Terms and conditions of transactions with related parties:

The sales to and purchases from related parties are made at normal market prices and settlement is made in cash. There have been no guarantees provided or received for any related party receivables or payables. For the years ended December 31, 2011 and 2010, the Group has not made any provision for doubtful accounts relating to amounts owed by related parties. This assessment is undertaken each financial year through examination of the financial position of the related party and the market in which the related party operates.

27. Trust Operations

The Parent is authorized under its Charter to offer trust services and administer trust funds through its Trust Banking Group. The Parent accepts funds entrusted by clients and undertakes as trustee to invest such funds in acceptable securities or other investment outlets. Trust funds or assets under Management of the Parent under its trust operations amounted to P66,525,827 and P49,366,167 as at December 31, 2011 and 2010, respectively.

Summary of Assets under Management is as follows:

	2011	2010
Special Purpose Trust	6,937,449	9,111,632
Other Fiduciary Accounts	11,468,917	7,978,624
Agency	34,181,870	18,675,827
Trust	13,937,591	13,600,084
	66,525,827	49,366,167

In compliance with the requirements of the General Banking Law, government securities with total face value of P738,000 in 2011 and P774,260 in 2010 are deposited with BSP as security for the Parent's faithful performance of its fiduciary obligation.

28. Derivative Financial Instruments

Derivative instruments – fair values are estimated based on quoted market prices, prices provided by independent parties or values determined using accepted valuation models with observable inputs.

Freestanding Derivatives

Currency Forwards

As of December 31, 2011, the outstanding notional amount of the currency sell forward/ swap agreements with maturity of less than six months amounted to P18,345.71 million with market value of P18,445.16 million.

Foreign Exchange (FX) Risk Cover

The foreign exchange risk cover on foreign borrowings is a derivative financial instrument per BSP Monetary Board Resolution No. 1063 dated August 14, 2008 and its fair value changes are reported in the income statement. As of December 31, 2011, the outstanding notional amount of the FX risk cover amounted to US$40.42 million and JPY30,710.36 million.

Embedded Derivatives

Embedded Credit Derivatives

This includes credit default swaps embedded in host debt instruments and with credit linkages to reference entities. As of December 31, 2011, the Parent has no such outstanding credit derivatives.

Embedded Optionalities in Debt Investments

This includes call, put, extension, and conversion options in debt securities and loan receivables. The embedded call, put and extension options are deemed to be closely related to their host contracts, while the put option embedded in a debt investment is not deemed to be significant.

Embedded Currency Derivatives

The Group has currency derivatives embedded in host non-financial contracts such as lease agreements and purchase orders. As of December 31, 2011, these currency derivatives are not deemed to be significant.

29. Commitments and Contingent Liabilities

In the normal course of business, the Group makes various commitments and incurs certain contingent liabilities which are not presented in the financial statements. The Group does not anticipate material losses from these commitments and contingent liabilities.

The Group is contingently liable for lawsuits or claims filed by third parties which are either pending decision by the courts or under negotiation, the outcome of which is not presently determinable. In the opinion of Management and its legal counsel, the eventual liability under these lawsuits or claims, if any, will not have a material effect on the Group's financial statements.

The following is a summary of various commitments and contingencies at their equivalent peso revalued amounts arising from off-balance sheet items which the Parent has contracted:

	Parent	
	2011	**2010**
Trust Department accounts	66,525,827	49,366,167
Commitments	19,647,360	21,407,285
Standby/commercial letters of credit	4,900,134	8,175,571
Derivatives	404,053	611,219
Outstanding guarantees	1,569,604	1,430,564
Spot exchange contracts	964,480	43,840
Late deposits received	561,868	335,432
Outward bills for collection	60,096	96,349
Others	3,186,092	1,884,601
	97,819,514	83,351,028

30. Financial Performance

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

	2011	**2010**
Net interest margin ratio	4.22%	4.71%
Return on average assets	1.47%	1.50%
Return on average equity	13.80%	14.79%

31. Capital Funds

The Parent complies with the provision of RA 7656 on dividend declaration to the National Government (NG) and with the loan and guarantee agreements between the World Bank, the Parent and the Department of Finance (DOF). On February 6, 2012 and April 18, 2012, the Parent remitted an aggregate amount of P5.0 billion cash dividend to the NG, of which, P0.41 billion represents additional cash dividend for CY 2010 net income and P4.59 billion for CY2011 net income.

