BPI DIRECT SAVINGS BANK, INC.

FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED
DECEMBER 31, 2009 AND 2008

Independent Auditor's Report

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

We have audited the accompanying financial statements of BPI Direct Savings Bank, Inc., which comprise the statements of condition as of December 31, 2009 and 2008, and the statements of income, statements of total comprehensive income, changes in capital funds and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and the fair presentation of these financial statements in accordance with Philippine Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 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.

Opinion

In our opinion, the accompanying financial statements present fairly, in all materials respects, the financial position of BPI Direct Savings Bank, Inc. as of December 31, 2009 and 2008, and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards.

Isla Lipana & Co.

Blesilda A.Pestaño
Partner
CPA Cert. No. 40446
P.T.R. No. 0007713, issued on January 13, 2010, Makati City
SEC A.N. (individual) as general auditors 0049-AR-2
SEC A.N. (firm) as general auditors 0009-FR-2
TIN 112-071-927
BIR A.N. 08-000745-7-2007, issued on August 24, 2007; effective until August 24, 2010
BOA/PRC Reg. No. 0142, effective until December 31, 2010

Makati City
March 24, 2010

BPI DIRECT SAVINGS BANK, INC.

STATEMENTS OF CONDITION
DECEMBER 31, 2009 AND 2008
(All amounts in Philippine peso)

	Notes	**2009**	2008
RESOURCES			
DUE FROM OTHER BANKS	5	**75,907,813**	86,374,155
INTERBANK CALL LOANS RECEIVABLE	5	**174,058,000**	245,000,000
DUE FROM BANGKO SENTRAL NG PILIPINAS	5, 6	**2,730,826,295**	1,293,076,572
AVAILABLE-FOR-SALE SECURITIES, net	7	**28,468**	21,398
HELD-TO-MATURITY SECURITIES, net	8	**564,838,467**	674,728,222
LOANS AND ADVANCES, net	9	**793,148,171**	645,987,885
ASSETS HELD FOR SALE, net		**3,962,866**	3,962,867
INVESTMENT PROPERTY, net	10	**3,776,852**	3,886,925
BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT, net	11	**1,959,581**	2,013,248
OTHER RESOURCES	13	**28,372,696**	26,828,901
Total resources		**4,376,879,209**	2,981,880,173
LIABILITIES AND CAPITAL FUNDS			
DEPOSIT LIABILITIES	14	**3,774,180,771**	2,162,778,640
ACCRUED TAXES, INTEREST AND OTHER EXPENSES	15	**17,539,387**	14,404,425
OTHER LIABILITIES	16	**9,684,318**	270,201,220
Total liabilities		**3,801,404,476**	2,447,384,285
CAPITAL FUNDS	17		
Share capital		**374,533,300**	374,533,300
Reserves		**601,420**	601,420
Surplus		**200,315,545**	159,343,770
Accumulated other comprehensive income		**24,468**	17,398
Total capital funds		**575,474,733**	534,495,888
Total liabilities and capital funds		**4,376,879,209**	2,981,880,173

(The notes on pages 1 to 42 are an integral part of these financial statements.)

BPI DIRECT SAVINGS BANK, INC.

STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008
(All amounts in Philippine Peso)

	Notes	**2009**	2008
INTEREST INCOME			
Loans and advances	9	**74,684,734**	52,710,660
Deposits with banks	5,6	**88,840,111**	53,285,010
Held-to-maturity securities	8	**36,144,244**	37,931,322
Interbank call loans receivable	5	**8,836,153**	10,150,486
Available-for-sale securities	7	**-**	2,123,796
Gross receipts tax		**(10,425,258)**	(7,810,064)
		198,079,984	148,391,210
INTEREST EXPENSE ON DEPOSITS		**59,969,361**	29,105,801
NET INTEREST INCOME		**138,110,623**	119,285,409
(PROVISION FOR) REVERSAL OF PROVISION FOR IMPAIRMENT	9	**(7,568,685)**	1,498,046
NET INTEREST INCOME AFTER (PROVISION FOR) REVERSAL OF PROVISION FOR IMPAIRMENT		**130,541,938**	120,783,455
OTHER INCOME (CHARGES)			
Rental income	22	**-**	150,072
Profit on assets sold		**-**	43,600
Miscellaneous income	19	**14,714,080**	9,498,668
Gross receipts tax		**(1,320,127)**	(678,604)
		13,393,953	9,013,736
OTHER EXPENSES			
Compensation and fringe benefits	21	**29,865,695**	22,263,850
Occupancy and equipment-related expenses	10,11	**4,839,914**	5,269,288
Other operating expenses	22	**50,193,370**	31,071,340
		84,898,979	58,604,478
INCOME BEFORE PROVISION FOR INCOME TAX		**59,036,912**	71,192,713
PROVISION FOR INCOME TAX			
Current		**26,796,071**	20,687,853
Deferred	12	**(8,730,934)**	(2,240)
	20	**18,065,137**	20,685,613
NET INCOME FOR THE YEAR		**40,971,775**	50,507,100

(The notes on pages 1 to 42 are an integral part of these financial statements.)

BPI DIRECT SAVINGS BANK, INC.

STATEMENTS OF TOTAL COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008
(All amounts in Philippine Peso)

	Notes	2009	2008
NET INCOME FOR THE YEAR		**40,971,775**	50,507,100
OTHER COMPREHENSIVE INCOME	17		
Net change in fair value reserve on available-for-sale securities		**7,070**	(1,270,041)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**40,978,845**	49,237,059

(The notes on pages 1 to 42 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, 2009 AND 2008
(All amounts in Philippine Peso)

	Share Capital (Note 17)	Reserves (Note 17)	Surplus (Note 17)	Accumulated other comprehensive income	Total
Balance, January 1, 2008	374,533,300	493,494	308,836,670	1,287,439	685,150,903
Total comprehensive income for the year	-	-	50,507,100	(1,270,041)	49,237,059
Dividends declared	-	-	(200,000,000)		(200,000,000)
Value of services under the stock option plan	-	107,926	-	-	107,926
Balance, December 31, 2008	374,533,300	601,420	159,343,770	17,398	534,495,888
Total comprehensive income for the year	**-**	**-**	**40,971,775**	**7,070**	**40,978,845**
Dividends declared	**-**	**-**	**-**	**-**	**-**
Value of services under the stock option plan	**-**	**-**	**-**	**-**	**-**
Balance, December 31, 2009	**374,533,300**	**601,420**	**200,315,545**	**24,468**	**575,474,733**

(The notes on pages 1 to 42 are an integral part of these financial statements.)

