and Shareholder of
BPI Direct Savings Bank, Inc.
6th Floor, BPI Direct Bank Center
Paseo de Roxas corner Dela Rosa Sts.
Makati City

Report on the Financial Statements

We have audited the accompanying financial statements of BPI Direct Savings Bank, Inc., which comprise the statements of condition as at December 31, 2010 and 2009, and the statements of income, statements of total comprehensive income, statements of changes in capital funds and statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Isla Lipana & Co., 29th Floor, Philamlife Tower, 8767 Paseo de Roxas, 1226 Makati City, Philippines
T: +63 (2) 845 2728, F: +63 (2) 845 2806, www.pwc.com/ph



Isla Lipana & Co.

Independent Auditor's Report
To the Board of Directors and Shareholder of
BPI Direct Savings Bank, Inc.
Page 2

Opinion

In our opinion, the accompanying financial statements present fairly, in all materials respects, the financial position of BPI Direct Savings Bank, Inc. as at December 31, 2010 and 2009, and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards.

Report on Bureau of Internal Revenue Requirement

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information on taxes and licenses in Note 25 to the financial statements is presented for purposes of filing with the Bureau of Internal Revenue and is not a required part of the basic financial statements. Such supplementary information is the responsibility of management and has been subjected to the auditing procedures applied in our audit of the basic financial statements. In our opinion, the supplementary information is fairly stated in all material respects in relation to the basic financial statements taken as whole.

Isla Lipana & Co.

A handwritten signature in black ink that reads "John-John Patrick V. Lim".

John-John Patrick V. Lim
Partner

CPA Cert. No. 83389

P.T.R. No. 0007706, issued on January 4, 2011, Makati City

SEC A.N. (individual) as general auditors 0050-AR-2

SEC A.N. (firm) as general auditors 0009-FR-2

TIN 112-071-386

BIR A.N. 08-000745-17-2010, issued on May 31, 2010; effective until May 30, 2013

BOA/PRC Reg. No. 0142, effective until December 31, 2013

Makati City
March 23, 2011

BPI Direct Savings Bank, Inc.

Financial Statements

As at and for the years ended December 31, 2010 and 2009

BPI Direct Savings Bank, Inc.

Statements of Condition
December 31, 2010 and 2009
(All amounts in Philippine Peso)

	Notes	2010	2009
<u>RESOURCES</u>			
DUE FROM OTHER BANKS	5	284,336,207	75,907,813
INTERBANK CALL LOANS RECEIVABLE	5	-	174,058,000
DUE FROM BANGKO SENTRAL NG PILIPINAS	5, 6	2,511,710,901	2,730,826,295
AVAILABLE-FOR-SALE SECURITIES, net	7	27,544	28,468
HELD-TO-MATURITY SECURITIES	8	457,621,944	564,838,467
LOANS AND ADVANCES, net	9	2,585,096,237	793,148,171
ASSETS HELD FOR SALE		8,878,286	3,962,866
INVESTMENT PROPERTY, net	10	-	3,776,852
BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT, net	11	2,874,394	1,959,581
DEFERRED INCOME TAX ASSETS, net	12	20,655,092	11,358,172
OTHER RESOURCES	13	35,693,407	17,014,524
Total resources		5,906,894,012	4,376,879,209
<u>LIABILITIES AND CAPITAL FUNDS</u>			
DEPOSIT LIABILITIES	14	5,242,444,762	3,774,180,771
ACCRUED TAXES, INTEREST AND OTHER EXPENSES	15	14,348,983	17,539,387
OTHER LIABILITIES	16	23,521,460	9,684,318
Total liabilities		5,280,315,205	3,801,404,476
CAPITAL FUNDS	17		
Share capital		374,533,300	374,533,300
Stock option reserve		-	601,420
Surplus		252,021,963	200,315,545
Accumulated other comprehensive income		23,544	24,468
Total capital funds		626,578,807	575,474,733
Total liabilities and capital funds		5,906,894,012	4,376,879,209

(The notes on pages 1 to 41 are an integral part of these financial statements.)

BPI Direct Savings Bank, Inc.

Statements of Income
For the years ended December 31, 2010 and 2009
(All amounts in Philippine Peso)

	Notes	2010	2009
INTEREST INCOME			
Loans and advances	9	139,884,519	74,684,734
Deposits with banks	5,6	106,028,325	88,840,111
Held-to-maturity securities	8	35,213,053	36,144,244
Interbank call loans receivable	5	7,298,361	8,836,153
Gross receipts tax		(14,418,963)	(10,425,258)
		274,005,295	198,079,984
INTEREST EXPENSE ON DEPOSITS	14	75,175,152	59,969,361
NET INTEREST INCOME		198,830,143	138,110,623
PROVISION FOR IMPAIRMENT	9	(15,872,937)	(7,568,685)
NET INTEREST INCOME AFTER PROVISION FOR IMPAIRMENT		182,957,206	130,541,938
OTHER INCOME (CHARGES)			
Profit on assets sold		355,193	-
Miscellaneous income	19	29,438,600	14,714,080
Gross receipts tax		(2,086,854)	(1,320,127)
		27,706,939	13,393,953
OTHER EXPENSES			
Compensation and fringe benefits	21,22	44,015,933	29,865,695
Occupancy and equipment-related expenses	10,11	8,427,186	4,839,914
Other operating expenses	22	84,728,343	50,193,370
		137,171,462	84,898,979
INCOME BEFORE PROVISION FOR INCOME TAX		73,492,683	59,036,912
PROVISION FOR INCOME TAX	20		
Current		29,170,721	26,796,071
Deferred	12	(7,234,709)	(8,730,934)
		21,936,012	18,065,137
NET INCOME FOR THE YEAR		51,556,671	40,971,775

(The notes on pages 1 to 41 are an integral part of these financial statements.)

BPI Direct Savings Bank, Inc.

Statements of Total Comprehensive Income
For the years ended December 31, 2010 and 2009
(All amounts in Philippine Peso)

	Note	2010	2009
NET INCOME FOR THE YEAR		51,556,671	40,971,775
OTHER COMPREHENSIVE (LOSS) INCOME			
Net change in fair value reserve on available-for-sale securities	17	(924)	7,070
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		51,555,747	40,978,845

(The notes on pages 1 to 41 are an integral part of these financial statements.)

BPI Direct Savings Bank, Inc.

Statements of Changes in Capital Funds
For the years ended December 31, 2010 and 2009
(All amounts in Philippine Peso)

	Share capital (Note 17)	Stock option reserve (Note 17)	Surplus (Note 17)	Accumulated other comprehensive income	Total
Balance, January 1, 2009	374,533,300	601,420	159,343,770	17,398	534,495,888
Comprehensive income					
Net income for the year	-	-	40,971,775	-	40,971,775
Other comprehensive income					
Net change in fair value reserve on available-for-sale securities	-	-	-	7,070	7,070
Total comprehensive income for the year	-	-	40,971,775	7,070	40,978,845
Balance, December 31, 2009	374,533,300	601,420	200,315,545	24,468	575,474,733
Comprehensive income					
Net income for the year	-	-	51,556,671	-	51,556,671
Other comprehensive income					
Net change in fair value reserve on available-for-sale securities	-	-	-	(924)	(924)
Total comprehensive income for the year	-	-	51,556,671	(924)	51,555,747
Transaction with owners					
Employee stock option plan					
Exercise of options	-	(451,673)	-	-	(451,673)
Transfer of unexercised stock options	-	(149,747)	149,747	-	-
Total transaction with owners	-	(601,420)	149,747	-	(451,673)
Balance, December 31, 2010	374,533,300	-	252,021,963	23,544	626,578,807

(The notes on pages 1 to 41 are an integral part of these financial statements.)

BPI Direct Savings Bank, Inc.

Statements of Cash Flows
For the years ended December 31, 2010 and 2009
(All amounts in Philippine Peso)

	Notes	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax		73,492,683	59,036,912
Adjustments for:			
Provision for impairment	9	15,872,937	7,568,685
Depreciation and amortization	10,11	2,105,574	1,531,507
Share-based compensation		(451,673)	-
Interest income		(288,424,258)	(208,505,242)
Interest expense		75,175,152	59,969,361
Interest received on loans and advances and bank deposits		247,564,325	172,798,184
Interest paid		(75,113,222)	(59,463,152)
Operating income before changes in operating assets and liabilities		50,221,518	32,936,255
Changes in operating assets and liabilities			
(Increase) decrease in:			
Due from Bangko Sentral ng Pilipinas	5,6	(17,000,000)	(34,000,000)
Loans and advances	9	(1,800,835,978)	(154,801,448)
Other resources	13	(20,017,028)	7,730,956
Assets held for sale		(4,915,420)	-
Investment properties	10	3,666,778	
Increase (decrease) in:			
Deposit liabilities	14	1,468,263,991	1,611,402,132
Accrued taxes, interest and other expenses	15	(1,064,499)	2,158,691
Other liabilities	16	13,837,141	(260,516,901)
Net cash (absorbed by) generated from operations		(307,843,497)	1,204,909,685
Income tax paid		(33,420,764)	(27,234,538)
Net cash (used in) from operating activities		(341,264,261)	1,177,675,147
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of:			
Held-to-maturity securities	8	(60,907,283)	-
Maturities/disposal of:			
Available-for-sale securities	7	-	-
Held-to-maturity securities	8	167,543,945	113,821,394
Interest received on:			
Available-for-sale securities		-	-
Held-to-maturity securities		35,792,914	32,212,605
Additions to bank premises, furniture, fixtures and equipment	11	(2,910,314)	(1,367,767)
Proceeds from disposal of bank premises, furniture, fixtures and equipment		-	-
Net cash from investing activities		139,519,262	144,666,232
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS		(201,744,999)	1,322,341,379
CASH AND CASH EQUIVALENTS			
January 1		2,902,792,107	1,580,450,728
December 31	5	2,701,047,108	2,902,792,107

(The notes on pages 1 to 41 are an integral part of these financial statements.)

BPI Direct Savings Bank, Inc.