Capital Management

The overall capital management objective of the Group is to create a more efficient capital structure while ensuring compliance with externally imposed capital requirements.

The Group manages its capital by maintaining strong credit ratings and healthy capital ratios to support its business and sustain its mandate. Adjustments to the Group's capital structure are made in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

Regulatory Qualifying Capital

Under existing BSP regulations, the Parent's compliance with regulatory requirements and ratios is determined based on the amount of the Parent's unimpaired capital (regulatory net worth) as reported to the BSP.

In addition, the risk-based capital ratio of a bank, expressed as a percentage of qualifying capital to risk-weighted assets, should not be less than 10 per cent for both stand-alone basis (head office and branches) and consolidated basis (Parent and subsidiaries engaged in financial allied undertakings but excluding insurance companies). Qualifying capital and risk-weighted assets are computed based on BSP regulations. Risk-weighted assets consist of total assets less cash on hand, due from BSP, loans covered by hold-out on or assignment of deposits, loans or acceptances under letters of credit to the extent covered by margin deposits and other non-risk items determined by the Monetary Board (MB) of the BSP.

BSP Circular No. 360, effective July 1, 2003, issued guidelines that required a market risk charge when computing the capital-to-risk assets ratio (CAR). On August 4, 2006, BSP Circular No. 538 was issued prescribing the implementing guidelines for the revised risk-based capital adequacy framework for the Philippine banking system to conform with Basel II recommendations. The new BSP guidelines implemented effective July 1, 2007 included capital charges for operational risk using the basic indicator or standardized approach.

	(Amounts in Millions)			
	Group		Parent	
	2011	2010	2011	2010
Tier 1 Capital	41,597	37,836	41,645	37,869
Tier 2 Capital	13,604	19,486	13,589	19,476
Gross Qualifying Capital	55,201	57,322	55,234	57,345
Less: Required Deductions	1,146	1,105	2,309	2,193
Total Qualifying Capital	54,055	56,217	52,925	55,152
Risk Weighted Assets	324,056	311,597	321,371	309,464
Adjusted Tier 1 Capital ratio	12.66%	11.97%	12.60%	11.88%
Total Capital ratio (CAR)	16.68%	18.04%	16.47%	17.82%

The regulatory qualifying capital of the Parent consists of Tier 1 (core) capital, which comprises paid-up common stock, surplus including current year profit, surplus reserves less required deductions such as unsecured credit accommodations to DOSRI and deferred income tax. The other component of regulatory capital is Tier 2 (supplementary) capital, which includes unsecured subordinated debt, general loan loss provision and 45 per cent of net unrealized gain on available for sale equity securities purchased.

The Qualifying Capital of the Group and Parent decreased as of December 31, 2011 due to full settlement of the $150 million LT II unsecured subordinated notes last October 18, 2011 offset by increase in retained earnings. Increase in the Group's and Parent's risk-weighted assets as of December 31, 2011 was due to the expanded loan portfolio.

LBP Group has fully complied with the CAR requirement of the BSP.

32. Financial Risk Management

RISK MANAGEMENT ORGANIZATION

The LBP Group is involved in various banking activities that expose it to various risks which under the regular course of business requires the Bank to effectively measure and analyze, monitor and control identified risks. This includes credit risk, market risk (price risk, interest rate risk and foreign exchange risk) and liquidity risk. The Bank manages all risks in accordance with set principles, properly aligned organizational structure, defined duties and responsibilities, established policies and procedures as well as appropriate measurement, monitoring and control processes.

