

**LAND BANK OF THE PHILIPPINES**  
**NOTES TO FINANCIAL STATEMENTS**  
**(Amounts in thousands, except as indicated)**

**1. Corporate Information**

The Land Bank of the Philippines (Parent) is a financial institution wholly-owned by the National Government. The Parent was established in 1963 as the financial intermediary of the Land Reform Program of the government. Later, it became the first universal bank by charter with expanded commercial banking powers to sustain its social mission of spurring countryside development.

The Parent is a depository bank of the government and its various instrumentalities. The Parent services the requirements of the national government, local government units and government-owned and controlled corporations. As of December 31, 2014, 69 percent of the deposit portfolio came from the government while the rest came from private depositors.

The Parent and its subsidiaries (Group) are engaged in the business of banking, financing, leasing, real estate, insurance brokering and other related services to personal, commercial, corporate and institutional clients. The Group's products and services include deposit-taking, lending and related services, treasury and capital market operations, trade services, payments and cash management, and trust services.

The Parent's principal office of business is located at the LandBank Plaza, 1598 M.H. Del Pilar corner Dr. J. Quintos Streets, Malate, Manila.

The accompanying comparative financial statements of the Parent were authorized for issue by the Parent's Board of Directors on February 23, 2015 while those of the subsidiaries were approved for issue by their respective Board of Directors on various dates.

**2. Summary of Significant Accounting Policies**

**2.1 Basis of Financial Statements Preparation**

The accompanying financial statements have been prepared on a historical cost basis except for financial assets and financial liabilities at fair value through profit or loss (FVPL), available-for-sale (AFS) investments, and derivative financial instruments that have been measured at fair value.

The financial statements of the Parent include the accounts maintained in the Regular Banking Unit (RBU) and Foreign Currency Deposit Unit (FCDU). The financial statements individually prepared for these units are combined after eliminating inter-unit accounts.

The functional currency of RBU and FCDU is Philippine Peso and United States Dollar (USD), respectively. For financial reporting purposes, FCDU accounts and foreign

currency-denominated accounts in the RBU are translated in Philippine Peso based on the Philippine Dealing System (PDS) closing rate prevailing at end of the year.

The consolidated financial statements are presented in Philippine peso, and all values are rounded to the nearest thousand pesos (P000) except when otherwise indicated.

## 2.2 Statement of Compliance

The consolidated financial statements of the Group and of the Parent have been prepared in compliance with the Philippine Financial Reporting Standards (PFRS).

## 2.3 Basis of Consolidation

The consolidated financial statements include the financial statements of the Parent and the following wholly-owned subsidiaries:

Name	Country of Incorporation	Principal Activity	Functional Currency
LBP Leasing Corporation	Philippines	Leasing	Philippine peso
LBP Insurance Brokerage Inc.	Philippines	Insurance brokerage	Philippine peso
LBP Resources and Development Corporation	Philippines	Real estate	Philippine peso
Masaganang Sakahan, Inc.	Philippines	Trading	Philippine peso
LBP Financial Services-Italy	Italy	Financial services	Euro

The consolidated financial statements were prepared using consistent accounting policies for like transactions and other events in similar circumstances. All significant inter-company balances and transactions have been eliminated in consolidation.

### **Significant Accounting Policies**

#### Foreign currency translation

##### *Transactions and balances*

The books of accounts of the RBU are maintained in Philippine Peso, while those of the FCDU are maintained in USD. For financial reporting purposes, the foreign currency-denominated monetary assets and liabilities in the RBU are translated in Philippine Peso based on the Philippine Dealing System (PDS) closing rate prevailing at the statement of financial position date. Foreign exchange differences arising from revaluation and translation of foreign-currency denominated assets and liabilities are credited to or charged against operations in the year in which the rates change.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

### Fair Value Measurement

The methods and assumptions used by the Group in estimating the fair value of the financial instruments include the following:

Cash and cash equivalents and short-term investments – Carrying amounts approximate fair values due to the relatively short-term maturity of these instruments.

Debt securities – Fair values are generally based upon quoted market prices. If the market prices are not readily available, fair values are estimated using either values obtained from counterparties or independent parties offering pricing services, values based on adjusted quoted market prices of comparable investments or values computed using the discounted cash flow methodology.

Equity securities - Fair values are based on quoted prices published in markets.

Loans and receivables – Fair values of loans are estimated using the discounted cash flow methodology using the Parent's current incremental lending rates for similar types of loans.

Mortgage loans – Fair values of loans on real estate are estimated using the discounted cash flow methodology using the Parent's current incremental lending rates for similar types of loans.

Short-term investments – Carrying amounts approximate fair values.

Others – Quoted market prices are not readily available for these assets. They are not reported at fair value and are not significant in relation to the Group's total portfolio of securities.

Obligations to repurchase securities are recorded at cost which approximates fair value.

Liabilities – Fair values are estimated using the discounted cash flow methodology using the Parent's current incremental borrowing rates for similar borrowings with maturities consistent with those remaining for the liability being valued. Except for the long-term fixed rates liabilities and floating rate liabilities with repricing periods beyond three months, the carrying values approximate fair values due to the relatively short term maturities of the liabilities or frequency of the repricing.

### Financial Instruments

#### *Date of recognition*

Purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace are recognized on the settlement date - the date that an asset is delivered to or by the Group. Securities transactions are also recognized on settlement date basis. Deposits, amounts due to banks and customers and loans are recognized when cash is received by the Group or advanced to the borrowers.

#### *Initial recognition of financial instruments*

All financial instruments, including trading and investment securities and loans and receivables, are initially measured at fair value. Except for financial assets and financial liabilities valued at FVPL, the initial measurement of financial instruments includes transaction costs. The Group classifies its financial assets in the following categories: financial assets at FVPL, HTM investments, AFS investments, and loans and receivables while financial liabilities are classified as financial liabilities at FVPL and financial liabilities carried at amortized cost. The classification depends on the purpose for which the investments were acquired and whether they are quoted in an active market. Management determines the classification of its investments at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

#### *Reclassification of financial assets*

A financial asset is reclassified out of the FVPL category when the following conditions are met:

- the financial asset is no longer held for the purpose of selling or repurchasing it in the near term; and
- there is a rare circumstance.

A financial asset that is reclassified out of the FVPL category is reclassified at its fair value on the date of reclassification. Any gain or loss already recognized in the consolidated statement of comprehensive income is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable.

#### *Determination of fair value*

The fair value for financial instruments traded in active markets at the statement of financial position date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and asking prices are not available, the price of the most recent transaction is used since it provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models, and other relevant valuation models.

#### *'Day 1' difference*

Where the transaction price in a non-active market is different from the fair value from other observable current market transactions for the same instrument or based on a valuation technique whose variables include only data from observable market, the Group recognizes the difference between the transaction price and fair value (a 'Day 1'

difference) in the statement of comprehensive income. In cases where the transaction price used is made of data which is not observable, the difference between the transaction price and model value is only recognized in the statement of comprehensive income when the inputs become observable or when the instrument is derecognized. For each transaction, the Group determines the appropriate method of recognizing the 'Day 1' difference amount.