Notes to Financial Statements

As at and for the years ended December 31, 2010 and 2009

(In the Notes, all amounts are shown in Philippine Peso unless otherwise stated)

Note 1 - General information

BPI Direct Savings Bank, Inc. (the "Bank") was incorporated in the Philippines and registered with the Securities and Exchange Commission (SEC) on September 26, 1986 primarily to engage in and carry on the general business of savings and mortgage banking.

The Bank, with principal place of business at the 8th Floor, BPI Card Center, Paseo de Roxas, Makati City, is a wholly-owned subsidiary of Bank of the Philippine Islands (BPI or the "Parent Bank"), a domestic commercial bank with an expanded banking license, which is also its ultimate parent.

The Bank has 66 and 63 regular employees as at December 31, 2010 and 2009, respectively.

These financial statements have been approved and authorized for issuance by the Board of Directors on March 23, 2011.

Note 2 - Summary of significant accounting policies

The principal accounting policies applied in the preparation of the Company's financial statements are set out below. These policies have been consistently applied to both years presented, unless otherwise stated.

2.1 Basis of preparation

The financial statements of the Bank have been prepared in accordance with Philippine Financial Reporting Standards (PFRS). The term PFRS in general includes all applicable PFRS, Philippine Accounting Standards (PAS), Philippine Interpretations Committee (PIC)/Standing Interpretations Committee (SIC)/International Financial Reporting Interpretations Committee (IFRIC) interpretations which have been approved by the Financial Reporting Standards Council (FRSC) and adopted by the SEC.

The financial statements of the Bank have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale securities.

The preparation of these financial statements in conformity with PFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 4.

(a) *Amendments and interpretation to existing standards that are effective for periods beginning January 1, 2010 and have been adopted by the Bank*

- *PFRS 2 (Amendment), Group Cash-settled Share-based Payment Transactions* (effective from January 1, 2010). In addition to incorporating Philippine Interpretation IFRIC 8, Scope of PFRS 2, and Philippine Interpretation IFRIC 11, PFRS 2 - Group and Treasury Share Transactions, the amendments expand on the guidance in Philippine Interpretation IFRIC 11 to address the classification of group arrangements that were not covered by that interpretation. The Bank adopted PFRS 2 (Amendment) from January 1, 2010 but has no material impact on the Bank's financial statements.
- *PFRS 3 (Revised), Business Combinations, and consequential amendments to PAS 27, Consolidated and Separate Financial Statements, PAS 28, Investments in Associates, and PAS 31, Interests in Joint Ventures.* These amendments are effective prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after July 1, 2009. The revised standard continues to apply the acquisition method to business combinations but with some significant changes compared with PFRS 3. For example, all payments to purchase a business are recorded at fair value at the acquisition date, with contingent payments classified as debt and subsequently re-measured through the statements of total comprehensive income. There is a choice on an acquisition-by-acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs are expensed. The Bank adopted the revised PFRS 3 and the consequential amendments to PAS 27, PAS 28 and PAS 31 from January 1, 2010 but has no material impact on the Bank's financial statements.
- *Philippine Interpretation IFRIC 17, Distribution of Non-cash Assets to Owners* (effective from July 1, 2009). This interpretation addresses accounting by an entity that makes a non-cash asset distribution to owners. An entity shall measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. If an entity gives its owner a choice of receiving either a non-cash asset or a cash alternative, the entity shall estimate the dividend payable by considering both the fair value of each alternative and the associated probability of owners selecting each alternative. At the end of each reporting period and at the date of settlement, the entity shall review and adjust the carrying amount of the dividend payable, with any changes in the carrying amount of the dividend payable recognized in capital funds as adjustment to the amount of the distribution. The Bank has adopted Philippine Interpretation IFRIC 17 from January 1, 2010 but has no material impact on the Bank's financial statements.

(b) *Standard and interpretations to existing standards effective January 1, 2010 that are not relevant to the Bank's operations*

- *PFRS 8, Operating Segments* (effective from January 1, 2010).
- *Philippine Interpretation IFRIC 9, Reassessment of Embedded Derivatives* (effective from July 1, 2009)
- *Philippine Interpretation IFRIC 16, Hedges of a Net Investment in a Foreign Operation* (effective from July 1, 2009)
- *Philippine Interpretation IFRIC 18, Transfers of Assets from Customers* (effective from July 1, 2009)

(c) *Amendments to PFRS which contain amendments that result in changes in accounting, presentation, recognition and measurement that are relevant to the Bank's financial statements*

The following are the relevant amendments to PFRS which contains amendments that result in changes in accounting, presentation, recognition and measurement. It also includes amendments that are terminology or editorial changes only which have either minimal or no effect on accounting (effective from January 1, 2010). These amendments are part of the IASB's annual improvements project published in April 2009.

- *PAS 1, Presentation of Financial Statements* (effective from January 1, 2010). The amendment clarifies that the classification of potential settlement of a liability by issuing an equity is not relevant to its classification as current or non-current. The definition of current liability is amended which permits a liability to be classified as non-current (provided that the entity has an unconditional right to defer settlement by transfer of cash or other assets for at least 12 months after the accounting period) notwithstanding the fact that the entity could be required by the counterparty to settle in shares at any time. The Bank has adopted PAS 1 (Amendment) from January 1, 2010 but has no material impact on the Bank's financial statements.
- *PAS 7, Statement of Cash Flows* (effective from January 1, 2010). This amendment requires that only expenditures that result in a recognized asset in the statement of financial position can be classified as investing activities. The Bank has adopted PAS 7 (Amendment) from January 1, 2010 but has no material impact on the Bank's financial statements.
- *PAS 17, Leases* (effective from January 1, 2010). This amendment deleted the specific guidance regarding the classification of leases of land as operating lease. It also eliminates the inconsistency with the general guidance on lease classification. As a result, leases of land should be classified as either finance or operating using the general principles of PAS 17. The Bank has adopted PAS 17 (Amendment) from January 1, 2010 but has no material impact on the Bank's financial statements.
- *PAS 36 (Amendment), Impairment of Assets* (effective from January 1, 2010). This amendment clarifies that the largest cash-generating unit (or group of units) to which goodwill should be allocated for purposes of impairment testing is an operating segment as defined in PFRS 8, Operating Segments. The Bank has adopted PAS 36 (Amendment) from January 1, 2010 but has no material impact on the Bank's financial statements.
- *PAS 39, Financial Instruments: Recognition and Measurement* (effective from January 1, 2010). The following are the amendments:
 - Clarifies that prepayment options, the exercise price of which compensates the lender for loss of interest by reducing the economic loss from reinvestment risk, should be considered closely related to the host debt contract;
 - Amended the scope exemption in PAS 39, Financial Instruments: Recognition and Measurement to clarify that:
 1. it only applies to binding (forward) contracts between an acquirer and a vendor in a business combination to buy an acquiree at a future date;
 2. the term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction; and

3. the exemption should not be applied to option contracts (whether or not currently exercisable) that on exercise will result in control of an entity, nor by analogy to investments in associates and similar transactions.
 - Amendment to clarify when to recognize gains or losses on hedging instruments as a reclassification adjustment in a cash flow hedge of a forecast transaction that results subsequently in the recognition of a financial instrument. The amendment clarifies that gains or losses should be reclassified from equity to profit or loss in the period in which the hedged forecast cash flow affects profit or loss.
 - Amendment to clarify that entities should no longer use hedge accounting for transactions between segments in their separate financial statements.

The Bank has adopted PAS 39 (Amendment) from January 1, 2010 but has no material impact on the Bank's financial statements.

- *PFRS 2, Share-based Payment (Amendment)* (effective from July 1, 2010). The amendment clarifies that in addition to business combinations as defined by PFRS 3, Business Combination, contributions of a business on formation of a joint venture and common control transactions are excluded from the scope of PFRS 2, Share-based Payment. The Bank has adopted PFRS 2 (Amendment) from January 1, 2010 but has no material impact on the Bank's financial statements.
- *PFRS 5 (Amendment), Non-current Assets Held for Sale and Discontinued Operations* (effective from January 1, 2010). This amendment clarifies the disclosures required in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Disclosures in other PFRS do not apply to such assets (disposal groups) unless:
 - Those PFRS require disclosure in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations; or
 - The disclosure relates to the measurement of assets or liabilities within a disposal group that are outside the scope of PFRS 5, measurement requirements and the information is not disclosed elsewhere in the financial statements.

The Bank has adopted PFRS 5 (Amendment) from January 1, 2010 but has no material impact on the Bank's financial statements.

- (d) *Standard, and amendments and interpretations to existing standards that are not yet effective and not early adopted by the Bank*
- *PAS 24 (Revised), Related Party Disclosures* (effective from January 1, 2011). The revised standard clarifies and simplifies the definition of a related party and removes the requirement for government-related entities to disclose details of all transactions with the government and other government-related entities. The Bank will apply PAS 24 (Revised) from January 1, 2011 but is not expected to have a significant impact on the Bank's financial statements.

- *PFRS 9, Financial Instruments* (effective from January 1, 2013). This standard is the first step in the process to replace PAS 39, Financial Instruments: Recognition and Measurement. PFRS 9 introduces new requirements for classifying and measuring financial assets and is likely to affect the Bank's accounting for its financial assets. Initial indications are that it may affect the Bank's accounting for its debt available-for-sale financial assets, as PFRS 9 only permits the recognition of fair value gains and losses in other comprehensive income if they relate to equity investments that are not held for trading. Fair value gains and losses on available-for-sale debt investments, for example, will therefore have to be recognized directly in profit or loss. The Bank will adopt PFRS 9 effective January 1, 2013 but is not expected to have a significant impact on the financial statements of the Bank since currently financial assets classified as available-for-sale are not significant.

Additions to PFRS 9 were issued late in 2010 and adopted locally in early 2011. The new requirements address the problem of volatility in profit or loss arising from an issuer choosing to measure its own debt at fair value. With the new requirements, an entity choosing to measure a liability at fair value will present the portion of the change in fair value due to changes in the entity's own credit risk in other comprehensive income rather than in profit or loss. This new requirement is not expected to have a significant impact on the Bank's financial statements as there are currently no debts carried at fair value.