BPI DIRECT SAVINGS BANK, INC.

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008
(All amounts in Philippine Peso)

	Notes	**2009**	2008
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before provision for income tax		**59,036,912**	71,192,713
Adjustments for:			
(Reversal of) Provision for impairment	9	**7,568,685**	(1,498,046)
Depreciation and amortization	10,11	**1,531,507**	989,045
Share-based compensation		**-**	107,926
Interest income		**(208,505,242)**	(156,201,274)
Interest expense		**59,969,361**	29,105,801
Interest received on loans and advances and bank deposits		**172,798,184**	123,490,866
Interest paid		**(59,463,152)**	(27,944,095)
Operating income before changes in operating assets and liabilities		**32,936,255**	39,242,936
Changes in operating assets and liabilities			
(Increase) decrease in:			
Due from Bangko Sentral ng Pilipinas	5,6	**(34,000,000)**	(16,000,000)
Loans and advances	9	**(154,801,448)**	(237,256,762)
Other resources	13	**7,730,956**	(13,931,290)
Assets held for sale		**-**	(4,391,642)
Increase (decrease) in:			
Deposit liabilities	14	**1,611,402,132**	1,002,227,008
Accrued taxes, interest and other expenses	15	**2,158,691**	4,291,929
Other liabilities	16	**(260,516,901)**	(65,507,699)
Net cash generated from operations		**1,204,909,685**	708,674,480
Income tax paid		**(27,234,538)**	(23,413,282)
Net cash generated from operating activities		**1,177,675,147**	685,261,198
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of:			
Held-to-maturity securities	8	**-**	(439,188,811)
Maturities/disposal of:			
Available-for-sale securities	7	**-**	83,432,957
Held-to-maturity securities	8	**113,821,394**	196,805,069
Interest received on:			
Available-for-sale securities		**-**	4,428,215
Held-to-maturity securities		**32,212,605**	44,142,747
Additions to bank premises, furniture, fixtures and equipment	11	**(1,367,767)**	(1,479,123)
Proceeds from disposal of bank premises, furniture, fixtures and equipment		**-**	-
Net cash provided by(used in) investing activities		**144,666,232**	(111,858,946)
NET INCREASE IN CASH AND CASH EQUIVALENTS		**1,322,341,379**	573,402,252
CASH AND CASH EQUIVALENTS			
January 1		**1,580,450,728**	1,007,048,476
December 31	5	**2,902,792,107**	1,580,450,728

(The notes on pages 1 to 42 are an integral part of these financial statements)

BPI DIRECT SAVINGS BANK, INC.

NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED
DECEMBER 31, 2009 AND 2008
(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 63 and 56 regular employees as of December 31, 2009 and 2008, respectively.

These financial statements have been approved and authorized for issuance by the Board of Directors on March 24, 2010.

Note 2 - Summary of Significant Accounting Policies

The principal accounting policies applied in the preparation of these 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, Philippines 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 financial assets.

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. Changes in assumptions may have a significant impact on the financial statements in the period the assumptions changed. Management believes that the underlying assumptions are appropriate and that the Bank’s financial statements therefore present the financial position and results fairly. 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.

New standards, interpretations and amendments to published
standards effective for periods beginning January 1, 2009 and onwards

The Bank adopted the following accounting standards and interpretations approved by the FRSC which are effective for annual periods beginning on or after January 1, 2009:

Philippine Interpretations effective for annual periods beginning on or after July 1, 2008

- *Philippine Interpretation IFRIC 13, Customer Loyalty Program,* (effective from July 1, 2008). This clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values. This interpretation does not have an impact as the Bank does not have any customer loyalty program.

- *Philippine Interpretation IFRIC 16, Hedges of a Net Investment in a Foreign Operation* (effective from October 1, 2008). This interpretation provides guidance on the following: (a) identifying the foreign currency risks that can qualify as a "hedged risk" in the hedge of a net investment in a foreign operation; (b) identifying situations where hedging instruments that are hedges of a net investment in a foreign operation can qualify for hedge accounting under PAS39; and (c) determining the amounts to be reclassified from equity to profit and loss for both the hedging instrument and the hedged item when using hedge accounting under PAS39. This interpretation does not have an impact on the Bank's financial statements as the Bank has no investment in foreign operations.

Standards and amendments to existing standards that are effective for annual periods beginning January 1, 2009 and have been adopted by the Bank.

- *PAS 1 (Revised), Presentation of Financial Statements* (effective from January 1, 2009). The revised standard requires the presentation of all non-owner changes in equity (i.e., comprehensive income) in a statement of total comprehensive income or in a statement of profit or loss together with a statement of total comprehensive income, separately from owner changes in equity. PAS 1 (Revised) also requires, as a minimum, the presentation of three statements of financial position (balance sheet) in a complete set of financial statements whenever there is a prior period adjustment or a reclassification of items in the financial statements – as at the end of the current period, the end of the comparative period and the beginning of the comparative period. In other cases, only two statements of financial position are required. Dividends recognized as distributions to owners and related per-share amounts should be presented on the face of the statement of changes in equity or in the notes and not on the face of the statement of total comprehensive income or the face of the income statement. As a result, the Bank presents in the statement of changes capital funds all owner changes in equity, whereas all non-owner changes in equity are presented in the statement of total comprehensive income. Further, the adoption of revised PAS 1 did not have an impact on surplus.

- *PAS 23 (Amended), Borrowing Costs* (effective from January 1, 2009). The amendment requires an entity to capitalize borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset (one that takes a substantial period of time to get ready for use or sale) as part of the cost of that asset. The option of immediately expensing those borrowing costs has been removed. PAS 23 (Amended) has been adopted from January 1, 2009 but is currently not applicable to the Bank as there are no qualifying assets.