The following key principles support the Bank's approach to risk management:

- The Board of Directors manages risk-related functions and activities of the Bank based on a top-down structure.
- The Board exercises its risk management oversight functions through various committees like the Risk Management Committee (RiskCom), the Audit Committee (AC), the Asset and Liability Committee (ALCO) and the Investment and Loans Committee (ILEC). In general, the RiskCom serves as the overseer for managing the Bank's credit, market, liquidity, operational and other bank-wide risks in a coordinated manner within the organization. Specifically, it approves policies and evaluates effectiveness of the Bank's risk management framework.
- The Risk Management Group (RMG) is independent from risk taking units and performs the oversight function for all major risk areas (credit, market and liquidity, operational and other bank-wide risks). It handles risk management implementation, monitoring and control.
- Under RMG, which is headed by the Chief Risk Officer, are three departments created to handle specific risk areas as follows: Credit Policy and Risk Management Department (CPRMD), Treasury Risk Management Department (TRMD), and Business Risk Management Department (BRMD) for operations risk, including system, legal, technology and other risk.
- Enterprise Risk Management (ERM) complements the Bank's silo risk management approach and reinforces risk analysis as it cross-functionally examines interdependencies and dissects its sources.

RISK CATEGORIES

As the Bank recognizes all risks inherent to its mandate and its various business activities, it embarked on an Enterprise-wide Risk Management (ERM) Project to capture all risk events categorized under BSP Circular No. 510 (Guidelines on Supervision by Risk): credit risks, market risks, compliance risks, liquidity risks, interest rate risks, operations risks, reputation risks and strategic risks. The 52 risks that comprise the Bank's Risk Universe and falling under the above eight categories are defined, customized and given substance in the LANDBANK Risk Dictionary developed under the ERM initiative.

	Group		Parent	
	2011	2010	2011	2010
On-Balance sheet financial assets				
Cash and balances with BSP (excluding Cash on hand)	77,579,295	85,202,002	77,578,540	85,157,443
Due from banks	2,229,622	1,424,256	1,923,084	1,145,898
Interbank loans receivable	7,582,769	5,721,600	7,582,769	5,721,600
Securities purchased under resale agreements	48,500,000	6,683,000	48,500,000	6,683,000
Financial assets designated at fair value through profit or loss-Held for trading	8,427,454	10,297,922	8,427,454	10,297,922
Available-for-Sale Investments	143,295,705	148,811,463	143,170,605	148,731,672
Held-to-maturity Investments	44,283,642	41,615,084	43,774,238	41,064,528
Loans and receivables	277,960,284	234,732,382	276,117,645	233,444,966
Total	609,858,771	534,487,709	607,074,335	532,247,029
Off-Balance sheet items				
Financial guarantees	482,178	1,087,683	482,178	1,087,683
Loan commitments and Contingent liabilities	25,634,920	29,925,736	25,634,920	29,925,736
	26,117,098	31,013,419	26,117,098	31,013,419
Total Credit Risk Exposure	635,975,869	565,501,128	633,191,433	563,260,448

Where financial instruments are recorded at fair value, the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

The details on the maximum exposure to credit risk for each class of financial instrument are referred to in specific notes.

Risk concentrations of the maximum exposure to credit risk

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions.

The Parent has established concrete guidelines and procedures relative to managing, monitoring and reporting large exposures and credit risk concentrations in accordance with the rules and regulations issued by the BSP.

As of 31 December 2011, the Parent's qualifying capital covering credit risk is P55.234 billion. Based on the BSP definition, the Parent has set the benchmark for large exposures at P2.76 billion.

On the other hand, the Parent's Single Borrower's Limit (SBL) is pegged at P16.177 billion for direct lending and P22.648 billion for wholesale lending.

Overall credit risk management is a function of the Board of Directors (BOD)-level Risk Management Committee. In general, mitigation measures on credit risks are implemented at various levels. However, oversight on credit risk management is vested on the Risk Management Group which is independent from the business function. This is critical in ensuring the integrity and objectivity of the credit risk assessment, pricing, and management process.