- *Philippine Interpretation IFRIC 14, PAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (Amendment)* (effective from January 1, 2011). The amendment corrects an unintended consequence of Philippine Interpretation IFRIC 14. Without the amendments, entities are not permitted to recognize as an asset some voluntary prepayments for minimum funding contributions. This was not intended when Philippine Interpretation IFRIC 14 was issued, and the amendment corrects this. The amendment should be applied retrospectively to the earliest comparative period presented. The Bank will apply Philippine Interpretation IFRIC 14 on January 1, 2011 but is not expected to have a significant impact on the Bank's financial statements.
- *Philippine Interpretation IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments* (effective from July 1, 2010). The interpretation clarifies the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability (debt for equity swap). It requires a gain or loss to be recognized in profit or loss, which is measured as the difference between the carrying amount of the financial liability and the fair value of the equity instruments issued. If the fair value of the equity instruments issued cannot be reliably measured, the equity instruments should be measured to reflect the fair value of the financial liability extinguished. The Bank will apply Philippine Interpretation IFRIC 19 effective on January 1, 2011 but is not expected to have a significant impact on the Bank's financial statements.

(e) *2010 Improvements to PFRS*

The following are the relevant amendments to PFRS which contains amendments that result in changes in accounting, presentation, recognition and measurement. It also includes amendments that are terminology or editorial changes only which have either minimal or no effect on accounting (effective from January 1, 2011). These amendments are part of the IASB's annual improvements project published in August 2009.

- *PAS 1, Presentation of Financial Statements* (effective January 1, 2011).
- *PAS 27, Consolidated and Separate Financial Statements* (effective from July 1, 2010)
- *PAS 34, Interim Financial Reporting* (effective from January 1, 2011)
- *PFRS 1 (Revised), First-time Adoption of Philippine Financial Reporting Standards* (effective from January 1, 2011)
- *PFRS 3, Business Combinations* (effective from July 1, 2010)
- *PFRS 7, Financial Instruments: Disclosures* (effective from January 1, 2011)
- *Philippine Interpretation IFRC 13, Customer Loyalty Program* (effective from January 1, 2011)

2.2 Cash and cash equivalents

Cash and cash equivalents consist of Due from Other Banks, Bangko Sentral ng Pilipinas (BSP) and Interbank Call Loans Receivable with maturities of less than three months from the date of acquisition and that are subject to insignificant risk of changes in value.

2.3 Financial assets

2.3.1 Classification

The Bank classifies its financial assets in the following categories: fair value through profit or loss, loans and receivables, held-to-maturity securities, and available-for-sale securities. Management determines the classification of its investments at initial recognition, depending on the purpose for which the financial assets were acquired. As of December 31, 2010 and 2009, the Bank has no financial assets classified at fair value through profit or loss.

(a) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and with no intention of trading. Significant accounts falling under this category are Loans and advances, Due from BSP, Due from other banks, Interbank call loans receivable, and accrued interest receivable and accounts receivable under Other resources.

(b) Held-to-maturity securities

Held-to-maturity securities are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. If the Bank were to sell other than an insignificant amount of held-to-maturity assets, the entire category would be reclassified as available-for-sale. Held-to-maturity securities are classified as such in the statement of condition.

(c) Available-for-sale securities

Available-for-sale securities are non-derivatives that are either designated in this category or not classified in any of the other categories. Available-for-sale securities are classified as such in the statement of condition.

2.3.2 Recognition and measurement

Regular-way purchases and sales of held-to-maturity securities and available-for-sale securities are recognized on trade-date, the date on which the Bank commits to purchase or sell the asset. Loans and receivables are recognized when cash is advanced to the borrowers. Financial assets are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss.

Available-for-sale securities are subsequently carried at fair value. Loans and receivables and held-to-maturity securities are subsequently carried at amortized cost using the effective interest method. Gains and losses arising from changes in the fair value of available-for-sale securities are recognized directly in the statement of changes in capital funds, until the financial asset is derecognized or impaired at which time the cumulative gain or loss previously recognized equity should be recognized in the statement of income. However, interest calculated on these securities using the effective interest method and foreign currency gains and losses on monetary assets classified as available-for-sale are recognized in the statement of income. Dividends on equity instruments are recognized in the statement of income when the Bank's right to receive payment is established.

2.3.3 Reclassification

The Bank may choose to reclassify financial assets that would meet the definition of loans and receivables out of the available-for-sale category if the Bank has the intention and ability to hold these financial assets for the foreseeable future or until maturity at the date of reclassification.

Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortized cost as applicable, and no reversals of fair value gains or losses recorded before reclassification date are subsequently made. Effective interest rates for financial assets reclassified to loans and receivables and held-to-maturity categories are determined at the reclassification date. Further increases in estimates of cash flows adjust effective interest rates prospectively.

2.3.4 Derecognition

A financial asset is derecognized when the contractual right to receive the cash flows from the asset has ceased to exist or the asset has been transferred and substantially all the risks and rewards of ownership of the asset are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition).

2.3.5 Impairment

(a) Assets carried at amortized cost

The Bank assesses at each balance sheet date 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 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 asset or group of financial assets that can be reliably estimated.

The criteria that the Bank uses to determine that there is objective evidence of impairment include:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower;
- Breach of loan covenants or conditions;
- Initiation of bankruptcy proceedings;
- Deterioration of the borrower's competitive position; and
- Deterioration in the value of collateral.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Financial assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

The amount of impairment loss is measured as the difference between the financial asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate (recoverable amount). The calculation of recoverable amount of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs of obtaining and selling the collateral, whether or not foreclosure is probable. Impairment loss is recognized in the statement of income and the carrying amount of the asset is reduced through the use of an allowance.

For purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e., on the basis of the Bank'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 Bank and historical loss experience for assets with credit risk characteristics similar to those in the Bank. 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 currently exist. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined.

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 income as a reduction of impairment losses for the year.

(b) Assets classified as available-for-sale

The Bank assesses at each balance sheet date whether there is evidence that a debt security classified as available-for-sale is impaired. For an equity security classified as available-for-sale, a significant or prolonged decline in the fair value below cost is considered in determining whether the securities are impaired. The cumulative loss (difference between the acquisition cost and the current fair value) is removed from capital funds and recognized in the statement of income when the asset is determined to be impaired. If in a subsequent period, the fair value of a debt instrument previously impaired increases and the increase can be objectively related to an event occurring after the impairment loss was recognized, the impairment loss is reversed through the statement of income. Reversal of impairment losses recognized previously on equity instruments is made directly to capital funds.

(c) Renegotiated loans

Loans that are either subject to collective impairment assessment or individually significant and whose terms have been renegotiated are no longer considered to be past due but are treated as new loans.

2.4 Financial liabilities

The Bank classifies its financial liabilities in the following categories: financial liabilities at fair value through profit or loss, and financial liabilities at amortized cost.

(a) Financial liabilities at fair value through profit or loss

This category comprises two sub-categories: financial liabilities classified as held for trading, and financial liabilities designated by the Bank as at fair value through profit or loss upon initial recognition.

A financial liability is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also categorized as held for trading unless they are designated and effective as hedging instruments. The Bank has no financial liabilities that are designated at fair value through profit loss.

(b) Other liabilities measured at amortized cost

Financial liabilities that are not classified as at fair value through profit or loss fall into this category and are measured at amortized cost. Financial liabilities measured at amortized cost include Deposits from customers and banks, Accrued interest and other expenses, and Other liabilities, primarily certain accounts payable.

Financial liabilities are derecognized when they have been redeemed or otherwise extinguished.

2.5 Determination of fair values of financial instruments

For financial instruments traded in active markets, the determination of fair values of financial assets and financial liabilities is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes mainly from Bloomberg.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indications that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs (for example, LIBOR yield curve, FX rates, volatilities and counterparty spreads) existing at reporting dates. The Bank uses widely recognized valuation models for determining fair values of non-standardized financial instruments of lower complexity, such as options or interest rate and currency swaps. For these financial instruments, inputs into models are generally market observable.

In cases when the fair value of unlisted equity instruments cannot be determined reliably, the instruments are carried at cost less impairment. The fair value for loans and advances as well as liabilities to banks and customers are determined using a present value model on the basis of contractually agreed cash flows, taking into account credit quality, liquidity and costs. The fair values of contingent liabilities and irrevocable loan commitments correspond to their carrying amounts.

2.6 Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of condition 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.

2.7 Bank premises, furniture, fixtures and equipment

Bank premises, furniture, fixtures and equipment are stated at historical cost less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the statement of income during the financial year in which they are incurred.

Depreciation on furniture, fixtures and equipment is calculated using the straight-line method to allocate their cost less residual values over the useful lives of three to five years.

Major renovations are depreciated over the remaining useful life of the related asset.

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. The recoverable amount is the higher of an asset's fair value less costs to sell or value in use.

The carrying amount of an asset is derecognized on disposal or when no future economic benefits are expected from its use or disposal. When assets are derecognized, their cost, accumulated depreciation and amortization are eliminated from the accounts. Gains and losses on disposals are determined by comparing proceeds with carrying amount and are included in the statement of income.

2.8 Investment property

Property that is held either to earn rental income or for capital appreciation or for both and that is not significantly occupied by the Bank is classified as investment property.

Investment property comprises land and building. Investment property is stated at cost less accumulated depreciation. Depreciation on investment property is determined using the same policy as applied to Bank premises, furniture, fixtures, and equipment. Impairment test is conducted when there is an indication that the carrying amount of the asset may not be recovered. An impairment loss is recognized for the amount by which the property's carrying amount exceeds its recoverable amount, which is the higher of the property's fair value less costs to sell and value in use.

Transfers to, or from, investment property shall be made when, and only when, there is a change in use, evidenced by:

- (a) commencement of owner-occupation, for a transfer from investment property to owner-occupied property;
- (b) commencement of development with a view of sale, for a transfer from investment property to real properties held-for-sale and development;
- (c) end of owner occupation, for a transfer from owner-occupied property to investment property; or
- (d) commencement of an operating lease to another party, for a transfer from real properties held-for-sale and development to investment property.

Transfers to investment property do not result in gain or loss.