- *PAS 32 (Amendment), Financial Instruments: Presentation, and PAS 1 (Amendment), Presentation of Financial Statements - Puttable Financial Instruments and Obligations Arising on Liquidation* (effective from January 1, 2009). The amended standards require entities to classify puttable financial instruments, or components of instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation as equity, provided the financial instruments have particular features and meet specific conditions. The Bank applied PAS 32 and PAS 1 (Amendment) from January 1, 2009 but Amendment has no significant impact on the Bank's financial statements.

- *PFRS 2 (Amendment), Share-based Payment* (effective from January 1, 2009). The amended standard deals with vesting conditions and cancellations. It clarifies that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. As such these features would need to be included in the grant date fair value for transactions with employees and others providing similar services, that is, these features would not impact the number of awards expected to vest or valuation thereof subsequent to grant date. All cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The Bank applied PFRS 2 (Amendment) from January 1, 2009, but the Amendment has no material impact on the financial statements.

- *PFRS 7 (Amendment), Financial Instruments: Disclosures – Improving about Financial Instruments* (effective January 1, 2009). The amendment requires enhanced disclosures about fair value measurements and liquidity risk. In particular, the amendment requires disclosure of fair value measurement by level of fair value measurement hierarchy. The adoption of the amendment resulted in additional disclosures (see Note 3.5) but did not have an impact on the financial position or the total comprehensive income of the Bank.

- *PFRS 8, Operating Segments* (effective January 1, 2009). PFRS 8 replaces PAS 14 and aligns segment reporting with the requirements of the United States Statement of Financial Accounting Standard 131, "Disclosures about segments of an enterprise and related information". This new standard requires a "management approach", under which segment information is presented on the same basis as that used for internal reporting purposes. Under the requirements of PFRS 8, the Bank's external segment reporting will be based on the internal reporting to the Executive Committee of the Board of Directors (in its function as the chief operating decision-maker), which makes decisions on the allocation of resources and assesses the performance of the reportable segments. The adoption of PFRS 8 however, did not have a significant impact on the financial position of the Bank as it currently does not have operating segments.

Likewise, the following standards, amendments and interpretations to existing standards have been published and are applicable for the Bank beginning on or after January 1, 2010 but the Bank has not early adopted.

- *PAS 27 (Revised), Consolidated and Separate Financial Statements* (effective from July 1, 2009). The revised standard requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value and a gain or loss is recognized in profit or loss. This amendment is not expected to have an impact on the Bank's financial statements as the Bank does not have subsidiaries.

- *PFRS 3 (Revised), Business Combinations* (effective July 1, 2009). The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the income statement. There is a choice, on an acquisition-by-acquisition basis, to measure the non-controlling interest in the acquiree either at fair vale or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs should be expensed. This revised standard will be applied by the Bank in its financial statements for the period commencing January 1, 2010.

- *Philippine Interpretation IFRIC 17, Distribution of Non-Cash Assets to Owners* (effective for accounting periods beginning on or after 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 owners 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 equity as adjustments to the amount of the distribution. This interpretation will be adopted by the Bank on its financial statements beginning January 1, 2010.

- *Improvements to PFRS.* Improvements to PFRS comprise amendments that result in accounting changes for presentation, recognition or measurement purposes, as well as terminology or editorial amendments related to a variety of individual PFRS standards. Most of the amendments are effective for annual periods beginning on or after January 1, 2009 and January 1, 2010, with earlier application permitted. No material changes to accounting policies are expected as a result of these amendments.

- *IFRS 9, 'Financial Instruments part 1:, Classification and Measurement'*. IFRS 9 was issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of financial assets. Key features are as follows:

  (i) Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortized cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

  (ii) An instrument is subsequently measured at amortized cost only if it is a debt instrument and both the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and the asset's contractual cash flows represent only payments of principal and interest. All other debt instruments are to be measured at fair value through profit or loss.

  (iii) All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognize unrealized and realized fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

  While adoption of IFRS 9 is mandatory from January 1, 2013, earlier adoption is permitted. The Bank is currently assessing the implications and impact of IFRS 9.

2.2 Cash and cash equivalents

Cash and cash equivalents consist of Due from Other Banks and 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. As of December 31, 2009 and 2008, 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 (liquidity and statutory reserve account) and Other Banks and Interbank Call Loans Receivable.

(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. Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership.

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 capital funds, until the financial asset is derecognized or impaired at which time the cumulative gain or loss previously recognized in capital funds 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 Financial asset 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 of financial assets

Financial assets are derecognized when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets 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).

2.4 Impairment of financial assets

(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 an impairment loss include:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower (for example, equity ratio, net income percentage of sales);
- 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 the 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.

2.5 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. Gains and losses arising from changes in fair value of financial liabilities classified held for trading are included in the statement of income. 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, amounts due to BSP, subordinated notes and other debt securities in issue.

Financial liabilities are derecognized when they have been redeemed or otherwise extinguished. Collateral (shares and bonds) furnished by the Bank under standard repurchase agreements and securities lending and borrowing transactions is not derecognized because the Bank retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for de-recognition are therefore not met.

2.6 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.

For more complex instruments, the Bank uses internally developed models, which are usually based on valuation methods and techniques generally recognized as standard within the industry. Valuation models are used primarily to value derivatives transacted in the over-the-counter market, unlisted debt securities (including those with embedded derivatives) and other debt instruments for which markets were or have become illiquid. Some of the inputs to these models may not be market observable and are therefore estimated based on assumptions.

The Bank uses its own credit risk spreads in determining the current value for its derivative liabilities. When the Bank credit spreads widen, the Bank recognizes a gain on these liabilities because the value of the liabilities has decreased. When the Bank's credit spreads narrow, the Bank recognizes a loss on these liabilities because the value of the liabilities has increased.