The Parent ensures that the credit risks undertaken are commensurate with the risk appetite and the Parent's capacity to manage such risks. Thus, regular monitoring of both the level of risk and equity capital is undertaken to ensure that even in instances of major credit surprises, the Parent could sustain its operations in spite of the losses incurred and continue to be an efficient financial intermediary for development and institutional financing.

	Parent			
	2011		2010	
	Amount	%	Amount	%
Financial intermediation	36,420,149	14.2	33,907,918	15.9
Agriculture, hunting and forestry	50,007,025	19.6	44,599,605	20.9
Real estate, renting and business activities	27,104,951	10.6	23,502,935	11.0
Public administration and defense	46,587,741	18.2	44,800,302	21.0
Manufacturing	12,022,637	4.7	11,665,812	5.4
Community, social and personal services	5,951,724	2.3	5,161,334	2.4
Electricity, gas and water	46,018,614	18.0	18,957,505	8.9
Wholesale & retail trade, repair of motor vehicles, motorcycles & personal and household goods	10,236,585	4.0	7,733,395	3.6
Transport, storage and communication	12,608,962	4.9	13,059,312	6.1
Construction	2,526,034	1.0	2,112,444	1.0
Private households	1,110,379	0.4	2,256,965	1.0
Hotel and restaurant	2,047,832	0.8	2,145,267	1.0
Others	3,393,815	1.3	3,911,151	1.8
	256,036,448	100.0	213,813,945	100.0
Allowance for losses	(6,848,479)		(8,180,284)	
Total	249,187,969		205,633,661	

Collateral and other credit enhancements

The amount and type of collateral required depends on the type of borrower and assessment of the credit risk of the borrower. The Bank's revised Credit Manual provides the guidelines on the acceptability of collateral and maximum valuation for each type of collateral.

The following are the main collaterals accepted by the Bank:

- For commercial lending - cash or government securities, real estate properties, inventory, chattel.
- For retail lending - mortgages over residential properties.

The Bank also obtains guarantees from corporations which are counter-guaranteed by the Philippine National Government and from other corporations accredited by the Bank.

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

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

The Bank also makes use of master netting agreements with counterparties.

MARKET RISK MANAGEMENT

Market risk is the failure to anticipate and manage fluctuations in the values of the Bank's investments and could lead to economic losses. LBP recognizes three types of market risks: Interest Rate Risk, Foreign Exchange Risk, Equity Price Risk.

Market Risk Management Framework

LBP is exposed to market risks in both its trading and non-trading banking activities. The Bank assumes market risk in market making and position taking in government securities and other debt instruments, equity, foreign exchange and other securities, as well as, in derivatives or financial instruments that derive their values from price, price fluctuations and price expectations of an underlying instrument (e.g. share, bond, foreign exchange or index). LBP exposure on derivatives is currently limited to currency swaps and currency forwards to manage foreign exchange exposure. Although the Bank is also exposed to derivatives that are embedded in some financial contracts, these are considered insignificant in volume.

The Bank uses a combination of risk sensitivities, value-at-risk (VaR), stress testing, capital adequacy ratio and capital metrics to manage market risks and establish limits.

The LBP Board of Directors, Risk Management Committee and the Asset and Liability Committee (ALCO), supported by the Treasury Risk Management Department under the Risk Management Group, define and set Position limit, Management Alert limits, Value-at-Risk (VaR) limits, Monthly Stop Loss limits and Yearly Stop Loss caps for market risks for each trading portfolio. Management Alert Triggers are also set for Available-for Sale-(AFS) portfolio.

The Treasury Group, particularly the Foreign Exchange Department (FED) (which handles foreign exchange and foreign securities trading), and the Local Currency Department (LCD), which takes charge of Government Securities and Equities, allocate these limits to each of the traders in their respective departments.

A management loss alert is activated whenever losses during a specified period equal or exceed specified management loss alert level. LBP controls and minimizes the losses that may be incurred in daily trading activities through the VaR and stop loss limits.

Positions are monitored on a daily basis to ensure that these are maintained within established limits. Position Limits are also established to control losses but are subordinated to the VaR and Stop Loss Limits.