Investment property is derecognized when it has either been disposed of or when the investment property is permanently withdrawn from use and no future benefit is expected from its disposal. Gains or loss on derecognition of investment property is calculated as the difference between any disposal proceeds and the carrying amount of the related asset and is recognized in profit or loss in the year of derecognition.

2.9 Foreclosed assets

Assets foreclosed shown as Assets Held for Sale in the statement of condition are accounted for at the lower of cost and fair value less cost to sell similar to the principles of PFRS 5. The cost of assets foreclosed includes the carrying amount of the related loan less allowance for impairment at the time of foreclosure. Impairment loss is recognized for any subsequent write-down of the asset to fair value less cost to sell.

2.10 Accrued expenses and other liabilities

Accrued expenses and other liabilities are recognized in the period in which the related money, goods or services are received or when a legally enforceable claim against the Bank is established.

2.11 Provisions for legal and contractual obligations

Provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognized for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects the current market assessment of the time value of money and the risk specific to the obligation. The increase in the provision due to the passage of time is recognized as interest expense.

2.12 Interest income and expense

Interest income and expense are recognized in the statement of income for all interest-bearing financial instruments using the effective interest method.

When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees 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 future cash flows for the purpose of measuring impairment loss.

2.13 Fee and commission income

Fees and commissions, mainly representing Service fees presented among Miscellaneous income, are generally recognized on an accrual basis when the service has been provided.

2.14 Foreign currency translation

(a) Functional and presentation currency

Items in the financial statements of the Bank are measured using the currency of the primary economic environment in which it operates (the "functional currency"). The financial statements are presented in Philippine Peso, which is the Bank's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of income.

2.15 Income taxes

(a) Current income tax

Income tax payable is calculated on the basis of the applicable tax law in the respective jurisdiction and is recognized as an expense for the year except to the extent that current tax related to items (for example, current tax on available-for-sale investments) that are charged or credited in other comprehensive income or directly to capital funds.

The Bank has substantial income from its investment in government securities subject to final withholding tax. Such income is presented at its gross amount and the tax paid or withheld is included in Current provision for income tax.

(b) Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the reporting date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized for all deductible temporary differences, carry-forward of unused tax losses (net operating loss carryover or NOLCO) and unused tax credits (excess minimum corporate income tax or MCIT) to the extent that it is probable that future taxable profit will be available against which the temporary differences, unused tax losses and unused tax credits can be utilized.

The Bank reassesses at each balance sheet date the need to recognize a previously unrecognized deferred income tax asset.

The Bank has substantial income from its investment in government securities subject to final withholding tax. Such income is presented at its gross amount and the tax paid or withheld is included in Current provision for income tax.

(c) Recent tax laws and regulations

Republic Act 9337 (the Act), which was passed into law in May 2005, amended certain provisions of the National Internal Revenue Code of 1997. The more salient provisions of the Act included: 1) change in normal corporate income tax from 32% to 35% effective November 1, 2005 and from 35% to 30% effective January 1, 2009; 2) change in allowable deduction for interest expense from 38% to 42% effective November 1, 2005 and from 42% to 33% beginning January 1, 2009; and 3) revised rates for gross receipts tax (GRT).

On December 20, 2008, Revenue Regulation No. 16-2008 on the Optional Standard Deduction (OSD) was published. The regulation prescribed the rules for the OSD application by corporations in the computation of their final taxable income.

On February 18, 2010, Revenue Regulation No. 2-2010, amending Revenue Regulation No. 16-2008 with respect to the manner and period for making the election to claim OSD in the income tax returns was published. The regulation states that the election to claim either the OSD or the itemized deduction for the taxable year must be signified in the income tax return filed for the first quarter of the taxable year adopted by the taxpayer. Once the election is made, the same type of deduction must be consistently applied for all the succeeding quarterly returns and in the final income tax return for the taxable year.

The Bank did not avail of the OSD for purposes of income tax calculation in 2010 and 2009.

On December 28, 2010, Revenue Regulation (RR) No. 15-2010 became effective and amended certain provisions of RR No. 21-2001 prescribing the manner of compliance with any documentary and/or procedural requirements in connection with the preparation and submission of financial statements, income tax returns and information on taxes, duties and license fees paid or accrued during the year.

2.16 Employee benefits

(a) Pension benefits

BPI and its subsidiaries, which include the Bank, have a unified defined benefit plan that shares risks among entities within the BPI Group. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. The plan is funded through payments to trustee-administered funds, determined by periodic actuarial calculations and compensation.

The liability recognized in the statement of condition in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs. 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 using interest rates of government bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension liability.

Cumulative actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of the greater of 10% of the value of plan assets or 10% of the defined benefit obligation are spread to income over the employees' expected average remaining working lives. Past-service costs are recognized immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortized on a straight-line basis over the vesting period.

Where the calculation results in a benefit to the Bank, the recognized asset is limited to the net total of any unrecognized actuarial losses and past service costs, and the present value of any reductions in future contributions to the plan.

For individual financial reporting purposes, the unified plan assets are allocated among the BPI Group entities, including the Company, based on the level of the defined benefit obligation attributable to each entity to arrive at the net liability or asset that should be recognized in the individual financial statements.

(b) Profit-sharing and bonus plans

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

(c) Share-based compensation

The Bank's management awards high-performing employees bonuses in the form of options to purchase Parent Bank's common shares, from time to time, on a discretionary basis. The options are subject to certain service vesting conditions.

The fair value of the services received is measured by reference to the fair value of the shares or share options granted on the date of the grant. The cost of employee services received in respect of the shares or share options granted is recognized in the statements of income (with a corresponding increase in reserve in capital funds) over the period that the services are received, which is the vesting period.

The fair value of the options granted is determined using option pricing models which take into account the exercise price of the option, the current share price, the risk-free interest rate, the expected volatility of the share price over the life of the option and other relevant factors.

When the stock options are exercised, the proceeds received, net of any directly attributable transaction costs, are credited to capital stock (par value) and paid-in surplus for the excess of exercise price over par value.

(d) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Bank recognizes termination benefits when it is demonstrably committed to either terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal, or providing termination benefits as a result of an offer made to encourage voluntary redundancy.

2.17 Share capital

Common shares are classified as equity.

Incremental costs directly attributable to the issue of new shares are shown in capital funds as a deduction from the proceeds, net of tax.

2.18 Dividends on common shares

Dividends are recognized as a liability in the Bank's financial statements in the year in which they are approved by the Board of Directors and the BSP.

2.19 Leases

(a) Bank is the lessee

Leases in which substantially all risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments, including prepayments, made under the operating leases are charged to the statement of income on a straight-line basis over the period of the lease.

(b) Bank is the lessor

Properties leased out under operating leases are included in investment property in the statement of condition. Rental income is recognized in the statement of income on a straight-line basis over the lease.

2.20 Subsequent events (or Events after the reporting date)

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

Note 3 - Financial risk and capital management

Risk management in the Bank covers all perceived areas of risk exposure, even as it continuously endeavors to uncover hidden risks. Capital management is understood to be a facet of risk management. The Board of Directors is the Bank's principal risk and capital manager, and the Bank's only strategic risk taker. The Board of Directors provides written policies for overall risk management, as well as written procedures for the management of foreign exchange risk, interest rate risk, credit risk, equity risk, and contingency risk, among others.

The primary objective of the Bank is the generation of recurring acceptable returns to shareholders' capital. To this end, the Bank's policies, business strategies, and business activities are directed towards the generation of cash flows that are in excess of its fiduciary and contractual obligations to its depositors, and to its various other funders and stakeholders.

To generate acceptable returns to its shareholders' capital, the Bank understands that it has to bear risk, that risk-taking is inherent in its business. Risk is understood by the Bank as the uncertainty in its future incomes - an uncertainty that emanates from the possibility of incurring losses that are due to unplanned and unexpected drops in revenues, increases in expenses, impairment of asset values, or increases in liabilities.

The possibility of incurring losses is, however, compensated by the possibility of earning more than expected incomes. Risk-taking is, therefore, not entirely a bad step to be avoided. Risk-taking presents opportunities if risks are accounted, deliberately taken, and are kept within rationalized limits.

The Risk Management Office (RMO) is responsible for the management of market and liquidity risks. Its objective is to minimize adverse impacts on the Bank's financial performance due to the unpredictability of financial markets. Market and credit risks management in the Bank is carried out through policies approved by the Risk Management Committee (RMC) and the Board of Directors. In addition, Internal Audit is responsible for the independent review of risk assessment measures and procedures and the control environment. For risk management purposes, risks emanating from Treasury activities are managed independently.

The most important risks that the Bank manages are credit risk, liquidity risk, market risk and other operational risks. Market risk includes currency exchange risk, interest rate and other price risks.

3.1 Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss to the Bank by failing to discharge an obligation. Significant changes in the economy, or in the prospects of a particular industry segment that may represent a concentration in the Bank's portfolio, could result in losses that are different from those provided for at the reporting date. Management therefore carefully manages its exposure to credit risk.

Credit exposures arise principally in (a) Loans and advances, Due from BSP, Due from other banks, Interbank calls loan receivable and accrued interest receivable and accounts receivable under Other resources and (b) debt securities consisting of investments in Available-for-sale and Held-to-maturity securities. The Credit Policy Group works with the Credit Committee in managing credit risks, and reports are regularly provided to the Board of Directors.

3.1.1 Credit risk management

(a) Loans and advances

In measuring credit risk of loan and advances at a counterparty level, the Bank considers three components (i) the probability of default by the client or counterparty on its contractual obligations; (ii) current exposures to the counterparty and its likely future development; and (iii) the likely recovery ratio on the defaulted obligations. In the evaluation process, the Bank also considers the conditions of the industry/sector to which the counterparty is exposed, other existing exposures to the group where the counterparty may be related, as well as the client and Bank's fallback position assuming the worst-case scenario. Outstanding and potential credit exposures are reviewed to likewise ensure that they conform to existing internal credit policies.