The output of a model is always an estimate or approximation of a value that cannot be determined with certainty, and valuation techniques employed may not fully reflect all factors relevant to the positions the Bank holds. Valuations are therefore adjusted, where appropriate, to allow for additional factors including model risks, liquidity risk and counterparty credit risk. Based on the established fair value model governance policies, and related controls and procedures applied, management believes that these valuation adjustments are necessary and appropriate to fairly state the values of financial instruments carried at fair value in the statement of condition. Price data and parameters used in the measurement procedures applied are generally reviewed carefully and adjusted, if necessary –particularly in view of the current market developments.

The fair value of over-the-counter (OTC) derivatives is determined using valuation methods that are commonly accepted in the financial markets, such as present value techniques and option pricing models. The fair value of foreign exchange forwards is generally based on current forward exchange rates. Structured interest rate derivatives are measured using appropriate option pricing models (for example, the Black-Scholes model) or other procedures such as Monte Carlo simulation.

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.

2.7 Classes of financial instruments

The Bank classifies the financial instruments into classes that reflect the nature of information and take into account the characteristics of those financial instruments. The classification made can be seen in the table below:

	Categories (as defined by PAS 39)	Classes (as determined by the Bank): Main classes	Sub-classes	
Financial assets	Financial assets at fair value through profit or loss	- Trading securities	- Debt securities - Equity securities	
		- Derivative financial assets		
	Loans and receivables	- Loans and advances to banks		
		- Loans and advances to customers	- Loans to individuals (retail)	- Real estate mortgages - Auto loans - Credit cards - Others
			- Loans to corporate entities	- Large corporate customers - SMEs
	Held-to-maturity investments	- Investment securities (debt securities)	- Listed - Unlisted	
	Available-for-sale financial assets	- Investment securities (debt securities)	- Listed - Unlisted	
		- Investment securities (equity securities)	- Listed - Unlisted	
Financial Liabilities	Financial liabilities at fair value through profit or loss	Derivative financial liabilities		
	Financial liabilities at amortized cost	Deposits from customers	Retail customers Large corporate customers SMEs	
		Deposits from banks		
		Unsecured subordinated debts		
		Bills payable		
		Other liabilities		
Off-balance sheet financial instruments	Loan commitments			
	Guarantees, acceptances and other financial facilities			

2.8 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.

2.9 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.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are included in the statement of income.

2.10 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.

2.11 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.

2.12 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 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.

2.16 Provisions

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.

2.17 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 substantially 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 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

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 30% effective January 1, 2009; 2) change in allowable deduction for interest expense from 38% to 42% effective November 1, 2005 and 33% beginning January 1, 2009; and 3) revised rates for gross receipts tax (GRT).

On December 20, 2008, Revenue Regulations 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. The Bank did not avail of the OSD for purposes of income tax calculation in 2009 and 2008.

On February 18, 2010, Revenue Regulations No. 2-2010, amending Revenue Regulations 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.

2.18 Employee benefits

(a) Pension obligations

The BPI Group, which includes the Bank, operates various pension schemes. The schemes are funded through payments to trustee-administered funds, determined by periodic actuarial calculations. The group, has 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 unified plan is funded through payments to trustee-administered funds, determined by periodic actuarial calculations.

The liability recognized in the statement of condition in respect of defined benefit pension plan is the present value of the defined benefit obligation at the reporting date less the fair value of plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs, if any. 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 to 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 entities within the BPI Group 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) Share-based compensation

The Bank engages in equity settled share-based payment transaction in respect of services received from certain of its employees.

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 employee services received in respect of the shares or share options granted is recognized in the statement 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.

2.19 Capital stock

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.

2.20 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.

2.21 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.

2.22 Comparatives

Except when a standard or an interpretation permits or requires otherwise, all amounts are reported or disclosed with comparative information.

Where PAS 8 applies, comparative figures have been adjusted to conform with changes in presentation in the current year.

2.23 Subsequent events or (Events after the balance sheet)

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

Note 3 - Financial Risk 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 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 consisting of Due from BSP and Other Banks, Interbank Calls Loan Receivable and (b) debt securities consisting of Investment 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:

a. *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.

b. *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.

c. *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.

d. *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.

e. *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. Some of these specific control and mitigation measures are outlined below.

(a) Collateral

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.

(b) Master netting arrangements

The Bank further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, the credit risk associated with favorable contracts (asset position) is reduced by a master netting arrangement to the extent that if a default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Bank's overall exposure to credit risk on derivative instruments subject to master netting arrangements can change substantially within a short period, as it is affected by each transaction subject to the arrangement.

(c) Credit-related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Standby letters of credit carry the same credit risk as loans. Documentary and commercial letters of credit - which are written undertakings by the Bank on behalf of a customer authorizing a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions - are collateralized by the underlying shipments of goods to which they relate and therefore carry less risk than a direct loan.

Commitments to extend credit represent unused portions of authorizations to extend credit in the form of loans, or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

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 2.4).

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

	2009		2008	
	Loans and advances (%)	**Impairment provision (%)**	Loans and advances (%)	Impairment provision (%)
Unclassified	**97.65**	**0.40**	99.64	0.07
Loans especially mentioned	**0.00**	**0.00**	0.05	3.63
Substandard	**1.96**	**27.48**	0.00	0.00
Doubtful accounts	**0.39**	**0.00**	0.31	58.00
	100.00		100.00	

3.1.4 Maximum exposure to credit risk

Credit risk exposures relating to balance sheet financial assets at December 31 are as follows:

	Notes	**2009**	2008
Due from other banks	5	**75,907,813**	86,374,155
Interbank call loans receivable	5	**174,058,000**	245,000,000
Due from BSP	5,6	**2,730,826,295**	1,293,076,572
Available-for-sale securities, net	7	**28,468**	21,398
Held-to-maturity securities	8	**564,838,467**	674,728,222
Loans and advances, net	9	**793,148,171**	645,987,885
Other resources	13	**7,745,795**	12,368,947

The above table represents a worst case scenario of credit risk exposure to the Bank at December 31, 2009 and 2008, without taking into account any collateral held or other credit enhancements attached. The exposures set out above are based on net carrying amounts as reported in the statement of condition.