Managing Market Risk Components

The following discusses the key market risk components along with respective risk mitigation techniques:

Interest Rate Risk Management

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair values of financial instruments. LBP adopts two perspectives in measuring Interest Rate Risk as follows:

- **Earnings Perspective** – The Bank uses the Earnings-at-Risk (EaR) Model to estimate changes in net interest income (NII) under a variety of rate scenarios over a 12 month horizon. It is a simulation method that analyzes the interest rate risk in the banking book in terms of earnings (accrual basis). EaR measures the loss of NII resulting from upward/downward interest rate movements in a "Business as usual" environment, either through gradual movements or as a one-off large interest rate shock over a particular time horizon. An increase in NII could result if rates move favourable to the Bank's position or could result to a decrease in NII if interest rates move against the Bank.

- **Economic Value Perspective** – The Bank uses the Economic Value of Equity (EVE) Model to assess the potential long-term effects of changes in interest rates. This model provides long-term view of possible effects of interest rate changes over the remaining life of the Bank's holdings. This model also measures the change in the Bank's economic value of equity for specified changes in interest rates.

Foreign Exchange Risk Management

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. LBP views the Philippine Peso as its functional currency. Positions are monitored daily to ensure that these are within established limits.

The following limits are set for foreign-currency related transactions:

	Position Limit	Management Loss Alert	Stop loss Limit
	(In millions)	Monthly	Monthly
Foreign Exchange Trading	$50	$180,000	$230,000
Foreign Securities	$20	$180,000	$235,000

LBP had the following significant exposures denominated in foreign currencies as of December 31, 2011:

	(In thousands)		
	US$	Others	Total
Assets			
Foreign Currency & Coins on Hand /Cash & other cash items	710,214	33,907	744,121
Due from banks	782,456	566,120	1,348,576
Held for trading	81,697	-	81,697
Available for sale investments	24,803,854	240,386	25,044,240
Held to maturity investments	8,313,367	56,742	8,370,109
Interbank loans receivable	3,945,600	3,637,169	7,582,769
Loans and receivables	13,558,622	7,215,774	20,774,396
Investment in subsidiaries	62,595	47,051	109,646
Other assets	398,351	107,553	505,904
Total Assets	52,656,756	11,904,702	64,561,458
Liabilities			
Deposit liabilities	28,590,808	3,826,774	32,417,582
Bills payable	6,132,345	25,980,347	32,112,692
Others	1,185,951	358,074	1,544,025
Total Liabilities	35,909,104	30,165,195	66,074,299

Equity Price Risk Management

The Bank is exposed to equity price risk as a consequence of value fluctuations of equity securities. Equity price risk results from changes in the levels of volatility of equity prices, which in turn affect the value of equity securities and impacts on profit and loss of the Bank. Equities are subject to daily mark-to-market and controlled through risk limits such as position, VaR, Management Alert and Stop Loss.

Market Risk Measurement Models

*** Value-at-Risk Analysis**

Value at Risk (VaR) is a statistical approach for measuring the potential variability of trading revenue. It is used to measure market risk in the trading book under normal conditions, estimating the potential range of loss in the market value of the trading portfolio, over a one-day period, at the 99 per cent confidence level, assuming a static portfolio. This level implies that on 99 trading days out of 100, the mark-to-market of the portfolio will likely either (1) increase in value, or (2) decrease in value by less than the VaR estimate; and that on 1 trading day out of 100, the mark-to-market of the portfolio will likely decrease in value by an amount that will exceed the VaR estimate. The VaR measure enables LBP to apply a constant and uniform measure across all of its trading business and products. It also facilitates comparisons of the Bank's market risk estimates both over time and against its daily trading results.

VaR is calculated by simulating changes in the key underlying market risk factors (e.g., interest rates, interest rate spreads, equity prices, foreign exchange rates) to determine the potential distribution of changes in the market value of LBP's portfolios of market risk sensitive financial instruments.