The Bank assesses the probability of default of individual counterparties using internal rating tools tailored to the various categories of counterparty. The Bank has internal credit risk rating systems designed for corporate, SMEs, and retail accounts. For corporate and SMEs, the rating system is a 10-point scale that measures the borrower's credit risk based on quantitative and qualitative factors. The ratings of individual exposures may subsequently migrate between classes as the assessment of their probabilities of default changes. For retail, the consumer credit scoring system is a formula-based model for evaluating each credit application against a set of characteristics that experience has shown to be relevant in predicting repayment. The Bank regularly validates the performance of the rating systems and their predictive power with regard to default events, and enhances them if necessary. The Bank's internal ratings are mapped to the following standard BSP classifications:

- i. *Unclassified* - these are loans that do not have a greater-than-normal risk and do not possess the characteristics of loans classified below. The counterparty has the ability to satisfy the obligation in full and therefore minimal loss, if any, is anticipated.
- ii. *Loans especially mentioned* - these are loans that have potential weaknesses that deserve management's close attention. These potential weaknesses, if left uncorrected, may affect the repayment of the loan and thus increase the credit risk of the Bank.

- iii. *Substandard* - these are loans which appear to involve a substantial degree of risk to the Bank because of unfavorable record or unsatisfactory characteristics. Further, these are loans with well-defined weaknesses which may include adverse trends or development of a financial, managerial, economic or political nature, or a significant deterioration in collateral.
- iv. *Doubtful* - these are loans which have the weaknesses similar to those of the Substandard classification with added characteristics that existing facts, conditions, and values make collection or liquidation in full highly improbable and substantial loss is probable.
- v. *Loss* - these are loans which are considered uncollectible and of such little value that their continuance as bankable assets is not warranted although the loans may have some recovery or salvage value.

(b) Debt securities and other bills

For debt securities, external ratings such as *Standard & Poor's*, *Moody's* and *Fitch's* ratings or their equivalent are used by the Bank for managing credit risk exposures. Investments in these securities and bills are viewed as a way to gain better credit quality mix and at the same time, maintain a readily available source to meet funding requirements.

3.1.2 Risk limit control and mitigation policies

The Bank manages, limits and controls concentrations of credit risk wherever they are identified - in particular, to individual counterparties and groups, and to industries.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a regular basis and subject to an annual or more frequent review, when considered necessary. Limits on large exposures and credit concentration are approved by the Board of Directors.

The exposure to any one borrower is further restricted by sub-limits covering on- and off-balance sheet exposures. Actual exposures against limits are monitored regularly.

Exposure to credit risk is also managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate.

The Bank employs a range of policies and practices to mitigate credit risk. One of the most traditional and common practice in mitigating credit risk is requiring security for loans and advances. The Bank implements guidelines on the acceptability of specific classes of collateral for credit risk mitigation. The principal collateral types for loans and advances are:

- Mortgages over real estate properties and chattels; and
- Hold-out on financial instruments such as debt securities, deposits, and equities.

In order to minimize credit loss, the Bank seeks additional collateral from the counterparty when impairment indicators are observed for the relevant individual loans and advances.

3.1.3 Impairment and provisioning policies

As described in Note 3.1.1, the Bank's credit-quality mapping on loans and advances is based on the standard BSP loan classifications. Impairment provisions, however, are recognized for financial reporting purposes only for losses that have been incurred at the reporting date based on objective evidence of impairment (Note 2.3.5).

The table below shows the percentage of the Bank's loans and advances and the related allowance for impairment at December 31:

	2010		2009	
	Loans and advances (%)	Impairment provision (%)	Loans and advances (%)	Impairment provision (%)
Unclassified	98.00	0.28	97.65	0.40
Loans especially mentioned	0.00	0.00	0.00	0.00
Substandard	1.88	29.90	1.96	27.48
Doubtful accounts	0.00	0.00	0.39	0.00
Loss	0.12	100.00	0.00	0.00
	100.00		100.00	

3.1.4 Maximum exposure to credit risk

Credit risk exposures relating to financial assets in the statement of condition at December 31 are as follows:

	2010	2009
Due from other banks	284,336,207	75,907,813
Interbank call loans receivable	-	174,058,000
Due from BSP	2,511,710,901	2,730,826,295
Held-to-maturity securities	457,621,944	564,838,467
Loans and advances	2,610,195,356	802,374,353
Other resources	25,302,458	7,745,795

The above table represents a worst case scenario of credit risk exposure to the Bank at December 31, 2010 and 2009, without taking into account any collateral held or other credit enhancements attached. The exposures set out above are based on gross carrying amounts.

Management is confident in its ability to continue to control and sustain minimal exposure to credit risk of the Bank resulting from its loan and advances portfolio based on the following:

- 98% of the loans and advances portfolio is categorized in the top two grades of the internal rating system in 2010 (2009 - 97.7%);
- Mortgage loans are backed by collateral;
- 97.81% of the loans and advances portfolio are considered to be neither past due nor impaired in 2010 (2009 - 97.4%); and
- The Bank has introduced a more stringent selection process upon granting loans and advances.

3.1.5 Loans and advances

Loans and advances at December 31 are summarized as follows:

	2010	2009
Neither past due nor impaired	2,552,987,667	781,718,707
Past due but not impaired	4,995,605	1,801,897
Past due and impaired	52,212,084	18,853,749
	2,610,195,356	802,374,353
Allowance for impairment	(25,099,119)	(9,226,182)
	2,585,096,237	793,148,171

There were no renegotiated loans and advances in 2010 and 2009.

(a) Loans and advances neither past due nor impaired

Loans and advances that were neither past due nor impaired consist mainly of accounts with unclassified rating and no provision for impairment is required as a result of management's assessment of the portfolio on an individual and collective basis. Details of these accounts at December 31 are as follows:

	2010	2009
Corporate entities		
Large corporate customers	236,453,941	41,432,289
Small and medium enterprises	23,040,946	2,758,926
Retail customers:		
Real estate mortgages	2,155,416,066	631,152,534
Auto loans	138,076,714	106,374,958
	2,552,987,667	781,718,707

(b) Loans and advances past due but not impaired

The table below presents the gross amount of loans and advances that were past due but not impaired. Collateralized past due loans are not considered impaired when the cash flows that may result from foreclosure of the related collateral are higher than the carrying amount of the loans.

	2010	2009
Past due up to 30 days	1,027,375	647,039
Past due 31 - 90 days	1,760,491	1,154,858
Past due 91 - 180 days	262,027	-
Over 180 days	1,945,712	-
	4,995,605	1,801,897
Fair value of collateral	204,755,836	135,548,004

(c) Loans and advances past due and impaired

Loans and advances that were past due and impaired represents accounts that are aged more than 90 days past due, amounting to P52,212,084 (2009 - P18,853,749). Fair value of collaterals supporting past due and impaired real estate mortgage loans amounted to P113,898,328 (2009 – P29,568,054). For 2010, loans under this category pertain to real estate mortgage and auto loans, and are thus subjected to collective assessment.

3.1.6 Credit quality of other financial assets

(a) Due from BSP

Due from BSP amounting to P2,511,711 thousand and P2,730,826 thousand as at December 31, 2010 and 2009, respectively are made with sovereign counterparty and are considered fully performing.

(b) Due from other banks and interbank call loans receivable

Due from other banks and interbank call loans receivable are considered fully performing at December 31, 2010 and 2009. The table below presents the credit rating of counterparty banks.

	2010	2009
Lower than A-	-	174,058,000
Unrated	284,336,207	75,907,813
	284,336,207	249,965,813

(c) Held-to-maturity securities

The table below presents the ratings of debt securities, Treasury bills and other government securities classified under held-to-maturity securities at December 31 based on Standard & Poor's:

	Amount
December 31, 2010	
Lower than A-	457,621,944
December 31, 2009	
Lower than A-	564,838,467

(d) Other financial assets

The Bank's other financial assets (shown under Other resources) as at December 31, 2010 and 2009 consist mainly of accounts receivable and accrued interest and fees receivable from various unrated counterparties.

3.1.7 Repossessed or foreclosed collateral

In 2010, the Bank acquired assets by taking possession of collaterals held as security for loans and advances with carrying amount of P2,063,448 (2009 - P4,391,641). The related foreclosed collaterals have aggregate fair value of P2,635,000 (2009 - P12,587,000). Foreclosed collaterals include real estate (land and building).

Reposessed properties are sold as soon as practicable and are classified as “Assets Held for Sale” in the statement of condition.

3.1.8 Concentrations of risks of financial assets with credit risk exposure

The Bank’s main credit exposures at their carrying amounts, as categorized by industry sectors, follow:

	Financial Institutions	Consumer	Manufacturing	Business Services and Real Estate	Others	Less - Allowance	Total
Due from other banks	284,336,207	-	-	-	-	-	284,336,207
Due from BSP	2,511,710,901	-	-	-	-	-	2,511,710,901
Held-to-maturity	-	-	-	-	457,621,944	-	457,621,944
Loans and advances, net	-	-	14,726,920	546,875,473	2,048,592,963	(25,099,119)	2,585,096,237
Other resources	-	-	-	-	25,302,458	-	25,302,458
At December 31,							
2010	2,796,047,108	-	14,726,920	546,875,473	2,531,517,365	(25,099,119)	5,864,067,747
2009	2,980,792,108	675,884,875	857,162	96,383,685	601,832,893	(9,226,182)	4,346,524,541

3.2 Market risk

The Bank is exposed to market risk, the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk is managed by the RMC guided by policies and procedures approved by the RMC and confirmed by the Board of Directors.

3.2.1 Interest rate risk

There are two types of interest rate risk - (i) fair value interest risk and (ii) cash flow interest risk. Fair value interest rate risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market interest rates. Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may also result in losses in the event that unexpected movements arise. The Board of Directors sets limits on the level of mismatch of interest rate repricing that may be undertaken, which is monitored daily by the Risk Management Office.

Interest rate risk in the banking book arises from the Bank’s core banking activities. The main source of this type of interest rate risk is repricing risk, which reflects the fact that the Bank’s assets and liabilities are of different maturities and are priced at different interest rates.

The table below summarizes the Bank's exposure to interest rate risk, categorized by the earlier of contractual repricing or maturity dates.