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:

- 97.7% of the loans and advances portfolio is categorized in the top two grades of the internal rating system in 2009 (2008 - 99.7%);
- Mortgage loans are backed by collateral;
- 97.4% of the loans and advances portfolio are considered to be neither past due nor impaired in 2009 (2008 - 98.5%); 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:

	Note	2009	2008
Neither past due nor impaired		**781,718,707**	637,960,014
Past due but not impaired		**1,801,897**	1,530,398
Past due and impaired		**18,853,749**	8,154,970
	9	**802,374,353**	647,645,382
Allowance for impairment	9	**(9,226,182)**	(1,657,497)
	9	**793,148,171**	645,987,885

There were no renegotiated loans and advances in 2009 and 2008.

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 the management's assessment of the portfolio on an individual and collective basis. Details of these accounts at December 31 are as follows:

	Note	2009	2008
Corporate entities:			
Large corporate customers		**41,432,289**	32,283,394
Small and medium enterprises		**2,758,926**	12,050,943
Retail customers:			
Real estate mortgages		**631,152,534**	507,117,356
Auto loans		**106,374,958**	86,508,321
	9	**781,718,707**	637,960,014

Loans and advances that were past due and impaired represents past due accounts from 1 - 30 days to more than 180 days past due. Non-performing loans under this category, aged more than 90 days past due, amounted to 18,853,749 (2008 – P8,154,970). Loans and advances under this category are assessed for impairment on individual and collective basis. For 2009, 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 P2,730,826 thousand and P1,293,076 thousand as of December 31, 2009 and 2008, 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, 2009 and 2008. The table below presents the credit rating of counterparty banks.

	2009	2008
AAA	**-**	-
AA- to AA+	**-**	-
A- to A+	**-**	-
Lower than A-	**174,058,000**	245,000,000
Unrated	**75,907,813**	86,374,155
	249,965,813	331,374,155

c. Debt securities, treasury bills and other government securities

The table below presents the ratings of debt securities, treasury bills and other government securities at December 31 based on Standard & Poor's:

<u>At December 31, 2009</u>

	Note	Available-for-Sale	Held-to-Maturity	Total
December 31, 2009				
Lower than A-	8	-	564,838,467	564,838,467
Unrated		-	-	-
		-	564,838,467	564,838,467

<u>At December 31, 2008</u>

	Note	Available-for-Sale	Held-to-Maturity	Total
December 31, 2008				
Lower than A-	8	-	674,728,222	674,728,222
Unrated		-	-	-
		-	674,728,222	674,728,222

d. Other financial assets

The Bank's other financial assets (shown under Other resources) as of December 31, 2009 and 2008 consist mainly of accounts receivable and accrued interest and fees receivable from various unrated counterparties.

3.1.7 Repossessed or foreclosed collateral

In 2009, the Bank acquired assets by taking possession of collaterals held as security for loans and advances with carrying amount of P4,391,641. The related foreclosed collaterals have aggregate fair value of P4,514,375. Foreclosed collaterals include real estate (land and building).

Repossessed 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	75,907,813	-	-	-	-	-	**75,907,813**
Interbank call loans receivable	174,058,000	-	-	-	-	-	**174,058,000**
Due from BSP	2,730,826,295	-	-	-	-	-	**2,730,826,295**
Available-for-sale, net	-	-	-	-	-	-	-
Held-to-maturity	-	-	-	-	564,838,467	-	**564,838,467**
Loans and advances, net	-	675,884,875	857,162	96,383,685	29,248,631	(9,226,182)	**793,148,171**
Other resources	-	-	-	-	7,745,795	-	**7,745,795**
At December 31, 2009	2,980,792,108	675,884,875	857,162	96,383,685	601,832,893	(9,226,182)	**4,346,524,541**
2008	86,374,155	523,783,117	929,214	111,552,475	2,236,588,127	(1,669,909)	**2,957,557,179**

3.2 Market risk management

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 which affects mainly the Bank's trading securities portfolio and cash flow risks on available for sale securities portfolio which is carried at market. 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, 2009					
Assets					
Due from other banks	-	-	-	75,907,813	**75,907,813**
Interbank call loans receivable	-	-	-	174,058,000	**174,058,000**
Due from BSP	-	-	-	2,730,826,295	**2,730,826,295**
Available-for-sale, net	-	-	-	28,468	**28,468**
Held-to-maturity	-	-	-	564,838,467	**564,838,467**
Loans and advances, net	95,818,359	142,856,769	544,275,013	10,198,030	**793,148,171**
Other resources	-	-	-	7,745,795	**7,745,795**
Total financial assets	95,818,359	142,856,769	544,275,013	3,563,602,868	**4,346,553,009**
Liabilities					
Deposit liabilities	736,350,971	-	-	3,037,829,800	**3,774,180,771**
Accrued interest	2,295,802	-	-	264,662	**2,560,464**
Other liabilities	-	-	-	1,181,919	**1,181,919**
Total financial liabilities	738,646,773	-	-	3,039,276,381	**3,777,923,154**
Total interest repricing gap	(642,828,414)	142,856,769	544,275,013	524,326,487	**568,629,855**
As at December 31, 2008					
Total financial assets	5,475,814	60,268,036	261,903,857	2,629,909,472	**2,957,557,179**
Total financial liabilities	471,583,817	-	-	1,894,422,780	**2,366,006,597**
Total interest repricing gap	(466,108,003)	60,268,036	261,903,857	735,486,692	**591,550,582**

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 Bank has minimal financial assets and liabilities denominated in foreign currency. As such, the Bank has no significant exposure to foreign exchange risk (Note 19).

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:

	2009	2008
Deposit liabilities	**3,774,180,771**	2,162,778,640
Accrued interest	**2,560,384**	2,054,254
Other liabilities	**1,181,919**	201,173,703
	3,777,923,074	2,366,006,597

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 value 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	
	2009	2008	**2009**	2008
Financial assets				
Due from other banks	**75,907,813**	86,374,155	**75,907,813**	86,374,155
Interbank call loans receivable	**174,058,000**	245,000,000	**174,058,000**	245,000,000
Due from BSP	**2,730,826,295**	1,293,076,572	**2,730,826,295**	1,293,076,572
Held-to-maturity, net	**564,838,467**	674,728,222	**559,400,988**	669,169,993
Loans and advances, net	**793,148,171**	645,987,885	**1.032,294,872**	867,469,446
Other resources, net	**7,745,795**	12,368,947	**7,745,795**	12,368,947
Financial liabilities				
Deposit liabilities	**3,774,180,771**	2,162,778,640	**3,774,180,771**	2,162,778,640
Accrued interest	**2,560,384**	2,054,254	**2,560,384**	2,054,254
Other liabilities	**1,181,919**	201,173,703	**1,181,919**	201,173,703

(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 of December 31, 2009, the Bank has available-for-sale financial assets in the form of equity securities that fall under Level 1 amounting to P28,468. The Bank has no financial instruments that fall under the Levels 2 and 3 categories as of December 31, 2009.