Daily VaR calculations are compared against VaR limits, the monetary amount of risk deemed tolerable by management. Trading positions are marked-to-market and monitored daily. Value-at-Risk (VaR) is computed for marked-to-market portfolios to measure likely impact on earnings due to interest rate movements. As a policy, LBP employs a 2.326 standard deviation measure of VaR that implies a one-tailed confidence interval of 99 per cent in its VaR calculation. For daily VaR measures, time to unwind have a minimum of 24 hours, such that revaluations are based on day-to-day movements in interest rates.

The Value-at-Risk disclosure for the trading activities is based on Variance-Covariance or Parametric Value-at-Risk Model. For Equities, Foreign Exchange and Foreign Securities trading portfolio, Parametric VaR is run parallel with the internally developed Historical Simulation VaR Calculation Model as the Bank continuously pursues initiatives to improve processes in preparation to the bank's migration towards an Internal Model Approach for capital charging. The VaR disclosure is intended to ensure consistency of market risk reporting for internal risk management, for external disclosure and for regulatory purposes. The over-all Value-at-Risk limit for the LBP Treasury Group's trading activities was P80 million (with a 99 per cent confidence level, and a one-day holding period) throughout 2011.

*** Back-Testing**

Back-testing is the basic technique used in verifying the quality of risk measures used by the Bank. It is the process of comparing actual trading results with model-generated risk measures.

Back-testing is a standard measure in determining the accuracy and predictive ability of risk models. The results of back-testing are used to assess the performance of treasury or trading strategies. In back-testing, the focus is on the comparison of actual daily changes in portfolio value, and hypothetical changes in portfolio value that would occur if end-of-day positions remain unchanged during the one-day holding period.

Back testing results are presented to the Asset and Liability Committee (ALCO) which serves as management risk committee for LBP management level and the Risk Management Committee for the Board level. The Committees analyze actual performance against VaR measures to assess model accuracy and to enhance the risk estimation process in general.

*** Stress Testing**

Measuring market risk using statistical risk management models has recently become the main focus of risk management efforts in the banking industry where banking activities are exposed to changes in fair value of financial instruments. LBP believes that the statistical models alone do not provide reliable method of monitoring and controlling risk. While VaR models are relatively sophisticated, they have several known limitations. Most significantly, standard VaR models do not incorporate the potential loss caused by very unusual market events. Thus, the VaR process is complemented by Stress testing to measure this potential risk.

Stress test is a risk management tool used to determine the impact on earnings of market movements considered "extreme", i.e., beyond "normal" occurrence. Stress tests are LBP's measures of risks to estimate possible losses which the Value at Risk (VaR) does not capture.

The Bank's portfolio scenario analysis (PSA) report is a model forecasting the loss return values of a selected portfolio. It calculates the size of possible losses related to a precise scenario. It identifies scenarios which may influence the portfolio strongly and which market variables may trigger these scenarios to be able to come up with a sound portfolio risk management. The Portfolio scenario analysis is a replication scenario based on historical events based on imagined crises or future developments that have not yet occurred.

Results of PSA were also simulated to Capital Adequacy Ratio of the Bank to be able to assess its impact on the CAR compliance set at 10 per cent.

Liquidity Risk Management

Liquidity Risk Management Framework

The LBP Board has delegated the responsibility of managing the overall liquidity of the Bank to a committee of senior managers known as Asset/ Liability Management Committee (ALCO). This Committee meets twice a month or more frequently as required by prevailing situations. Senior management is responsible for effectively executing the liquidity strategy and overseeing the daily and long-term management of liquidity risk. ALCO delegates day-to-day operating responsibilities to the treasury unit based on specific practices and limits established in governing treasury operations. The Treasury Risk Management Department is responsible for the oversight monitoring of the Bank's risk positions and ensures that reports on the bank's current risk are prepared and provided to ALCO and BOD/RiskCom in a timely manner.

LBP's liquidity risk management framework is structured to identify, measure and manage the liquidity risk position of the bank. The policies that govern liquidity risk management are reviewed and approved on a regular basis by ALCO and RiskCom.