	Up to 1 year	Over 1 up to 3 years	Over 3 years	Non-repricing	Total
As at December 31, 2010					
Assets					
Due from other banks	-	-	-	284,336,207	284,336,207
Due from BSP	-	-	-	2,511,710,901	2,511,710,901
Held-to-maturity	-	-	-	457,621,944	457,621,944
Loans and advances, net	845,029,906	250,026,912	1,291,615,823	198,423,596	2,585,096,237
Other resources	-	-	-	25,302,458	25,302,458
Total financial assets	845,029,906	250,026,912	1,291,615,823	3,477,395,106	5,864,067,747
Liabilities					
Deposit liabilities	853,309,992	-	-	4,389,134,770	5,242,444,762
Accrued interest and other expenses	2,196,124	-	-	9,644,920	11,841,044
Other liabilities	-	-	-	7,366,125	7,366,125
Total financial liabilities	855,506,116	-	-	4,406,145,815	5,261,651,931
Total interest repricing gap	(10,476,210)	250,026,912	1,291,615,823	(928,750,709)	602,415,816
As at December 31, 2009					
Total financial assets	95,818,359	142,856,769	544,275,013	3,563,602,868	4,346,553,009
Total financial liabilities	738,646,773	-	-	3,049,559,530	3,788,206,303
Total interest repricing gap	(642,828,414)	142,856,769	544,275,013	514,043,338	558,346,706

3.2.2 Foreign exchange risk

The Bank takes on exposure to the effects of fluctuations in the prevailing exchange rates on its foreign currency financial position and cash flows.

The table below summarizes the Bank's exposure to foreign currency exchange rate risk at December 31, 2010 and 2009 relative to its financial assets denominated in United States Dollar (US Dollar). The Company had no foreign-currency denominated liabilities as at December 31, 2009.

	2010	2009
Financial assets		
Due from other banks	10,693,868	167,144
Financial liabilities		
Deposit liabilities	10,558,448	-
Accrued interest	19,739	-
Balance, December 31	10,578,187	-
Net assets - December 31	115,681	167,144

At December 31, 2010, if the Philippine Peso had weakened/strengthened by 5% (2009 - 5%) against the US Dollar based on historical information in the last five years with all other variables held constant, net income and capital funds as at and for the year ended December 31, 2010 would have been P5,784 (2009 – P8,357) higher/lower, mainly as a result of foreign exchange gains/losses on translation of US Dollar-denominated deposits with other banks and deposit liabilities.

3.2.3 Price risk

The Bank's investment securities held under Available-for-Sale and Held-to-Maturity Securities are mainly in the form of debt securities which are exposed to credit (Note 3.1.6) and interest rate (Note 3.2.1) risks. These securities are not exposed to equity price risk.

3.3 Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfill commitments to lend.

3.3.1 Liquidity risk management process

The Bank's liquidity management process, as carried out within the Bank and monitored by the RMC and the Risk Management Office includes:

- Day-to-day funding, managed by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature or are borrowed by customers;
- Maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- Monitoring balance sheet liquidity ratios against internal and regulatory requirements;
- Managing the concentration and profile of debt maturities; and
- Performing periodic liquidity stress testing on the Bank's liquidity position by assuming a faster rate of withdrawals in its deposit base.

Monitoring and reporting take the form of cash flow measurement and projections for the next day, week and month as these are key periods for liquidity management. The starting point for those projections is an analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets.

3.3.2 Funding approach

Sources of liquidity are regularly reviewed by the Bank to maintain a wide diversification by currency, geography, counterparty, product and term.

3.3.3 Maturity analysis

The Bank's financial liabilities at December 31 maturing within one year are as follows:

	2010	2009
Deposit liabilities	5,242,444,762	3,774,180,771
Accrued interest and other expenses	11,841,044	12,843,613
Other liabilities	7,366,125	1,181,919
	5,261,651,931	3,788,206,303

Assets available to meet all of the liabilities include Due from BSP and other banks, Interbank call loans receivable, Available-for-sale securities, Held-to-maturity securities and Loans and advances to customers. The Bank would also be able to meet unexpected net cash outflows by accessing additional funding sources.

3.4 Fair values of financial assets and liabilities

The table below summarizes the carrying amounts and fair values of those financial assets and liabilities at December 31 not presented in the statement of condition at fair value.

	Carrying Value		Fair Value	
	2010	2009	2010	2009
Financial assets				
Due from other banks	284,336,207	75,907,813	284,336,207	75,907,813
Interbank call loans receivable	-	174,058,000	-	174,058,000
Due from BSP	2,511,710,901	2,730,826,295	2,511,710,901	2,730,826,295
Held-to-maturity securities	457,621,944	564,838,467	469,659,475	559,400,988
Loans and advances, net	2,585,096,237	793,148,171	2,954,396,699	1,032,294,872
Other resources, net	25,302,458	7,745,795	25,302,458	7,745,795
Financial liabilities				
Deposit liabilities	5,242,444,762	3,774,180,771	5,242,444,762	3,774,180,771
Accrued interest	11,841,044	12,843,613	11,841,044	12,843,613
Other liabilities	7,366,125	1,181,919	7,366,125	1,181,919

(i) Due from BSP and other banks; Interbank call loans receivable

The fair value of floating rate placements and overnight deposits approximates their carrying amount. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity.

(ii) Investment securities

Fair value of held-to-maturity assets is based on market prices. Where this information is not available, fair value is estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

(iii) Loans and advances

The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

(iv) Financial liabilities

The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand.

The estimated fair value of fixed interest-bearing deposits is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

(v) Other resources/liabilities

Carrying amounts of other resources/liabilities which have no definite repayment dates are assumed to be their fair values.

3.5 Fair value hierarchy

PFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example, Philippine Stock Exchange, Inc., Philippine Dealing and Exchange Corp., etc.) and exchanges traded derivatives like futures (for example, NASDAQ, S&P 500).
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).
- Level 3 - Inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components. This hierarchy requires the use of observable market data when available. The Bank considers relevant and observable market prices in its valuations where possible.

As at December 31, 2010, the Bank has available-for-sale financial assets in the form of equity securities that fall under Level 1 amounting to P27,544. The Bank has no financial instruments that fall under the Levels 2 and 3 categories as at December 31, 2010.

3.6 Capital management

The Bank manages its capital following the framework of Basel Committee on Banking Supervision Accord II (Basel II) and its implementation in the Philippines by the BSP. The BSP through its Circular 538 requires each bank and its financial affiliated subsidiaries to keep its Capital Adequacy Ratio (CAR) - the ratio of qualified capital to risk-weighted exposures - to be no less than 10%. In quantifying its CAR, the Bank currently uses the Standardized Approach (for credit risk and market risk) and the Basic Indicator Approach (for operational risk). Capital adequacy reports are filed with the BSP every quarter.

Qualifying capital and risk-weighted assets are computed based on BSP regulations. The qualifying capital of the Bank consists of core tier 1 capital and tier 2 capital. Tier 1 capital comprises paid-up share capital, paid-in surplus, surplus including net income for the year, surplus reserves less deductions such as deferred income tax, unsecured credit accommodations to DOSRI and unrealized fair value losses on available-for-sale securities. Tier 2 capital includes net unrealized fair value gains on available-for-sale investments, and general loan loss provisions for BSP reporting purposes.

The table below summarizes the CAR of the Bank under the Basel II framework for the years ended December 31, 2010 and 2009. The Basel II framework following BSP Circular 538 took effect on July 1, 2007.

	2010	2009
Tier 1 capital	578,930,331	559,870,473
Tier 2 capital	19,927,599	5,959,020
Gross qualifying capital	598,857,930	565,829,493
Less: Required deductions	-	-
Total qualifying capital	598,857,930	565,829,493
Risk weighted assets	2,359,380,388	823,822,488
CAR (%)	25.382%	68.683%

The Bank has fully complied with the CAR requirement of the BSP.

Note 4 - Critical accounting estimates, assumptions and judgments

The Bank makes estimates and assumptions that affect the reported amounts of resources and liabilities. Estimates, assumptions and judgments 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. It is reasonably possible that the outcomes within the next financial year could differ from assumptions made at reporting date and could result in the adjustment to the carrying amount of affected assets and liabilities.

4.1 Critical accounting estimate

Impairment losses on loans and advances (Note 9)

The Bank reviews its loan portfolios to assess impairment at least on a monthly basis. In determining whether an impairment loss should be recorded in the statement of income, the Bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for resources 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. On the basis of existing knowledge, it is reasonably possible that outcomes within the next financial year, which are different from the assumptions used, may amount to a material difference compared to this year's impairment loss. It is, however, impracticable to estimate the impact of such difference in outcomes.

4.2 Critical accounting judgments

(a) Held-to-maturity securities (Note 8)

The Bank follows the guidance of PAS 39 "Financial instruments - Recognition and Measurement" in classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgment. In making this judgment, the Bank evaluates its intention and ability to hold such investments to maturity. If the Bank fails to keep these investments to maturity other than for the specific circumstances - for example selling an insignificant amount close to maturity - it will be required to reclassify the entire class as available-for-sale. The investments would therefore be measured at fair value and not at amortized cost.

(b) Valuation and classification of assets held for sale

Management follows the principles in PFRS 5 in classifying certain foreclosed assets (consisting of real estate and auto or chattel), as assets held for sale when the carrying amount of the assets will be recovered principally through sale. Management is committed to a plan to sell these foreclosed assets and the assets are actively marketed for sale at a price that is reasonable in relation to their current fair value. In determining the fair value of assets held for sale, sales prices are analyzed by applying appropriate units of comparison, adjusted by differences between the subject asset or property and related market data. Should there be a subsequent write-down of the asset to fair value less cost to sell, such write-down is recognized as impairment loss in the statement of income.

In 2010 and 2009, the Bank did not recognize impairment loss on its foreclosed assets.

(c) Realization of deferred income tax assets (Note 12)

Management reviews at each reporting date the carrying amounts of deferred tax assets. The carrying amount of deferred tax assets is reduced to the extent that the related tax assets cannot be utilized due to insufficient taxable profit against which the deferred tax losses will be applied. Management believes that sufficient taxable profit will be generated to allow all or part of the deferred income tax assets to be utilized.