(a) *Financial assets designated at fair value through profit or loss (FVPL)*

FVPL consists of securities held for trading and financial assets that are voluntarily designated as FVPL on trade date.

The FVPL category includes government debt securities purchased and held principally with the intention of selling them in the near term. These securities are carried at fair market value, based primarily on quoted market prices, or if quoted market prices are not available, discounted cash flows using market rates that are commensurate with the credit quality and maturity of the investments.

Realized and unrealized gains and losses on these instruments are recognized under the trading and foreign exchange profits accounts in the statement of comprehensive income.

(b) *Loans and receivables, amounts due from BSP and other banks, interbank loans receivable and securities purchased under resale agreements*

These are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as other financial assets held for trading, designated as AFS investments or financial assets designated at FVPL.

(c) *Held-to-Maturity (HTM) investments*

HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Group's management has the positive intention and ability to hold to maturity. Where the Group sells other than an insignificant amount of HTM investments or those close to maturity, the entire category would be tainted and reclassified as AFS investments. These investments are carried at amortized cost using the effective interest rate method, reduced by any impairment in value. Gains and losses are recognized in statement of comprehensive income when the HTM investments are derecognized or impaired, as well as through the amortization process.

(d) *Available-for-sale (AFS) investments*

AFS investments are those which do not qualify to be classified as designated as FVPL, HTM or loans and receivables. They are purchased and held indefinitely, but which the Group anticipates to sell in response to liquidity requirements or changes in market conditions. AFS investments are carried at fair market value. The effective yield component (including premium, discounts and directly attributable transaction costs) and foreign exchange restatement results of available-for-sale debt securities are reported in earnings. Dividends on AFS equity instruments are recognized in the statement of

comprehensive income when the entity's right to receive payment is established. The unrealized gains and losses arising from the recognition of fair value changes on AFS assets are reported as a separate component of capital funds in the statement of financial position.

#### Impairment of Financial Assets

The Group determines at each reporting date whether there is objective evidence that a financial asset may be impaired.

##### *Financial assets carried at amortized cost*

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

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for assets that are not individually significant. If it is determined that no objective evidence of impairment exists for individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics (i.e., on the basis of the Group's scoring process that considers asset term, industry and collateral) and that group of assets is collectively assessed for impairment. Those characteristics are relevant to the estimation of future cash flows for group 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. 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 for impairment.

If there is objective evidence that an impairment loss on loans and receivables carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through use of an allowance account.

The amount of loss is charged to current operations. If a loan or HTM investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, any amounts formerly charged are credited to 'Provision for credit and impairment losses' in the statement of comprehensive income and the allowance account, reduced. The HTM investments, together with the associated allowance accounts, are written off when there is no realistic prospect of future recovery and all collateral has been realized.

The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

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

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

When a loan is uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are charged to income.

#### *Restructured loans*

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews restructured loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate. The difference between the recorded value of the original loan and the present value of the restructured cash flows, discounted at the original effective interest rate, is recognized in 'Provision for credit losses' in the statement of comprehensive income.

#### *Assets Carried at Cost*

If there is objective evidence that an impairment loss on an unquoted equity instruments that are not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such unquoted equity instrument has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

### *AFS Investments*

If an AFS investment is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss on that security previously recognized in profit or loss – is removed from equity and recognized in the statement of comprehensive income. Impairment losses on equity instruments recognized in the statement of comprehensive income are not reversed through the statement of comprehensive income. If, in a subsequent period, the fair value of a debt instrument classified as AFS investment increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the statement of comprehensive income.

### Derecognition of Financial Assets and Liabilities

*Financial Assets.* A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired;
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay. Where continuing involvement takes the form of a written and/or purchase option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Group's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

*Financial Liabilities.* A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expired. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in profit or loss.



### *Derivative Instruments*

The Group enters into derivative contracts such as currency forwards and currency swaps to manage its foreign exchange exposure. These derivative financial instruments are initially recorded at fair value on the date at which the derivative contract is entered into and are subsequently remeasured at fair value. Any gains or losses arising from changes in fair values of derivatives (except those accounted for as accounting hedges) are taken directly to the statement of comprehensive income. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Derivative instruments are booked at its notional amount under contingent account on trade date and subsequently measured using the mark to forward methods. Any gains/(losses) arising from the market valuation are booked under asset account "Derivatives with positive fair value" if the market valuation is positive and under the liability account "Derivatives with negative fair value" if the market valuation is negative contra foreign exchange gain/(loss) account.

For the purpose of hedge accounting, hedges are classified primarily as either: a) a hedge of the fair value of an asset, liability or a firm commitment (fair value hedge); or b) a hedge of the exposure to variability in cash flows attributable to an asset or liability or a forecasted transaction (cash flow hedge).

The Group did not apply hedge accounting treatment for its derivative transactions.

The Group has certain derivatives that are embedded in host financial contracts (such as structured notes, debt investments, and loan receivables) and non-financial contracts (such as purchase orders, lease contracts and service agreements). These embedded derivatives include credit default swaps (which are linked to a reference bond), and calls and puts in debt and equity securities; conversion options in loans receivable; and foreign-currency derivatives in debt instruments, lease contracts, purchase orders and service agreements.

Embedded derivatives are separated from their host contracts and carried at fair value with fair value changes being reported through profit or loss, when the entire hybrid contracts (composed of both the host contract and the embedded derivative) are not accounted for as financial instruments at FVPL and when their economic risks and characteristics are not closely related to those of their respective host contracts.

### Offsetting financial instruments

Offsetting of financial assets and financial liabilities are only made and the net amount are reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and the Group intends to either settle on a net basis, or to realize the asset and the liability simultaneously.

### Fiduciary Activities

Assets and income arising from fiduciary activities together with related undertakings to return such assets to customers are excluded from the financial statements where the Group acts in a fiduciary capacity such as nominee, trustee or agent.

### Subsequent Events

Any post-year-end event that provides additional information about the Group's position at the statement of financial position date (adjusting event) is reflected in the financial statements. Post-year-end events that are non adjusting events, if any, are disclosed in the Notes to the financial statements, when material.

### Impairment of Property and Equipment, Investment Property and Other Resources

At each reporting date, the Group assesses whether there is any indication that the property and equipment and investment properties may be impaired.

Where an indicator of impairment exists, the Group makes a formal estimate of recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. Recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or group of assets.

### Investments in Subsidiaries

The Group's investments in subsidiaries and entities in which the Group has control are accounted for under the cost method of accounting in the separate financial statements. These are carried in the statement of financial position at cost less any impairment in value.

### Property and Equipment

Property and equipment are carried at cost less accumulated depreciation and amortization and any impairment in value. When the assets are sold or retired, their cost and accumulated depreciation and amortization are eliminated from the accounts and any gain or loss resulting from their disposal is included in the statement of comprehensive income.

The initial cost of property and equipment comprises its purchase price and any directly attributable cost of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the fixed assets have been put into operation, such as repairs and maintenance costs, are normally charged to profit and loss in the period in which the costs are incurred.