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 capital stock, 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, 2009 and 2008. The Basel II framework following BSP Circular 538 took effect on July 1, 2007.

	2009	2008
Tier 1 capital	**559,870,473**	522,980,000
Tier 2 capital	**5,959,020**	4,231,000
Gross qualifying capital	**565,829,493**	527,211,000
Less: Required deductions	**-**	-
Total qualifying capital	**565,829,493**	527,211,000
Risk weighted assets	**823,822,488**	616,114,000
CAR (%)	**66.683%**	85.570%

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.

A. Critical accounting estimates

(a) 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.

(b) Pension liability on defined benefit plan (Note 21)

The Bank estimates its pension benefit obligation and expense for defined benefit pension plans based on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in Note 21 and include, among others, the discount rate, expected return on plan assets and future salary increases. The present value of the defined benefit obligations of the Bank at December 31, 2009 and 2008 are determined using the market yields on Philippine government bonds with terms consistent with the expected payments of employee benefits. Plan assets are invested in either equity securities, debt securities or other forms of investments. Equity markets may experience volatility, which could affect the value of pension plan assets. This volatility may make it difficult to estimate the long-term rate of return on plan assets. Actual results that differ from the Bank's assumptions are accumulated and amortized over future periods and therefore generally affect the Bank's recognized expense and recorded obligation in such future periods. The Bank's assumptions are based on actual historical experience and external data regarding compensation and discount rate trends.

B. Critical accounting judgments

(a) Impairment of available-for-sale securities (Note 7)

The Bank follows the guidance of PAS 39 - "Financial instruments - Recognition and Measurement" to determine when an available-for-sale security is impaired. This determination requires significant judgment. In making this judgment, the Bank evaluates, among other factors, the duration and extent to which the fair value of an investment is less than its cost; and the financial health and near-term business outlook of the investee, including factors such as industry and sector performance, changes in technology and operational and financing cash flow.

(b) 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.

(c) 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 2009, the Bank did not recognize impairment loss on its foreclosed assets (2008 – P428,775).

(d) 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 can not 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	**2009**	2008
Due from other banks		**75,907,813**	86,374,155
Interbank call loans receivable		**174,058,000**	245,000,000
Due from BSP	6	**2,652,826,294**	1,249,076,573
		2,902,792,107	1,580,450,728

Interbank call loans receivable at December 31, 2009 and 2008 represents short-term lendings to the BSP. Average effective interest rates on interbank call loans receivable is 4.47% and 5.63% in 2009 and 2008, 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

The account at December 31 consists of:

	2009	2008
Government securities	**-**	-
Other investments	**40,880**	33,810
	40,880	33,810
Accrued interest receivable	**-**	-
Allowance for impairment	**(12,412)**	(12,412)
	28,468	21,398

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

	2009	2008
Balance, January 1	**21,398**	85,773,264
Additions	**-**	-
Maturities	**-**	(81,945,000)
Amortization of premium	**-**	(1,487,957)
Fair value adjustment	**7,070**	(14,490)
Accrued interest receivable	**-**	(2,304,419)
Balance, December 31	**28,468**	21,398

Available-for-sale securities are in the form of government securities with maturities of less than one year. In 2009, the only movement for available-for-sale securities pertains to fair value adjustment.

Note 8 - Held-to-Maturity Securities

The account consists of government securities and movement in the account is summarized as follows:

	2009	2008
Balance, January 1	**674,728,222**	439,793,431
Additions	**-**	439,188,811
Maturities	**(113,821,394)**	(196,805,069)
Amortization of premium	**(8,611,355)**	(20,384,634)
Accrued interest receivable	**12,542,994**	12,935,683
Balance, December 31	**564,838,467**	674,728,222

Average effective interest rates on held-to-maturity securities are 7.08% and 7.03% in 2009 and 2008, respectively.

Note 9 - Loans and Advances

The account at December 31 consists of:

	2009	2008
Corporate entities		
Large corporate customers	**41,432,289**	32,283,392
Small and medium enterprise	**2,788,691**	12,050,943
Retail customers		
Real estate mortgages	**643,697,608**	510,863,793
Auto loans	**130,824,179**	104,526,044
	818,742,767	659,724,172
Accrued interest receivable	**4,220,500**	4,341,552
Unearned discount	**(20,588,914)**	(16,420,342)
	802,374,353	647,645,382
Allowance for impairment	**(9,226,182)**	(1,657,497)
	793,148,171	645,987,885

	2009	2008
Current	**8,534,048**	7,348,225
Non-current	**793,840,305**	640,297,157
	802,374,353	647,645,382

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

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

	2009	2008
Private household with employed persons	**84.24**	80.92
Real estate, renting and other related activities	**12.01**	17.22
Wholesale and retail trade	**0.44**	0.65
Agriculture and forestry	**0.00**	0.00
Manufacturing	**0.11**	0.14
Financial institutions	**0.00**	0.00
Others	**3.20**	1.07
	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

	2009	2008
Secured loans		
Real estate mortgage	**685,610,654**	558,743,820
Chattel mortgage	**110,235,265**	88,105,701
Others	**5,007,279**	-
	800,853,198	646,849,521
Unsecured loans	**1,521,155**	795,861
	802,374,353	647,645,382

Average effective interest rates on loans and advances are 10.12% and 10.57% in 2009 and 2008, respectively.