The Bank's liquidity policy is to maintain adequate liquidity at all times and hence to be in a position to meet all of its obligations, in normal course of business. In managing its liquidity, LBP has the following sources of funding: cash from operations, stock of marketable assets, government and retail deposit sources, and various credit lines from Banks.

The Treasury Group submits to the IBSS Sector Head and the President, Daily Treasury Reports which include the Bank's cash/near cash investments and other data related to liquidity which assist senior management in decision making.

The Bank's liquidity position is subjected to stress testing and scenario analysis to evaluate the impact of sudden stress events. The scenarios are based on historic events, case studies of liquidity crises and models using hypothetical events.

Liquidity Risk Measurement Models

The Bank formulated different types of liquidity risk measurement tools to determine any future liquidity structural imbalances to be able to formulate strategies to mitigate liquidity risk and address funding needs.

Liquidity is being monitored and controlled thru maturities of assets and liabilities over time bands and across functional currencies as reflected in the Liquidity Gap Report. This report is prepared to provide senior management and the Board timely appreciation of the Bank's liquidity position.

The following table sets out the Bank's liquidity position as of the dates indicated:

	2011	2010
	(In million Pesos)	
Liquid Assets 1/	340,975	308,068
Financial Ratios		
Liquid Assets to Total Assets	53.01%	54.14%
Liquid Assets to Total Deposits	67.19%	71.06%

	PARENT					
	2011			2010		
	Due Within One Year	Due Greater than One Year	Total	Due Within One Year	Due Greater than One Year	Total
Liabilities						
Deposits						
Demand	211,224,363	-	211,224,363	162,518,260	-	162,518,260
Savings	270,268,538	-	270,268,538	246,357,475	1,490,459	247,847,934
Time	17,508,405	7,907,480	25,415,885	14,703,916	7,932,222	22,636,138
LTCND	-	549,189	549,189	-	512,686	512,686
Bills Payable	3,367,197	30,027,218	33,394,415	5,318,795	28,931,678	34,250,473
Unsecured Subordinated Debt	-	6,934,000	6,934,000	-	13,510,000	13,510,000
Due to BTr, BSP, & MCs/PCIC	1,758,300	-	1,758,300	1,132,877	-	1,132,877
Due to Local Banks & Others	11,948	-	11,948	5,261	-	5,261
Other Liabilities & Payables	978,604	16,910,433	17,889,037	1,141,742	18,849,592	19,991,334
Total Liabilities	505,117,355	62,328,320	567,445,675	431,178,326	71,226,637	502,404,963

- The Bank does liquidity gap analysis using the Liquidity Gap Report (LGR). It is a risk measurement tool used in identifying the current liquidity position to determine the ability to meet future funding needs. It breaks down balance sheet items according to estimated maturities of assets and liabilities in order to determine any future structural imbalances such as long-term assets growing faster than long term liabilities. The TRMD assists ALCO in its function by preparing Peso, FX Regular, Regular Banking Unit, FCDU and consolidated Liquidity Gap Reports on a monthly basis.

The following table sets forth the asset-liability gap position over the detailed time period for the Parent at carrying amounts in million pesos as of 31 December 2011 based on contractual repayment arrangements which take into account the effective maturities as indicated by LBP's deposit retention history.

	Due within 3 mos	Due more than 3 to 6 mos	Due more than 6 mos to 1 year	Due more than 1 year to 5 years	Due more than 5 years	Total
Financial Assets						
Cash and Due from Banks	84,293	-	10,926	1	1	95,221
Total Loans	106,990	18,547	22,812	58,172	125,679	332,200
Total Investments	8,459	2,598	21,705	64,752	98,374	195,888
Other Assets	651	-	-	-	19,316	19,967
Total Assets	200,393	21,145	55,443	122,925	243,370	643,276
Financial Liabilities						
Deposits	378,774	9,561	363	4,302	114,458	507,458
Borrowings	1,017	795	1,555	10,833	19,195	33,395
Other Liabilities and Unsecured Subordinated Debt	2,020	31	697	2,288	21,557	26,593
Total Capital	-	-	-	-	75,830	75,830
Total Liabilities	381,811	10,387	2,615	17,423	231,040	643,276
Asset & Liabilities Gap	(181,418)	10,758	52,828	105,502	12,330	-

Although the "Due within 3 months" show a negative gap, the Bank has not experienced liquidity issues in the past that it cannot address. However, looking at the bucketed asset and liability position reveals vulnerabilities as a result of the account maturity mismatch which risk the Bank could avoid or mitigate. As contingency, the Bank has identified all AFS securities earmarked as Deposits Reserve to cover funding requirements resulting from liquidity structural gap.