Depreciation and amortization is calculated on a straight-line basis over the estimated useful life (EUL) of the property and equipment as follows:

	<u>Number of Years</u>
Buildings	10 - 30
Furniture, fixtures and equipment	5 - 10
Leasehold rights	10 - 30*
Transportation equipment	7 - 10

\*EUL shall depend on the length of the lease. It shall be the period of the lease or the EUL of the assets, as given, whichever is shorter.

The useful life and depreciation and amortization methods are reviewed periodically to ensure that the period and method of depreciation and amortization are consistent with the expected pattern of economic benefits from items of property and equipment.

#### Investment properties

Property acquired by the Group in settlement of loans through foreclosure or dation in payment, and that is not significantly occupied by the Group, is classified as investment property. Investment property comprises land and building.

Investment properties are measured at their fair value as the deemed cost as allowed under PFRS 1 and PAS 40. Subsequent to initial recognition, investment properties are stated at cost less accumulated depreciation and impairment loss. Investment properties are derecognized when they have either been disposed of or when the investment property is permanently withdrawn from use and no future benefit is expected from its disposal. Any gains or losses on derecognition of an investment property are recognized in the profit and loss in the year of derecognition.

Expenditures incurred after the fixed investment properties have been put into operation, such as repairs and maintenance costs, are normally charged to income in the period in which the costs are incurred.

Depreciation is calculated on a straight-line basis over 10 to 30 years, which is the estimated useful life of the investment properties.

#### Intangible Assets

##### Computer software

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortized on the basis of the expected useful lives (three to five years).

Costs associated with developing or maintaining computer software programs are recognized as an expense as incurred.

#### Income Taxes

Income tax on the profit for the year comprises current tax only. Income tax is recognized in the statement of comprehensive income except to the extent that it relates to items recognized directly in equity. Current income tax is the expected tax payable on the taxable income for the year using tax rates enacted or substantially enacted as of the reporting date, and any adjustment to tax payable in respect to previous years.

Deferred tax assets are recognized for the future tax consequences attributable to temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amount used for taxation purposes and the carry forward benefits of the net operating loss carryover (NOLCO) and the minimum corporate

income tax (MCIT) over the regular corporate income tax. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amounts of assets and liabilities, using tax rates that have been enacted or substantially enacted as of the reporting date. A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized. The carrying amount of the deferred tax asset is reviewed at each reporting date and reduced, if appropriate.

#### Employee Benefits

The Group maintains a defined contribution plan which provides for estimated pension benefits on its contributory retirement plan covering all regular employees.

#### Leases

(a) LBP Group is the lessee

(i) Operating lease - leases in which substantially all risks and rewards of ownership are retained by another party, the lessor, are classified as operating leases. Payments, including prepayments, made under operating leases (net of any incentives received from the lessor) are charged to the statement of comprehensive income on a straight-line basis over the period of the lease.

(ii) Financial lease - leases of assets where the LBP Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and the finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in deferred credits and other liabilities. The interest element of the finance cost is charged to the statement of comprehensive income over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

(b) LBP Group is the lessor

(i) Operating lease - properties leased out under operating leases are included in investment property in the statement of financial position. Rental income under operating leases is recognized in the statement of comprehensive income on a straight-line basis over the period of lease.

(ii) Finance lease - when assets are leased out under a finance lease, the present value of the lease payments is recognized as a receivable. The difference between the gross receivable and the present value of the receivable is recognized as unearned income.

Lease income under finance lease is recognized over the term of the lease using the net investment method before tax, which reflects a constant periodic rate of return.

### Revenue Recognition

Interest income and fees which are considered an integral part of the effective yield of a financial asset are recognized using the effective interest method, unless collectibility is in doubt.

Interest is recognized on impaired loans and other financial assets based on the rate used to discount future cash flows to their net present value.

Dividend income is recognized when the right to receive payment is established.

Gains or losses arising from the trading of securities and foreign currency are reported in the statement of comprehensive income.

Generally, commissions, service charges and fees are recognized only upon collection or accrued where there is reasonable degree of certainty as to its collectibility.

Commitment fees received to originate a loan when the loan commitment is outside the scope of PAS 39 are deferred and recognized as an adjustment to the effective interest rate. If the loan commitment expires, the fee is recognized as revenue on expiry.

### Borrowing Costs

Borrowing costs are expensed when incurred.

## **Changes in Accounting Policies and Disclosures**

### **New and amended Standards and Interpretations**

The Group applied the following applicable new and revised accounting standards. Unless otherwise indicated, these new and revised accounting standards have no impact to the Group. Except for these standards and amended PFRS which were adopted as of January 1, 2014, the accounting policies adopted are consistent with those of the previous financial year.

#### *PAS 32, Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities (Amendments)*

The amendments clarify the meaning of “currently has a legally enforceable right to set-off” and also clarify the application of the PAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The amendments have no impact on the Group’s financial position or performance.

#### *PAS 36, Impairment of Assets – Recoverable Amount Disclosures for Non-Financial Assets (Amendments)*

These amendments remove the unintended consequences of PFRS 13 on the disclosures required under PAS 36. In addition, these amendments require disclosure of the recoverable amounts for the assets or cash-generating units (CGUs) for which impairment loss has been recognized or reversed during the period. These amendments

are effective retrospectively for annual periods beginning on or after January 1, 2014 with earlier application permitted, provided PFRS 13 is also applied. The amendments have no impact on the Group's financial position or performance.

#### Investment Entities (Amendments to PFRS 10, PFRS 12 and PAS 27)

These amendments provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under PFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. This amendment is not relevant to the Group since none of the entities in the Group qualifies as an investment entity under PFRS 10.

#### **Annual Improvements to PFRS/PAS (2010-2012 cycle)**

In the 2010-2012 annual improvement cycle, seven amendments to six standards were issued, which included an amendment to PFRS 13, *Fair Value Measurement*. The amendment to PFRS 13 is effective immediately and it clarifies that short-term receivables and payables with no stated interest rates can be measured at invoice amounts when the effect of discounting is immaterial. This amendment has no impact on the Group's financial position or performance.

#### **New Standards, Amendments and Interpretations not yet adopted**

The Group intends to adopt the following standards when they become effective. Except as otherwise indicated, the Group does not expect the adoption of these new and amended standards to have significant impact on its financial statements.

#### **New Standards**

##### *PFRS 9, Financial Instruments – Classification and Measurement (2010 version) –*

PFRS 9 (2010 version) reflects the first phase on the replacement of PAS 39 and applies to the classification and measurement of financial assets and liabilities as defined in PAS 39, *Financial Instruments: Recognition and Measurement*. PFRS 9 requires all financial assets to be measured at fair value at initial recognition. A debt financial asset may, if the fair value option (FVO) is not invoked, be subsequently measured at amortized cost if it is held within a business model that has the objective to hold the assets to collect the contractual cash flows and its contractual terms give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal outstanding. All other debt instruments are subsequently measured at fair value through profit or loss. All equity financial assets are measured at fair value either through other comprehensive income (OCI) or profit or loss. Equity financial assets held for trading must be measured at fair value through profit or loss. For FVO liabilities, the amount of change in the fair value of a liability that is attributable to changes in credit risk must be presented in OCI. The remainder of the change in fair value is presented in profit or loss, unless presentation of the fair value change in respect of the liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss. All other PAS 39 classification and measurement requirements for financial liabilities have been carried forward into PFRS 9, including the embedded derivative separation rules and the criteria for using FVO. The adoption of the first phase of PFRS 9 will have an effect on the classification

and measurement of the Group's financial assets, but will potentially have no impact on the classification and measurement of financial liabilities.