The movement in allowance for impairment is as follows:

	2009	2008
Balance, January 1	**1,657,497**	3,584,319
Provision for (reversal of provision for) impairment	**7,568,685**	(1,926,822)
Balance, December 31	**9,226,182**	1,657,497

Reversal of provision for impairment is attributed to improved level of past due loans in a particular aging category, where collective impairment provision is assessed and determined by the Bank.

Note 10 - Investment Property

The account at December 31 consists of:

	2009	2008
Land	**419,850**	419,850
Building	**5,502,079**	5,502,079
	5,921,929	5,921,929
Accumulated depreciation	**(2,145,077)**	(2,035,004)
	3,776,852	3,886,925

The movement in the account is summarized as follows:

	2009	2008
Balance, January 1	**3,886,925**	3,996,998
Depreciation	**(110,073)**	(110,073)
Balance, December 31	**3,776,852**	3,886,925

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:

	2009	2008
Cost		
Balance, January 1	**5,010,213**	3,531,090
Additions	**1,367,767**	1,479,123
Disposals	**-**	-
Balance, December 31	**6,377,980**	5,010,213
Accumulated depreciation		
Balance, January 1	**2,996,965**	2,117,993
Depreciation	**1,421,434**	878,972
Disposals	**-**	-
Balance, December 31	**4,418,399**	2,996,965
Net book value - December 31	**1,959,581**	2,013,248

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:

	Notes	**2009**	2008
Deferred income tax assets			
Allowance for impairment	9	**2,900,210**	629,605
MCIT		**1,695,687**	787,163
NOLCO		**7,503,604**	1,066,940
Expense accruals		**180,426**	180,426
Total deferred income tax assets		**12,279,927**	2,664,134
Deferred income tax liability			
Pension asset	21	**(921,755)**	(945,420)
Deferred income tax asset, net	13	**11,358,172**	1,718,714

Net deferred income tax asset is included under Other resources in the statement of condition.

	2009	2008
Deferred income tax assets		
Amount to be recovered within 12 months	**250,000**	-
Amount to be recovered after 12 months	**12,029,927**	2,664,134
	12,279,927	2,664,134
Deferred income tax liabilities		
Amount to be settled within 12 months	**535,199**	23,665
Amount to be settled after 12 months	**386,556**	921,755
	921,755	945,420

The movement in the net deferred income tax asset is summarized below:

	2009	2008
At January 1	**1,718,714**	929,311
Income statement charge	**8,730,934**	2,240
MCIT	**908,524**	787,163
At December 31	**11,358,172**	1,718,714

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

	2009	2008
Allowance for impairment	**(2,270,605)**	629,250
Pension asset	**(23,664)**	(349,097)
NOLCO	**(6,436,665)**	(1,066,940)
Others	**-**	784,547
	(8,730,934)	(2,240)

The outstanding NOLCO at December 31 consists of:

Year of Incurrence	Year of Expiration	**2009**	2008
2009	2012	**21,455,549**	-
2008	2011	**3,556,464**	3,556,464
		25,012,013	3,556,464
Used portion during the year		**-**	-
Expired portion during the year		**-**	-
		25,012,013	3,556,464
Tax rate		**30%**	30%
Deferred income tax asset on NOLCO		**7,503,604**	1,066,939

The details of MCIT at December 31 are as follows:

Year of Incurrence	Year of Expiration	**2009**	2008
2009	2012	**908,524**	
2008	2011	**787,163**	787,163
		1,695,687	787,163
Used portion during the year		**-**	-
Derecognized MCIT		**-**	-
		1,695,687	787,163

Note 13 - Other Resources

The account at December 31 consists of:

	Note	2009	2008
Accrued interest receivable		**3,707,715**	4,023,850
Accounts receivable		**4,038,080**	4,115,856
Pension asset	21	**3,072,517**	3,151,399
Deferred income tax asset, net	12	**11,358,172**	1,718,714
Prepaid expenses		**1,031,100**	1,046,698
Miscellaneous		**5,165,112**	12,772,384
		28,372,696	26,828,901

	2009	2008
Current	**9,053,547**	9,670,596
Non-current	**19,319,149**	17,158,305
	28,372,696	26,828,901

Accrued interest receivable in 2009 and 2008 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:

	2009	2008
Savings	**2,823,060,839**	1,554,690,537
Time deposits	**736,350,971**	471,583,818
Demand	**214,768,961**	136,504,285
	3,774,180,771	2,162,778,640

	2009	2008
Current	**3,774,180,771**	2,162,778,640
Non-current	**-**	-
	3,774,180,771	2,162,778,640

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

	2009	2008
Demand	**2,036,534**	563,355
Savings	**30,213,627**	16,514,045
Time	**27,719,200**	12,028,401
At December 31	**59,969,361**	29,105,801

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 of December 31 is comprised of:

	2009	2008
Due from BSP		
Reserve deposit account	**151,172,118**	42,674,836
Special deposit account	**75,586,059**	85,349,673
Cash in vault	**-**	-
Available for sale securities	**-**	-
Due from local banks	**-**	-
	226,758,177	128,024,509

Note 15 - Accrued taxes, interest and other expenses

The account at December 31 consists of:

	2009	2008
Accrued taxes and licenses	**4,695,774**	4,291,373
Accrued interest	**2,560,384**	2,054,254
Accrued other expenses	**10,283,229**	8,058,798
	17,539,387	14,404,425

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

Note 16 - Other Liabilities

This account consists mainly of miscellaneous payables amounting to 8 million in 2009 and dividends declared amounting to P200 million (Note 17) and other payable to a customer of P60 million in 2008.

Note 17 - Capital Funds

Authorized capital at December 31, 2009 and 2008 consist of:

	Number of Shares	Amount
Common shares, at P100 par value per share		
Class A	3,300,000	330,000,000
Class B	600,000	60,000,000
	3,900,000	390,000,000
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

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.

As of December 31, 2009 and 2008, outstanding number of Class A and Class B common shares is 3,300,000 and 445,333, respectively.

There were no movements in the number of issued common shares in 2009 and 2008.