Note 5 - Cash and cash equivalents

The account at December 31 consists of:

	Note	2010	2009
Due from other banks		284,336,207	75,907,813
Interbank call loans receivable		-	174,058,000
Due from BSP	6	2,416,710,901	2,652,826,294
		2,701,047,108	2,902,792,107

Interbank call loans receivable at December 31, 2009 represent short-term lendings to the BSP. Average effective interest rate on interbank call loans receivable is 4.06% and 4.47% in 2010 and 2009, respectively.

Note 6 - Due from Bangko Sentral ng Pilipinas

This account consists of special deposit accounts (classified as cash equivalents in Note 5) and fixed-term demand Philippine Peso deposits in compliance with regulatory requirements.

Note 7 - Available-for-sale securities, net

The account at December 31 consists of:

	2010	2009
Equity securities	39,956	40,880
Allowance for impairment	(12,412)	(12,412)
	27,544	28,468

The movement in available-for-sale securities is summarized as follows:

	2010	2009
Balance, January 1	28,468	21,398
Fair value adjustment	(924)	7,070
Balance, December 31	27,544	28,468

Note 8 - Held-to-maturity securities

The account consists of government securities and movements in the account are summarized as follows:

	2010	2009
Balance, January 1	564,838,467	674,728,222
Additions	67,402,116	-
Maturities	(167,543,945)	(113,821,394)
Amortization of premium	(19,037,827)	(8,611,355)
Accrued interest receivable	11,963,133	12,542,994
Balance, December 31	457,621,944	564,838,467

Average effective interest rates on held-to-maturity securities are 6.80% and 7.08% in 2010 and 2009, respectively.

Note 9 - Loans and advances, net

The account at December 31 consists of:

	2010	2009
Corporate entities		
Large corporate customers	235,974,079	41,432,289
Small and medium enterprise	22,932,695	2,788,691
Retail customers		
Real estate mortgages	2,200,131,221	643,697,608
Auto loans	164,539,454	130,824,179
	2,623,577,449	818,742,767
Accrued interest receivable	11,254,099	4,220,500
Unearned discount	(24,636,192)	(20,588,914)
	2,610,195,356	802,374,353
Allowance for impairment	(25,099,119)	(9,226,182)
	2,585,096,237	793,148,171
	2010	2009
Current	38,581,687	8,534,048
Non-current	2,571,613,669	793,840,305
	2,610,195,356	802,374,353

Details of the loans and advances portfolio at December 31 are as follows:

(a) As to industry/economic sector (in %)

	2010	2009
Private household with employed persons	72.45	84.24
Real estate, renting and other related activities	20.95	12.01
Wholesale and retail trade	1.98	0.44
Manufacturing	0.56	0.11
Others	4.06	3.20
	100.00	100.00

The BSP considers that concentration of credit exists when the loan exposure to a particular industry or sector exceeds 30% of total loan portfolio.

(b) As to collateral

	2010	2009
Secured loans		
Real estate mortgage	2,345,666,440	685,610,654
Chattel mortgage	141,005,678	110,235,265
Others	22,811,328	5,007,279
	2,509,483,446	800,853,198
Unsecured loans	89,457,811	1,521,155
	2,598,941,257	802,374,353

Average effective interest rates on loans and advances are 9.34% and 10.12% in 2010 and 2009, respectively.

The movement in allowance for impairment is as follows:

	2010	2009
Balance, January 1	9,226,182	1,657,497
Provision for impairment	15,872,937	7,568,685
Balance, December 31	25,099,119	9,226,182

Note 10 - Investment property

The account at December 31 consists of:

	2010	2009
Land	-	419,850
Building	-	5,502,079
	-	5,921,929
Accumulated depreciation	-	(2,145,077)
	-	3,776,852

The movement in the account is summarized as follows:

	2010	2009
Balance, January 1	3,776,852	3,886,925
Transfer to Assets held for sale	(3,666,779)	-
Depreciation	(110,073)	(110,073)
Balance, December 31	-	3,776,852

Depreciation is included in Occupancy and equipment-related expenses in the statement of income.

Note 11 - Bank premises, furniture, fixtures and equipment

The movements in the account are summarized as follows:

	2010	2009
Cost		
Balance, January 1	6,377,980	5,010,213
Additions	2,910,314	1,367,767
Balance, December 31	9,288,294	6,377,980
Accumulated depreciation		
Balance, January 1	4,418,399	2,996,965
Depreciation	1,995,501	1,421,434
Balance, December 31	6,413,900	4,418,399
Net book value - December 31	2,874,394	1,959,581

Depreciation is included in Occupancy and equipment-related expenses in the statement of income.

Note 12 - Deferred income taxes

Deferred income tax assets and liability at December 31 consist of:

	2010	2009
Deferred income tax assets		
Allowance for impairment	7,662,092	2,900,210
MCIT	3,757,898	1,695,687
NOLCO	9,351,569	7,503,604
Expense accruals	295,296	180,426
Total deferred income tax assets	21,066,855	12,279,927
Deferred income tax liability		
Pension asset	(411,763)	(921,755)
Deferred income tax asset, net	20,655,092	11,358,172

Deferred income tax assets (liabilities) are expected to be realized (settled) as follows:

	2010	2008
Deferred income tax assets		
Amount to be recovered within 12 months	1,495,160	250,000
Amount to be recovered after 12 months	19,571,695	12,029,927
	21,066,855	12,279,927
Deferred income tax liability		
Amount to be settled within 12 months	(411,763)	(535,199)
Amount to be settled after 12 months	-	(386,556)
	(411,763)	(921,755)

The movements in the net deferred income tax asset are summarized below:

	2010	2009
At January 1	11,358,172	1,718,714
Income statement credit	7,234,709	8,730,934
MCIT	2,062,211	908,524
At December 31	20,655,092	11,358,172

The deferred tax credit in the statement of income for the years ended December 31 comprises the following temporary differences:

	2010	2009
Allowance for impairment	(4,761,882)	(2,270,605)
Pension asset	(509,992)	(23,664)
NOLCO	(1,847,965)	(6,436,665)
Others	(114,870)	-
	(7,234,709)	(8,730,934)

The outstanding NOLCO at December 31 consists of:

Year of Incurrence	Year of Expiration	2010	2009
2010	2013	6,159,883	-
2009	2012	21,455,549	21,455,549
2008	2011	3,556,464	3,556,464
		31,171,896	25,012,013
Tax rate		30%	30%
Deferred income tax asset on NOLCO		9,351,569	7,503,604

The details of MCIT at December 31 are as follows:

Year of Incurrence	Year of Expiration	2010	2009
2010	2013	2,062,211	-
2009	2012	908,524	908,524
2008	2011	787,163	787,163
		3,757,898	1,695,687

Note 13 - Other resources

The account at December 31 consists of:

	Note	2010	2009
Accrued interest receivable		2,610,995	3,707,715
Accounts receivable		22,691,463	4,038,080
Pension asset	21	1,354,591	3,072,517
Prepaid expenses		1,061,100	1,031,100
Miscellaneous		7,975,258	5,165,112
		35,693,407	17,014,524

	2010	2009
Current	33,253,166	9,053,547
Non-current	2,440,241	7,960,977
	35,693,407	17,014,524

Accrued interest receivable in 2010 and 2009 mainly pertain to accrued interest on deposits with BSP.

Miscellaneous other resources mainly consist of investment in membership shares and other receivable from customers.

Note 14 - Deposit liabilities

The account at December 31 consists of:

	2010	2009
Demand	254,929,647	214,768,961
Savings	4,134,205,123	2,823,060,839
Time	853,309,992	736,350,971
	5,242,444,762	3,774,180,771

Deposit liabilities as at December 31, 2010 and 2009 are considered current.

Related interest expense on deposit liabilities is broken down as follows:

	2010	2009
Demand	2,120,674	2,036,534
Savings	45,229,526	30,213,627
Time	27,824,952	27,719,200
At December 31	75,175,152	59,969,361

Under existing BSP regulations, the Bank is subject to liquidity and statutory reserve requirements with respect to certain of its deposit liabilities. The Bank is in full compliance with all applicable liquidity reserve requirements.

The required liquidity and statutory reserves as reported to BSP as at December 31 is comprised of:

	2010	2009
Due from BSP		
Reserve deposit account	216,540,671	151,172,118
Special deposit account	95,000,000	75,586,059
	311,540,671	226,758,177

Note 15 - Accrued taxes, interest and other expenses

The account at December 31 consists of:

	2010	2009
Accrued taxes and licenses	2,507,939	4,695,774
Accrued interest	2,622,395	2,560,384
Accrued other expenses	9,218,649	10,283,229
	14,348,983	17,539,387

Accrued other expenses mainly consist of accruals for branch operating expenses, utilities, contractual and messengerial fees and other recurring charges.

Note 16 - Other liabilities

The account at December 31 consists of:

	2010	2009
Accounts payable	12,274,641	3,399,522
Withholding tax payable	2,479,062	1,678,808
Miscellaneous	8,767,757	4,605,988
	23,521,460	9,684,318

Miscellaneous liabilities consist mainly of collections from borrowers that have not been posted as at December 31 due to timing differences.

Note 17 – Capital funds

Details of share capital at December 31, 2009 and 2010 are as follows:

	Authorized		Issued and Outstanding	
	Number of Shares	Amount	Number of Shares	Amount
Common shares, at P100 par value per share				
Class A	3,300,000	330,000,000	3,300,000	330,000,000
Class B	600,000	60,000,000	445,333	44,533,300
	3,900,000	390,000,000	3,745,333	374,533,300
Preferred shares, at P100 par value per share, 12% cumulative, participating and redeemable				
Class A	400,000	40,000,000	-	-
Class B	400,000	40,000,000	-	-
	800,000	80,000,000	-	-
	4,700,000	470,000,000	3,745,333	374,533,300

The Class A (common and preferred) shares are available only to Philippine nationals while the Class B (common and preferred) shares may be issued to non-Filipinos. The Bank, at its option, may redeem the preferred shares after ten years from issue date.

There were no cash dividends declared in 2010 and 2009.