PFRS 9 (2010 version) is effective for annual period beginning on or after January 1, 2015. This mandatory adoption date was moved to January 1, 2018 when the final version of PFRS 9 was adopted by the Philippine Financial Reporting Standards Council (FRSC). Such adoption, however, is still for approval by the Board of Accountancy (BOA).

#### Philippine Interpretation IFRIC 15, *Agreements for the Construction of Real Estate*

This Interpretation covers accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. The Securities and Exchange Commission (SEC) and the FRSC have deferred the effectivity of this interpretation until the final Revenue standard is issued by the International Accounting Standards Board (IASB) and an evaluation of the requirements of the final Revenue standard against the practices of the Philippine real estate industry is completed. Adoption of the interpretation when it becomes effective will not have any impact on the financial statements of the Group.

The following new standards and amendments issued by the IASB were already adopted by the FRSC but are still for approval by BOA.

#### **Amendments**

##### *PAS 16, Property, Plant and Equipment and PAS 38, Intangible Assets – Clarification of Acceptable Methods of Depreciation and Amortization*

The revised PAS 16 and PAS 38 both establish the principle for the basis of depreciation and amortization as being the expected pattern of consumption of the future economic benefits of an asset. The amendments to PAS 16 explicitly prohibits revenue-based depreciation of property, plant and equipment while the amendments to PAS 38 introduce a rebuttable presumption that a revenue-based amortization method for intangible assets is inappropriate for the same reason that there are multiple factors that influence revenue and that not all these factors are related to the way the asset is used or consumed. The revised standards are effective for periods beginning January 1, 2016, with earlier application permitted.

##### *PAS 16, Property, Plant and Equipment and PAS 41, Agriculture – Change in Financial Reporting for Bearer Plants*

The amendments require entities to account for bearer plants in the same way as property, plant and equipment in PAS 16, Property, Plant and Equipment, because their operation is similar to that of manufacturing, bringing them within the scope of PAS 16, instead of PAS 41. The produce growing on bearer plants will remain within the scope of PAS 41. The amended standards are effective for annual periods beginning on or after January 1, 2016, with earlier application permitted. The amendments are not applicable to the Group.

*PAS 27, Separate Financial Statements – Equity Method in Separate Financial Statements*

The amendments will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying PFRS and electing to change to the equity method in its separate financial statements will have to apply that change retrospectively. For first-time adopters of PFRS electing to use the equity method in its separate financial statements, they will be required to apply this method from the date of transition to PFRS. The amendments are effective for annual periods beginning on or after January 1, 2016, with early adoption permitted. These amendments will not have any impact on the Group's consolidated financial statements.

*PFRS 10, Consolidated Financial Statements and PAS 28, Investments in Associates and Joint Ventures – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*

These amendments address an acknowledged inconsistency between the requirements in PFRS 10 and those in PAS 28 (2011) in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The amendments require that a full gain or loss is recognized when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary. These amendments are effective from annual periods beginning on or after January 1, 2016.

**Annual Improvements to PFRSs (2010 - 2012 cycle)**

The Annual Improvements to PFRSs (2010 - 2012 cycle) which will take effect for annual periods beginning on or after January 1, 2015, contain non-urgent but necessary amendments to the following standards:

*PFRS 2, Share-based Payment – Definition of Vesting Condition*

The amendment revised the definitions of vesting condition and market condition and added the definitions of performance condition and service condition to clarify various issues. This amendment shall be prospectively applied to share-based payment transactions for which the grant date is on or after January 1, 2015. This amendment does not apply to the Group as it has no share-based payments.

*PFRS 3, Business Combinations – Accounting for Contingent Consideration in a Business Combination*

The amendment clarifies that a contingent consideration that meets the definition of a financial instrument should be classified as a financial liability or as equity in accordance with PAS 32.

Contingent consideration that is not classified as equity is subsequently measured at fair value through profit or loss whether or not it falls within the scope of PFRS 9 (or PAS 39, if PFRS 9 is not yet adopted). The amendment shall be prospectively applied to



business combinations for which the acquisition date is on or after January 1, 2015. The Group shall consider this amendment for future business combinations.

*Revaluation Method (Amendments to PAS 16 and PAS 38 – Proportionate Restatement of Accumulated Depreciation and Amortization)*

The amendment clarifies that, upon revaluation of an item of property, plant and equipment, and intangible assets, the carrying amount of the asset shall be adjusted to the revalued amount, and the asset shall be treated in one of the following ways:

- a. The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. The accumulated depreciation or amortization at the date of revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account any accumulated impairment losses.
- b. The accumulated depreciation or amortization is eliminated against the gross carrying amount of the asset.

The amendments also clarify that the amount of the adjustment of the accumulated amortization should form part of the increase or decrease in the carrying amount accounted for in accordance with the standard.

The amendment shall apply to all revaluations recognized in annual periods beginning on or after the date of initial application of this amendment and in the immediately preceding annual period.

*PAS 24, Related Party Disclosures – Key Management Personnel*

The amendments clarify that an entity is a related party of the reporting entity if the said entity, or any member of a group for which it is a part of, provides key management personnel services to the reporting entity or to the parent company of the reporting entity. The amendments also clarify that a reporting entity that obtains management personnel services from another entity (also referred to as management entity) is not required to disclose the compensation paid or payable by the management entity to its employees or directors. The reporting entity is required to disclose the amounts incurred for the key management personnel services provided by a separate management entity. The amendments are applied retrospectively and affect disclosures only.

**Annual Improvement to PFRSs (2011-2013 cycle)**

The Annual Improvements to PFRSs (2011 - 2013 cycle) contain non-urgent but necessary amendments to the following standards:

*PFRS 1, First-time Adoption of Philippine Financial Reporting Standards – Meaning of ‘Effective PFRSs’*

The amendment clarifies that an entity may choose to apply either a current standard or a new standard that is not yet mandatory, but that permits early application, provided either standard is applied consistently throughout the periods presented in the entity's

first PFRS financial statements. This amendment is not applicable to the Group as it is not a first-time adopter of PFRS.

*PFRS 13, Fair Value Measurement – Portfolio Exception*

The amendment clarifies that the portfolio exception in PFRS 13 can be applied to financial assets, financial liabilities and other contracts. The amendment is effective for annual periods beginning on or after July 1, 2014 and is applied prospectively.

*PAS 40, Investment Property*

The amendment clarifies the interrelationship between PFRS 3 and PAS 40 when classifying property as investment property or owner-occupied property. The amendment stated that judgment is needed when determining whether the acquisition of investment property is the acquisition of an asset or a group of assets or a business combination within the scope of PFRS 3. This judgment is based on the guidance of PFRS 3. This amendment is effective for annual periods beginning on or after July 1, 2014 and is applied prospectively. The amendment has no significant impact on the Group's financial position or performance.