The LBP has established guidelines for liquidity risk limit setting to enable it to properly and prudently manage and control liquidity risk, consistent with the nature and complexity of its business activities, overall level of risk and its risk appetite. The maturity mismatch is within the level of liquidity versus Maximum Cumulative Outflow (MCO) limit which is set by the Board of Directors. This tool is used to manage and control the liquidity risk in the gap report of the Bank. It is a measure of the liquidity gap between maturing assets and liabilities. MCO limits put a cap on the total amount of negative gaps in the near time buckets. LBP's cumulative negative gaps should not be more than P12 billion. Liquidity limits are also set per book for Peso, FX Regular and FCDU.

Financial Analysis is another liquidity risk measurement tool that calculates and compares liquidity and leverage ratios derived from information on the Bank's financial statements against set liquidity/leverage limits. The Bank makes use of the following financial ratios for liquidity risk management:

1. Liquid Asset to Total Assets Ratio
2. Volatile Liabilities against Liquid Assets Ratio
3. Volatile Liabilities against Total Assets Ratio
4. Liabilities against Assets (Debt/Total Asset Ratio)

The Bank examines several possible situations, usually worst case, most likely case and best case. It does Portfolio Stress Test and Liquidity Stress Test. Result of scenario analysis helps the Bank focus on the level of liquidity that could be reasonably built within a specified period to meet different situations. This also serves as guide for the Bank in the limit setting process for the various ratios mentioned, for example, minimum liquid assets to volatile liabilities.

LBP developed the Liquidity Stress Test to address the shortcoming of LGR. This is a risk management tool used to evaluate the potential impact on liquidity of unlikely, although plausible, events or movements in a set of financial variables. While such unlikely outcomes do not mesh easily with LGR analysis, analysis of these outcomes can provide further information on expected portfolio losses or cash flow over a given time horizon.

Liquidity management is one of the fundamental preconditions to achieving all other banking activities - strategically mapped by ALCO, actively managed by the Treasury Group through the Asset and Liabilities Management Department (ALMD) and overseen by the Treasury Risk Management Department (TRMD).

To limit liquidity risk, LBP Management has instituted the following:

1. **Active and Appropriate Board and Senior Management Oversight** -

   The Board and Senior Management receives regular liquidity reports and updates to fully inform them of the level of liquidity risk assumed by the Bank and if activities undertaken are within the prescribed risk tolerance in accordance with approved guidelines, liquidity/ funding policy (targets), risk limits.

2. **Diversified funding sources** - The Bank has identified the following sources of funding:

   - Cash from operations
   - Sale of Government Securities (GS) under Available for Sale (AFS)
   - Government and retail deposit sources
   - Interbank market
   - Borrowings from BSP
   - Undertaking Peso-Dollar Swaps
   - Accessing loans from multilateral and bilateral institutions (WB, ADB, JBIC, etc.)

LBP performs a comprehensive liquidity risk measurement and control using as tool the Consolidated Liquidity Gap Report covering the entire LBP Group. Risk models used in liquidity risk management are subjected to independent model validation. The Internal Audit Group is tasked to do model validation. An independent validation is also being done by the Basel Officer for Treasury who reports directly to the Head of the Risk Management Group.

LAND BANK OF THE PHILIPPINES

Ang Bangkong May Damdaming Bayan

LANDBANK Plaza 1598 M.H. del Pilar
cor. Dr. J. Quintos Sts., Malate, Manila, Philippines
Tel. Nos.: 522-0000 • 551-2200 • 450-7001
www.landbank.com

Network Directory

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