There were no cash dividends declared in 2009. Cash dividends declared by the Board of Directors of the Bank in 2008 are summarised below:

	Date approved by		Amount of Dividends	
Date declared	the BSP	Date paid	Per Share	Total
August 27, 2008	October 27, 2008	February 9, 2009	53.39	200,000,000

The movements in Reserves for the years ended December 31, 2009 and 2008 are summarised below:

	Note	**2009**	2008
Fair value reserve on available-for-sale securities			
At January 1		**17,398**	1,287,439
Net change in fair value		**7,070**	(1,270,041)
At December 31		**24,468**	17,398
Stock option scheme			
At January 1		**601,420**	493,494
Value of employee services	18	**-**	107,926
At December 31		**601,420**	601,420
		625,888	618,818

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:

	2009	2008
At January 1	**31,130**	25,942
Granted	**-**	5,188
At December 31	**31,130**	31,130
Exercisable	**31,130**	31,130

Options granted in 2008 represent additional entitlement as a result of the declaration of stock dividends by the Parent Bank (Note 17). 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 exercised in 2009 and 2008 is P31.48. Options outstanding at December 31, 2009 have remaining contractual life of one year (2008 - two years) and weighted exercise price of P31.48. All outstanding options are fully exercisable as at December 31, 2009.

Note 19 - Miscellaneous Income

The account for the years ended December 31 consists of:

	2009	2008
Service fees	**11,286,600**	6,521,215
Foreign exchange gains	**3,427,480**	2,952,601
Others	**-**	24,852
	14,714,080	9,498,668

Note 20 - Income Taxes

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

	2009		2008	
	Amount	**%**	Amount	%
Statutory income tax	17,710,867	30.00	24,917,450	35.00
Effect of items not subject to statutory tax rate				
Tax-paid income	354,270	0.60	(4,669,651)	(6.56)
Others, net	-	0.00	437,814	0.61
Actual provision for income tax	18,065,137	30.60	20,685,613	29.05

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:

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

	2009	2008	2007	2006	2005
Present value of defined benefit obligation	**35,306,114**	14,178,709	16,576,970	10,701,104	4,983,352
Fair value of plan assets	**(16,058,496)**	(11,558,855)	(11,927,679)	(7,800,958)	(5,142,158)
Unfunded obligation losses / (Excess of fair value of plan assets over preset value of defined benefit obligation)	**19,247,618**	2,619,854	4,649,291	2,900,146	(158,806)
Unrecognized actuarial losses	**(22,320,135)**	(5,771,253)	(8,319,102)	(6,651,789)	(3,345,641)
Pension asset recognized in the statement of condition	**(3,072,517)**	(3,151,399)	(3,669,811)	(3,751,643)	(3,504,447)

Experience adjustments at December 31 consist of:

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

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

	2009	2008	2007	2006
At January 1	**11,558,855**	11,927,679	7,800,958	5,142,158
Expected return on plan assets	**708,558**	989,997	936,115	562,925
Contributions	**1,817,311**	1,267,936	941,039	823,788
Benefit payments	**-**	(256,526)	-	(396,128)
Assets allocated from the Parent Bank due to transfer of employees		-	-	229,246
Actuarial (losses) gains	**1,973,772**	(2,370,231)	2,249,567	1,438,969
At December 31	**16,058,496**	11,558,855	11,927,679	7,800,958

The plan assets at December 31 consist of:

	2009		2008	
	Amount	**%**	Amount	%
Equity securities	**8,029,248**	**50**	6,015,216	52
Debt securities	**7,868,663**	**49**	5,428,724	47
Others	**160,585**	**1**	114,915	1
	16,058,496	**100**	11,558,855	100

Pension plan assets of the unified plan include investment in BPI's common shares with fair value of 2,597 million and P2,370 million at December 31, 2009 and 2008, respectively. The actual return on plan assets attributable to the Bank amounts to P2,682,330 gain and P1,380,234 loss for the year ended December 31, 2009 and 2008, respectively.

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

	2009	2008	2007	2006
At January 1	**14,178,709**	16,576,970	10,701,104	4,983,353
Current service cost	**817,079**	1,119,582	870,327	412,678
Interest cost	**1,613,537**	1,379,204	856,088	635,503
Liabilities allocated from the Parent Bank due to transfer of employees	**-**	-	-	229,246
Benefit payments	**-**	(256,526)	-	(396,128)
Actuarial losses (gains)	**18,696,789**	(4,640,521)	4,149,451	4,836,452
At December 31	**35,306,114**	14,178,709	16,576,970	10,701,104

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

	2009	2008
Current service cost	**817,079**	1,119,582
Interest cost	**1,613,537**	1,379,204
Expected return on plan assets	**(708,558)**	(989,997)
Net actuarial loss recognized during the year	**174,135**	277,559
Total expense included in Compensation and fringe benefits	**1,896,193**	1,786,348

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

	2009	2008
Discount rate	**10.87%**	11.38%
Expected return on plan assets	**10.52%**	6.13%
Future salary increases	**5.00%**	6.00%

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, 2009 and 2008 is 25 years.

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) Loans and advances and deposits from related parties

DOSRI loans and interest income earned are summarised below:

	2009	2008
Outstanding DOSRI loans	**2,575,352**	1,722,570
Percentage to total outstanding loans and advances	**0.32%**	0.27%
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, 2009 and 2008, 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:

	2009	2008
Parent Bank	**72,711,602**	77,589,224
Fellow subsidiaries	**3,196,211**	8,784,931

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

	2009	2008
Shared costs charged by the Parent Bank	**28,249,356**	15,825,191
Rent income	**-**	150,072
Interest income		
Parent Bank	**100,459**	111,778
Fellow subsidiaries	**15,779**	13,303

(c) Key management compensation

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

	2009	2008
Salaries and other short-term benefits	**7,850,908**	5,537,555
Post-employment benefits	**1,104,166**	513,569
Share-based compensation	**-**	107,925
Directors' remuneration	**498,000**	439,440

Note 23 - Basic Quantitative Indicators of Financial Performance

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

	2009	2008
Return on average equity	**7.37**	7.52
Return on average assets	**1.18**	2.17
Net interest margin	**4.01**	5.19

Note 24 - Other Commitments and Contingent Liabilities

The Bank has no outstanding commitments and contingent liabilities as of December 31, 2009 and 2008.