**Annual Improvements to PFRSs (2012 - 2014 cycle)**

The Annual Improvements to PFRSs (2012 - 2014 cycle) are effective for annual periods beginning on or after January 1, 2016 and are not expected to have a material impact on the Group. They include:

*PFRS 5, Non-current Assets Held for Sale and Discontinued Operations – Changes in Methods of Disposal*

The amendment is applied prospectively and clarifies that changing from a disposal through sale to a disposal through distribution to owners and vice-versa should not be considered to be a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in PFRS 5. The amendment also clarifies that changing the disposal method does not change the date of classification.

*PFRS 7, Financial Instruments: Disclosures – Servicing Contracts*

PFRS 7 requires an entity to provide disclosures for any continuing involvement in a transferred asset that is derecognized in its entirety. The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and arrangement against the guidance in PFRS 7 in order to assess whether the disclosures are required. The amendment is to be applied such that the assessment of which servicing contracts constitute continuing involvement will need to be done retrospectively. However, comparative disclosures are not required to be provided for any period beginning before the annual period in which the entity first applies the amendments.

*PFRS 7 – Applicability of the Amendments to PFRS 7 to Condensed Interim Financial Statements*

This amendment is applied retrospectively and clarifies that the disclosures on offsetting of financial assets and financial liabilities are not required in the condensed interim financial report unless they provide a significant update to the information reported in the most recent annual report.

*PAS 19, Employee Benefits – Regional Market Issue regarding Discount Rate*

This amendment is applied prospectively and clarifies that market depth of high quality corporate bonds is assessed based on the currency in which the obligation is denominated, rather than the country where the obligation is located. When there is no deep market for high quality corporate bonds in that currency, government bond rates must be used.

*PAS 34, Interim Financial Reporting – Disclosures of Information ‘Elsewhere in the Interim Financial Report’*

This amendment is applied retrospectively and clarifies that the required interim disclosures must either be in the interim financial statements or incorporated by cross-reference between the interim financial statements and wherever they are included within the greater interim financial report (e.g., in the management commentary or risk report).

**Effective January 1, 2018**

*PFRS 9, Financial Instruments – Hedge Accounting and Amendments to PFRS 9, PFRS 7 and PAS 39 (2013 version)*

PFRS 9 (2013 version) already includes the third phase of the project to replace PAS 39 which pertains to hedge accounting. This version of PFRS 9 replaces the rules-based hedge accounting model of PAS 39 with a more principles-based approach. Changes include replacing the rules based hedge effectiveness test with an objectives-based test that focuses on the economic relationship between the hedged item and the hedging instrument, and the effect of credit risk on that economic relationship; allowing risk components to be designated as the hedged item, not only for financial items but also for non-financial items, provided that the risk component is separately identifiable and reliably measurable; and allowing the time value of an option, the forward element of a forward contract and any foreign currency basis spread to be excluded from the designation of a derivative instrument as the hedging instrument and accounted for as costs of hedging. PFRS 9 also requires more extensive disclosures for hedge accounting.

PFRS 9 (2013 version) has no mandatory effective date. The mandatory effective date of January 1, 2018 was eventually set when the final version of PFRS 9 was adopted by the FRSC. The adoption of the final version of PFRS 9, however, is still for approval by BOA.

The adoption of PFRS 9 will have an effect on the classification and measurement of the Group’s financial assets but will have no impact on the classification and measurement

of the Group's financial liabilities. The adoption will also have an effect on the Group's application of hedge accounting.

#### *PFRS 9, Financial Instruments (2014 or final version)*

In July 2014, the final version of PFRS 9, *Financial Instruments*, was issued. PFRS 9 reflects all phases of the financial instruments project and replaces PAS 39, *Financial Instruments: Recognition and Measurement*, and all previous versions of PFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. PFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of PFRS 9 is permitted if the date of initial application is before February 1, 2015.

The adoption of PFRS 9 will have an effect on the classification and measurement of the Group's financial assets and impairment methodology for financial assets, but will have no impact on the classification and measurement of the Group's financial liabilities. The adoption will also have an effect on the Group's application of hedge accounting. The Group is currently assessing the impact of adopting this standard.

The Group conducted an evaluation of the financial impact of the adoption of PFRS 9 based on the audited financial statements as of December 31, 2013 and decided not to early adopt PFRS 9 in its 2014 financial reporting.

### **3. Significant Accounting Judgments and Estimates**

The preparation of the financial statements in compliance with PFRS requires the Group to make estimates and assumptions that affect the reported amounts of resources, liabilities, income and expenses and disclosure of contingent resources and contingent liabilities. Future events may occur which will cause the assumptions used in arriving at the estimates to change. The effects of any change in estimates are reflected in the financial statements as they become reasonably determinable.

Estimates 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.

#### **Judgments**

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

##### *a. Operating lease commitments*

The entity has entered into commercial property leases on its investment property portfolio. The entity has determined that it retains all the significant risks and rewards of ownership of these properties which are leased out on operating leases.

*b. Impairment losses on loans and receivables and HTM investments*

The Group reviews its loans and receivables and HTM investments to assess impairment at least on an annual basis or earlier when an indicator of impairment exists. In determining whether an impairment loss should be recorded in the statement of comprehensive income, the Group makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial asset before the decrease can be identified with an individual asset 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 assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. The carrying values of receivables from customers and HTM investments of the Group and the Parent are P498,001,532 and P496,290,816 as of December 31, 2014 and P363,315,524 and P361,103,483 as of December 31, 2013, respectively.

*c. Impairment of AFS investments*

The Group determines that available-for-sale investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment. In making this judgment, the Group evaluates among other factors, the normal volatility in price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows. The carrying values of AFS investments of the Group and the Parent are P191,341,109 and P191,341,109 as of December 31, 2014 and P179,836,155 and P179,836,155 as of December 31, 2013, respectively.

*d. Classification under HTM investments*

The classification of non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity requires significant judgment. In making this judgment, the Group evaluates its intention and ability to hold such investments to maturity. Further, the Group determines whether the investments are quoted or not; unquoted debt investments are classified under Loans and receivables. If the Group fails to keep these investments to maturity other than for specific circumstances – for example, selling an insignificant amount or close to maturity – it will be required to reclassify the entire held-to-maturity portfolio as available-for-sale. The investments would therefore be measured at fair value instead of amortized cost. The carrying values of held-to-maturity investments of the Group and the Parent are P95,814,860 and P95,025,587 as of December 31, 2014 and P40,904,585 and P40,101,183 as of December 31, 2013, respectively.

*e. Recognition of deferred tax asset*

The Group cannot yet establish when it will realize its deductible temporary differences and carry forward benefits of NOLCO and MCIT. When the Group is already in a

positive tax position, the Management will review the level of deferred tax assets that it will recognize in the books.

### Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

*a. Fair value of financial instruments (including derivatives)*

The fair value of financial instruments that are not quoted in active markets are determined by using generally accepted valuation techniques. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by the Risk Management Group. All models are reviewed before they are used to ensure that outputs reflect actual data and comparative market prices. To the extent practicable, models use only observable data, however, areas such as credit risk (both own and counterparty), volatilities and correlations require Management to make estimates. Changes in assumptions about these factors could affect reported fair values of financial instruments.

*b. Useful lives of property and equipment*

The Group's Management determines the estimated useful lives and related depreciation charges for its property and equipment. The Bank will increase the depreciation charge where useful lives are less than previously estimated, or it will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold. The carrying values of property and equipment of the Group and the Parent are P5,943,421 and P5,478,999 as of December 31, 2014 and P5,069,832 and P4,981,525 as of December 31, 2013, respectively.

## 4. Cash and Other Cash Items

This account consists of:

	Group		Parent	
	2014	2013	2014	2013
Cash on hand	23,991,772	20,077,969	23,991,754	20,077,683
Checks and other cash items	242,996	236,052	242,996	236,052
Returned checks and other cash items	8,151	36,610	8,151	36,610
Petty cash fund	4,137	3,857	3,982	3,731
Revolving fund	1,388	831	233	237
Payroll fund	573	536	573	536
	24,249,017	20,355,855	24,247,689	20,354,849

## 5. Due from Bangko Sentral ng Pilipinas

This account represents the Parent's demand and special deposits in local currency maintained with BSP to meet reserve requirements and to serve as clearing account for interbank claims consistent with BSP guidelines.

## 6. Due from Other Banks

This account consists of:

	Group		Parent	
	2014	2013	2014	2013
Deposit with local banks	216,299	119,205	122,502	69,267
Deposit with foreign banks	6,168,740	3,077,076	6,162,883	3,071,220
	6,385,039	3,196,281	6,285,385	3,140,487

The Group maintains nostro accounts on global basis with 22 foreign depository banks totaling 28 and 30 bank accounts in 2014 and 2013, respectively, the most significant of which are as follows:

2014		2013	
1. Wells Fargo Bank, N.A.		1. Wells Fargo Bank, N.A.	
2. Standard Chartered Bank, N.Y.		2. Standard Chartered Bank, N.Y.	
3. The Bank of New York		3. Standard Chartered Bank, Tokyo	
4. Standard Chartered Bank, Frankfurt		4. Mizuho Corporate Bank	
5. Mizuho Corporate Bank		5. The Bank of New York	

Deposits with foreign banks as of December 31, 2014 include special deposit account with Standard Chartered Bank - Tokyo and Bank of Tokyo-Mitsubishi, UFJ amounting to JPY393.22 million and JPY0.13 million, respectively, which are restricted for disbursements on special lending projects.

## 7. Interbank Loans Receivables

This account consists of the Parent's loans receivable from domestic and foreign banks amounting to P17,243,602 and P7,036,608 as of December 31, 2014 and 2013, respectively.

Interbank loans receivable carry interest rates at December 31, as follows:

	2014		2013	
Domestic	2.31%	to 3.22%	2.00%	to 2.75%
Foreign	0.05%	to 0.18%	0.05%	to 0.35%

## 8. Securities Purchased under Agreements to Resell

This account consists of:

	Group		Parent	
	2014	2013	2014	2013
Government Securities Purchased under Reverse Repurchase Agreement	56,390,000	6,122,000	56,390,000	6,122,000
	56,390,000	6,122,000	56,390,000	6,122,000

Securities Purchased under Agreements to Resell of the Group carry interest rate at 4.00 per cent and 3.50 per cent as of December 31, 2014 and 2013, respectively.

## 9. Financial Assets at Fair Value Through Profit or Loss

This consists of:

	Group		Parent	
	2014	2013	2014	2013
Government Securities – Domestic	13,059,318	6,215	13,059,318	6,215
Government Securities – Foreign	399,972	260,099	399,972	260,099
Private Securities – Domestic	46,634	92,116	46,634	92,116
Derivative with positive fair value	1,306,916	1,988,647	1,306,916	1,988,647
	14,812,840	2,347,077	14,812,840	2,347,077

Financial Assets at Fair Value Through Profit or Loss (FVPL) of the Group carry interest rates at December 31 as follows:

	2014		2013	
Domestic	1.62%	to 4.17%	4.80%	to 10.50%
Foreign	7.25%	to 7.39%	1.62%	to 8.00%

Financial Assets at FVPL includes the foreign exchange (FX) risk cover of the Parent's borrowings from multilateral agencies amounting to P1.19 billion in 2014 and P1.95 billion in 2013 which is treated as a derivative financial instrument per BSP Monetary Board Resolution No. 1063 dated August 14, 2008.

Under a Memorandum of Agreement between the National Government (thru the Department of Finance) and the Parent, the former shall guarantee and assume the FX risk relating to foreign currency denominated borrowings from multilateral agencies (i.e. World Bank, Asian Development Bank, JICA, etc.) which are relented in local currencies. The fair value changes on the FX risk cover are reported immediately in the statement of comprehensive income. As of December 31, 2014, the outstanding notional amount of the FX risk cover amounted to US\$7.77 million and JPY8,392.67 million.

Prior to 2007, the value of the FX risk cover as an option derivative varies on the movement of the foreign exchange rates of the Bills Payable. Beginning 2007, in accordance with Monetary Board Resolution No. 1063 dated August 14, 2008, the Bank



applied the standard option valuation model approach which resulted in a decrease in the derivative asset amounting to P0.76 billion and P1.46 billion in 2014 and 2013, respectively.

The derivative with positive fair value comprise of the following:

	2014	2013
Foreign Exchange Risk Cover	1,185,749	1,948,909
Debt Warrants	83,337	0
Forward Contracts	37,830	39,738
	<b>1,306,916</b>	<b>1,988,647</b>

The Garman-Kohlhagen valuation model used in pricing the derivative Foreign Exchange Risk Cover (FXRC) was found acceptable by the Bangko Sentral ng Pilipinas during the conduct of their on-site validation in 2009.

#### 10. Available for Sale Investments

This account consists of:

	Group		Parent	
	2014	2013	2014	2013
Domestic				
Government	141,401,875	136,723,341	141,401,875	136,723,341
Private	15,375,784	16,029,515	15,375,784	16,029,515
Foreign				
Government	24,730,076	18,516,809	24,730,076	18,516,809
Private securities	2,543,228	1,307,577	2,543,228	1,307,577
Investment in non-marketable securities, net of allowance for probable losses of P1,395,864 in 2014 and P1,436,564 in 2013	7,290,146	7,258,913	7,290,146	7,258,913
	<b>191,341,109</b>	<b>179,836,155</b>	<b>191,341,109</b>	<b>179,836,155</b>

Available-for-sale investments of the Group carry interest rates at December 31 as follows:

	2014		2013	
Domestic	1.62%	to	10.50%	1.62% to 12.87%
Foreign	2.75%	to	10.63%	2.75% to 10.62%

Available-for-sale investments-Domestic Private include 42.003 million MERALCO shares of stocks with market value of P10.753 billion which are subject of legal disputes.