The movements in the following accounts for the years ended December 31, 2010 and 2009 are summarized below:

	2010	2009
Fair value reserve on available-for-sale securities		
At January 1	24,468	17,398
Net change in fair value	(924)	7,070
At December 31	23,544	24,468
Stock option scheme		
At January 1	601,420	601,420
Value of employee services	(451,673)	-
Transfer of unexercised stock options	(149,747)	-
At December 31	-	601,420
	23,544	625,888

Note 18 - Stock option plan

The Bank grants options to qualified officers under its Executive Stock Option Plan (ESOP). The options vest over a period of three years as follows: (a) 40% after the second anniversary of the option grant date; and (b) 60% after the third anniversary of the option grant date. The option to purchase shares under this plan shall expire five years from grant date.

Movements in the number of share options are summarized below:

	2010	2009
At January 1	31,130	31,130
Granted	-	-
Exercised	(19,536)	-
Cancelled	(11,594)	-
At December 31	-	31,130
Exercisable	-	31,130

The fair value of options was determined using the Black-Scholes model. The significant inputs into the model were share prices of P61.50 at the grant date, exercise price of P37.78, standard deviation of expected share price returns of 30%, option life of 3 years, and annual risk free interest rate of 5.25%. The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of daily share prices over the last three years.

The weighted average share price for share options is P31.48.

Note 19 - Miscellaneous income

The account for the years ended December 31 consists of:

	2010	2009
Service fees	23,702,412	11,286,600
Foreign exchange gains	5,736,188	3,427,480
	29,438,600	14,714,080

Note 20 - Income taxes

A reconciliation between the provision for income tax at the statutory tax rate and the actual provision for income tax for the years ended December 31 is presented below:

	2010		2009	
	Amount	%	Amount	%
Statutory income tax	22,047,805	30.00	17,710,867	30.00
Effect of items not subject to statutory tax rate				
Tax-paid income	(14,562,940)	(19.82)	354,270	0.60
Others, net	14,451,147	19.66	-	0.00
Actual provision for income tax	21,936,012	29.84	18,065,137	30.60

Note 21 - Retirement plan

Under the BPI unified plan which includes the Bank, the normal retirement benefit consists of a lump sum benefit equivalent to 200% of the basic monthly salary of the employee at the time of his retirement for each year of service, if he has rendered at least 10 years of service, or to 150% of his basic monthly salary, if he has rendered less than 10 years of service. Under the plan, the normal retirement is 60. For voluntary retirement, the benefit is equivalent to 112.50% of the employee's basic monthly salary for a minimum of 10 years of service with the rate factor progressing to a maximum of 200% of basic monthly salary for service years of 25 or more. Death or disability benefit, on the other hand, shall be determined on the same basis as in normal or voluntary retirement.

Following are the amounts recognized that relate to the Bank based on the recent actuarial valuation reports:

Pension asset recognized in the statement of condition at December 31 consist of:

	2010	2009	2008	2007	2006
Present value of defined benefit obligation	59,571,152	35,306,114	14,178,709	16,576,970	10,701,104
Fair value of plan assets	(21,600,544)	(16,058,496)	(11,558,855)	(11,927,679)	(7,800,958)
Unfunded obligation	37,970,608	19,247,618	2,619,854	4,649,291	2,900,146
Unrecognized actuarial losses	(39,325,199)	(22,320,135)	(5,771,253)	(8,319,102)	(6,651,789)
Pension asset recognized in the statement of condition	1,354,591	3,072,517	3,151,399	3,669,811	3,751,643

Experience adjustments at December 31 consist of:

	2010	2009	2008	2007	2006
Experience adjustments on plan liabilities	18,532,888	18,790,386	3,927,907	6,977,566	2,164,591
Experience adjustments on plan assets	1,314,082	1,973,772	2,370,231	2,164,591	1,438,969

The movements in the fair value of plan assets are summarized below:

	2010	2009
At January 1	16,058,496	11,558,855
Expected return on plan assets	1,689,354	708,558
Contributions	2,538,612	1,817,311
Actuarial (losses) gains	1,314,082	1,973,772
At December 31	21,600,544	16,058,496

The plan assets at December 31 consist of:

	2010		2009	
	Amount	%	Amount	%
Debt securities	12,312,310	57	8,029,248	50
Equity securities	9,072,228	42	7,868,663	49
Others	216,006	1	160,585	1
	21,600,544	100	16,058,496	100

Pension plan assets of the unified retirement plan include investment in BPI's common shares with fair value of P2,209 million and P2,597 million at December 31, 2010 and 2009, respectively. The actual return on plan assets was P1,171 million and P1,099 million gain in 2010 and 2009, respectively.

The movements in the present value of defined benefit obligation are summarized below:

	2010	2009
At January 1	35,306,114	14,178,709
Current service cost	1,291,181	817,079
Interest cost	3,837,775	1,613,537
Actuarial losses (gains)	19,136,082	18,696,789
At December 31	59,571,152	35,306,114

Pension expense recognized in the statement of income for the years ended December 31 consists of:

	2010	2009
Current service cost	1,291,181	817,079
Interest cost	3,837,775	1,613,537
Expected return on plan assets	(1,689,354)	(708,558)
Net actuarial loss recognized during the year	816,936	174,135
Total expense included in Compensation and fringe benefits	4,256,538	1,896,193

The principal assumptions used for the actuarial valuations of the unified plan are as follows:

	2010	2009
Discount rate	10.63%	10.87%
Expected return on plan assets	10.00%	10.52%
Future salary increases	6.50%	5.00%

The expected return on plan assets was determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields as at the reporting date. Expected returns on equity securities and property investments reflect long-term real rates of return experienced in the respective markets.

Assumptions regarding future mortality and disability experience are based on published statistics generally used for local actuarial valuation purposes.

The average remaining service life of employees under the retirement plan as at December 31, 2010 and 2009 is 25 years.

The Bank's expected contribution to the retirement fund in 2011 amounts to P8,302,555.

Note 22 - Related party transactions

In the ordinary course of business, the Bank has transactions with its directors, officers, stockholders and related interests (DOSRI) and with its Parent Bank such as cash deposit arrangements, purchase of investment securities and outsourcing of certain services, primarily loans operations, branch operations and human resource-related functions.

Significant related party transactions are summarized below:

(a) Purchase of housing loan portfolio from a related party

On February 17, 2010, the Board of Directors of the Bank authorized the purchase of a housing loan portfolio from BPI Family Savings Bank, Inc. up to a maximum limit of P5.0 billion which shall be implemented in tranches. In 2010, P1.0 billion loans have been purchased.

(b) Loans and advances and deposits from related parties

DOSRI loans and interest income earned are summarised below:

	2010	2009
Outstanding DOSRI loans	3,473,402	2,575,352
Percentage to total outstanding loans and advances	0.13%	0.32%
Percentage to total outstanding DOSRI loans		
Unsecured DOSRI loans	Nil	Nil
Past due DOSRI loans	Nil	Nil
Non-performing DOSRI loans	Nil	Nil

At December 31, 2010 and 2009, the Bank is in full compliance with the General Banking Act and the BSP regulations on DOSRI loans.

Deposits to related parties at December 31 consist of:

	2010	2009
Parent Bank	169,764,769	72,711,602
Fellow subsidiaries	14,571,438	3,196,211

(c) Expenses and income transacted by the Bank with related parties are summarized below:

	2010	2009
Shared costs charged by the Parent Bank	42,268,150	28,249,356
Interest income		
Parent Bank	146,286	100,459
Fellow subsidiaries	13,331	15,779

(d) Key management compensation

Key management compensation and directors' remuneration for the years ended December 31 are summarized below:

	2010	2009
Salaries and other short-term benefits	13,574,353	7,850,908
Post-employment benefits	1,060,610	1,104,166
Directors' remuneration	579,600	498,000

Note 23 - Basic quantitative indicators of financial performance

The Bank's key financial performance indicators (in %) at December 31 are summarized below:

	2010	2009
Return on average equity	8.52	7.37
Return on average assets	1.04	1.18
Net interest margin	4.02	4.01

Note 24 - Other commitments and contingent liabilities

The Bank has no outstanding commitments and contingent liabilities as of December 31, 2010 and 2009.

Note 25 - Supplementary information required by BIR Revenue Regulations No. 15-2010

On December 28, 2010, Revenue Regulation (RR) No. 15-2010 became effective and amended certain provisions of RR No. 21-2002 prescribing the manner of compliance with any documentary and/or procedural requirements in connection with the preparation and submission of financial statements and income tax returns. Section 2 of RR No. 21-2002 was further amended to include in the notes to financial statements information on taxes, duties and license fees paid or accrued during the year in addition to what is mandated by PFRS.

Below is the additional information required by RR No. 15-2010 that is relevant to the Bank. This information is presented for purposes of filing with the Bureau of Internal Revenue (BIR) and is not a required part of the basic financial statements.

a) Documentary stamp tax

Documentary stamp taxes (DST) paid for the year ended December 31, 2010 consist of DST on deposit and loan documents amounting to P8,270,008.

A portion of the amount disclosed above was passed on to the counterparties.

b) Withholding taxes

Withholding taxes paid/accrued and/or withheld for the year ended December 31, 2010 consist of:

	Paid	Accrued	Total
Final income taxes withheld on interest on deposits and yield on deposit substitutes	13,076,179	1,218,622	14,294,801
Income taxes withheld on compensation	7,314,731	910,804	8,225,535
Creditable income taxes withheld (expanded)	1,836,517	349,636	2,186,153
	<u>22,227,427</u>	<u>2,479,062</u>	<u>24,706,489</u>

Creditable withholding tax as at December 31, 2010 amounts to P10,208.

c) All other local and national taxes

All other local and national taxes paid/accrued for the year ended December 31, 2010 consist of:

	Paid	Accrued	Total
Gross receipts tax	16,021,125	1,710,419	17,731,544
Fringe benefit tax	55,991	15,050	71,041
Municipal taxes / Mayor's permit	195,742	-	195,742
Real property tax	31,437	-	31,437
Others	15,617	-	15,617
	<u>16,319,912</u>	<u>1,725,469</u>	<u>18,045,381</u>

d) Tax cases and assessments

As at December 31, 2010, there are no tax cases under preliminary investigation, litigation and/or prosecution in courts or bodies outside the BIR.

As at reporting date, the year that remains open and currently under tax examination, for which no assessment has yet been received, is taxable year 2009.