In November 2008, MERALCO unlawfully cancelled the 42.003 million shares of stocks registered in the name of the Parent and reissued the same in favor of another individual allegedly in compliance with the Demand to Comply issued by the Sheriffs of the

Department of Agrarian Reform (DAR) Regional Adjudicator. Of these 42.003 million shares, 3.37 million shares had been negotiated by another party; 37.23 million shares remained quarantined at the Philippine Depository and Trust Corporation (PDTC); and another 1.4 million shares has not yet been lodged with PDTC. However, the execution sale which was the basis for the issuance of the Demand to Comply was null and void from the beginning because of the Supreme Court's Temporary Restraining Order (TRO) enjoining the sale and the Resolution quashing all acts done pursuant to the Adjudicator's Writ. On December 17, 2008, the DAR Adjudication Board so ordered and required:

- 1) For MERALCO to cancel the Stock Certificates issued in favor of another party;
- 2) To restore the ownership of the subject MERALCO shares of stock to the Land Bank of the Philippines and to record the same in the Stock and Transfer Book of MERALCO; and
- 3) For the Philippine Stock Exchange, Inc. (PSE), the Philippine Depository and Trust Corporation (PDTC), the Securities Transfer Services, Inc. (STS), the Philippine Dealing System Holdings, Corp. and Subsidiaries (PDS Group) and any stockholder, dealer or agent of subject MERALCO shares to forthwith STOP: trading or dealing those shares and/or affecting settlement thereof, *inter alia*, so as to undo the foregoing contravening acts.

The Parent's shares of stock in MERALCO are not part of the Agrarian Reform Fund (ARF), a fund which is solely answerable to the obligation of the National Government pursuant to its Agrarian Reform Program. In accordance with Section 63 of Republic Act 6657 (Comprehensive Agrarian Reform Law), assets of the bank cannot be used to pay for land acquisition as this shall only be sourced from the ARF.

In its December 14, 2011 *Decision* in G.R. No. 188376, the Supreme Court directed MERALCO to return to the Land Bank of the Philippines (LBP) 42,002,750 MERALCO shares of stock. The Supreme Court further declared that the MERALCO shares of stocks are corporates assets of LBP illegally taken to satisfy the payment of just compensation that should have been appropriated only from the ARF. This ruling has become final and executory on September 11, 2012 (Entry of Judgment).

LBP immediately filed a motion before the Regional Agrarian Reform Adjudicator (RARAD) for the issuance of a writ of execution to implement the Supreme Court decision. This was, however, vigorously opposed by the other party. On April 1, 2013, the RARAD finally issued the *Writ of Execution*. As partial compliance, MERALCO delivered to LBP 38,635,950 shares including cash dividends in the total amount of P1,206,955,617.77; and property dividends consisting of 108,884,212 shares of stock in Rockwell Land Corporation.

Still undelivered are 3,366,800 shares, plus accrued cash dividends thereon, amounting to P161,303,398.00 as of September 30, 2014, plus 9,488,394 shares of stock in Rockwell Land Corporation as property dividends, and the unpaid dividends due from the 1,402,750 MERALCO shares amounting to P8,145,009.73. These 1.4 million shares are part of the 38.63 million shares restored to LBP, but certificated in the name of the other party before the Supreme Court decision was partially implemented.

To recover fully the MERALCO shares and dividends, LBP sent its June 18, 2014 *Letter* to the Office of the Regional Adjudicator Region IV – B (MIMAROPA) requesting the office to direct the Sheriff to perform all necessary acts for the full implementation of the April 1, 2013 *Writ of Execution* such as, but not limited to, the issuance of another *Demand to Comply* to be served upon MERALCO. LBP again sent the August 15, 2014 *Letter* to RARAD reiterating its request to expedite the full implementation of the Supreme Court's ruling in G.R. No. 188376 and to prevent further damage to LBP.

On February 6, 2015, LBP received the January 24, 2014 *Sheriff's Report* from the Sheriff of the Regional Adjudicator Region IV-B (MIMAROPA) regarding MERALCO's partial compliance of the December 14, 2011 Supreme Court *Decision* in G.R. No. 188376. LBP's June 18, 2014 *Letter* and August 15, 2014 *Letter* were not acted upon by the RARAD, and no further writ of execution or demand to comply were issued.

Since RARAD no longer issued a writ of execution or demand to comply, LBP sent the February 11, 2015 *Letter* addressed to MERALCO to demand the delivery of the remaining 3,366,800 shares of stocks plus unpaid dividends. MERALCO failed to respond to LBP's demand.

On account of the January 24, 2014 *Sheriff's Report* and MERALCO's failure to respond to LBP's February 11, 2015 *Letter*, LBP prepared a petition for contempt against MERALCO and its representatives for failing to deliver the remaining 3,366,800 shares of stocks plus accrued dividends and the unpaid dividends due from the 1,402,750 MERALCO shares delivered to LBP, and to compel full compliance with the December 14, 2011 Supreme Court *Decision*.

On March 10, 2015, the petition was sent to the Office of the Government Corporate Counsel (OGCC) for review and signature. OGCC approved the filing of the petition before the Supreme Court. On April 14, 2015, the ***Petition to Cite Respondents in Indirect Contempt*** was filed before the Supreme Court.

Parent's Accumulated market gains/losses on AFS government and private issues as of December 31, 2014 amounted to P15,856.43 million. Parent's Net unrealized gains/losses on AFS was P13,505.33 million.

The difference in the amount outstanding of the local currency accumulated market gains/losses and net unrealized gains/losses on AFS as of December 31, 2014 in the amount of P2,351.10 million, represents the remaining unamortized portion of the net unrealized gain or loss, that has been recognized directly in equity when the Available-for-sale securities has been reclassified to Held to maturity securities on various dates. The said amount shall be continuously amortized to profit or loss over the remaining life of the Held-to-maturity securities.

Total Investment in Non-Marketable Equity Securities (INMES) account of the Parent includes investment of US\$143.15 million (P6,781.38 million) in Metro Rail Transit Corporation's (MRTC) preference shares and Unsecuritized Equity Rental Payments.

In 2008, the National Government, as confirmed through Executive Order No. 855 dated January 18, 2010, instructed LBP and the Development Bank of the Philippines (DBP) to acquire majority interest in MRTC as a result of the recommendation made by the inter-agency Committee tasked to review the MRT III project. In the same year, the LBP

Board of Directors approved the purchase of MRTC interests in the form of unsecured portion of the Equity Rental Payment (ERP), MRT Bonds (See Notes to the Financial Statements No.12) and Preference Shares issued by MRT III Funding Corporation. LBP together with DBP completed its acquisition in May 2009, collectively owning around 80 per cent of MRTC interests. LBP owns approximately 37.77 per cent economic interest in MRTC.

The acquisition cost, book value and percentage of economic interest in MRTC are as follows:

	Acquisition Cost As of December 31, 2014 (In US Dollars) In Millions	Book Value As of December 31, 2014 (In US Dollars) In Millions	Percentage in MRTC
▪ MRT III Bonds	125.36	199.56	
▪ MRT III Preferred Shares	54.00	54.00	
Securitized ERPs	179.36	253.56	26.65%
Unsecured ERPs	90.58	89.15	11.12%
	269.94	342.71	37.77%

The decrease in the investment in unsecured ERP was brought about by the refund of US\$1.48 million (equally shared by the Bank and DBP) received from a third party in 2010. The refund represents cash that was already in the account of the third party, hence this did not affect LBP's percentage of economic interest in MRTC. Another refund of US\$1.38 million was received by the Bank and DBP in early 2011 representing Accrued ERPs.

## 11. Held to Maturity Investments

This account consists of:

	Group		Parent	
	2014	2013	2014	2013
Government				
Domestic	84,435,914	36,504,244	83,646,641	35,700,842
Foreign	6,417,637	4,400,341	6,417,637	4,400,341
Private				
Domestic	4,390,830	0	4,390,830	0
Foreign	570,479	0	570,479	0
	95,814,860	40,904,585	95,025,587	40,101,183

Held to maturity investments of the Group carry interest rates at December 31 as follows:

	2014		2013	
Domestic	4.12%	to 18.25%	6.25%	to 18.25%
Foreign	6.38%	to 11.63%	2.88%	to 10.62%

## 12. Loans and Receivables

This account consists of:

	Group		Parent	
	2014	2013	2014	2013
Interbank loans receivable	25,995,346	21,707,225	25,995,346	21,707,225
Allowance for credit losses	(367,395)	(409,846)	(367,395)	(409,846)
	25,627,951	21,297,379	25,627,951	21,297,379
Loans to Government	80,506,194	78,813,536	82,824,859	80,632,037
Allowance for credit losses	(51,128)	(30,262)	(51,128)	(30,262)
	80,455,066	78,783,274	82,773,731	80,601,775
Agrarian Reform and other				
Agriculture Loans	55,795,543	45,470,004	55,754,236	45,446,063
Allowance for credit losses	(724,228)	(723,679)	(724,228)	(723,679)
	55,071,315	44,746,325	55,030,008	44,722,384
Microfinance Loans	6,971,020	4,399,067	6,971,020	4,399,067
Allowance for credit losses	(156,220)	(181,141)	(156,220)	(181,141)
	6,814,800	4,217,926	6,814,800	4,217,926
SME/MSE Loans	30,877,552	21,366,914	30,877,552	21,366,914
Allowance for credit losses	(1,111,226)	(1,284,008)	(1,111,226)	(1,284,008)
	29,766,326	20,082,906	29,766,326	20,082,906
Contract to Sell	1,282,225	2,548,535	1,282,225	2,548,535
Allowance for credit losses	(73,314)	(68,576)	(73,314)	(68,576)
	1,208,911	2,479,959	1,208,911	2,479,959
Loans to Private Corporation	165,321,960	116,884,935	163,804,143	115,396,117
Allowance for credit losses	(735,789)	(407,277)	(571,128)	(235,266)
	164,586,171	116,477,658	163,233,015	115,160,851
Loans to Individuals for Housing Purposes	3,101,040	2,547,012	3,101,040	2,547,012
Allowance for credit losses	(36,720)	(55,840)	(36,720)	(55,840)
	3,064,320	2,491,172	3,064,320	2,491,172
Loans to Individual for Consumption	14,541,032	831,643	14,477,277	829,381
Allowance for credit losses	(227,445)	(89,470)	(227,445)	(89,470)
	14,313,587	742,173	14,249,832	739,911
Loans to Individual for Other Purposes	1,528,750	8,864,128	1,528,758	8,864,129
Allowance for credit losses	(21,565)	(170,801)	(21,565)	(170,801)
	1,507,185	8,693,327	1,507,193	8,693,328
	382,415,632	300,012,099	383,276,087	300,487,591
Accrued interest receivable	3,160,859	2,782,723	3,156,316	2,776,387
Allowance for credit losses	(254,381)	(365,763)	(254,362)	(365,742)
	2,906,478	2,416,960	2,901,954	2,410,645
Accounts receivable	1,659,864	1,534,618	1,550,520	1,515,367
Allowance for credit losses	(796,957)	(767,194)	(755,355)	(731,471)
	862,907	767,424	795,165	783,896
Sales contract receivable	1,019,347	1,298,580	1,019,106	1,298,099
Allowance for credit losses	(10,422)	(12,492)	(10,422)	(12,492)

	Group		Parent	
	2014	2013	2014	2013
	1,008,925	1,286,088	1,008,684	1,285,607
Due from ARF	316,154	21,045	316,154	21,045
Unquoted debt securities	13,738,152	16,780,323	13,738,152	16,780,323
Allowance for credit losses	(770,967)	(766,807)	(770,967)	(766,807)
	12,967,185	16,013,516	12,967,185	16,013,516
Lease contract receivable	1,730,336	1,922,660	0	0
Allowance for credit losses	(20,945)	(28,853)	0	0
	1,709,391	1,893,807	0	0
	402,186,672	322,410,939	401,265,229	321,002,300

Interest rates on loans in 2014 range from 1.337 per cent to 39.00 per cent for peso denominated loans and from 0.204 per cent to 30.00 per cent for foreign currency denominated loans.

Unquoted debt securities of the Parent classified as loans consist of government and private securities amounting to P2,195.00 million and P10,722.74 million, respectively, as of December 31, 2014 and P4,460.71 million and P11,552.80 million, respectively, as of December 31, 2013. The account includes Metro Rail Transit Corporation's (MRTC) Bonds with book value of \$199.56 million (P8,924.48 million) which form part of LBP's interests in the said company purchased in accordance with the approval of the Bank's Board of Directors in November 2008 and broken down as follows:

	Face Value	Book Value	
	USD	USD	PHP
FX Regular	289.25	149.99	6,484.04
FCDU	115.57	54.57	2,440.44
	404.82	194.56	8,924.48

Covered by Memorandum of Agreement (MOA) signed on August 22, 1988 between LBP and Bangko Sentral ng Pilipinas, the unpaid obligations of rural banks to BSP were converted into LBP equity contribution to said rural banks. Accordingly, these became non-interest bearing obligations of LBP with BSP and all expenses or losses, if any, which LBP may suffer under the conversion scheme, shall be for the account of BSP.

Outstanding equity investments on closed rural banks and its corresponding borrowings account from BSP have been excluded from Unquoted Debt Securities Classified as Loans account and from the Bills Payable account, respectively, provided that these accounts have already been written-off by BSP.

Allowance for credit losses

The details of allowance for credit losses on loans of the Parent are:

	2014	2013
Balance, January 1	3,248,889	4,214,884
Provision	0	1,274,712

Write-offs	(560,159)	(924,218)
Transfers and other adjustments	651,639	(1,316,489)
Balance, December 31	3,340,369	3,248,889

As of December 31, 2014 and 2013, the breakdown of Gross Loans as to secured and unsecured follows:

	Parent			
	2014		2013	
	Amount	%	Amount	%
Secured loans:				
Guarantee of the Republic of the Philippines	64,885,108	16.78	59,069,775	19.45
Various guarantees	125,785,578	32.54	104,371,568	34.36
Various mortgages	94,176,989	24.36	70,091,303	23.08
	284,847,675	73.68	233,532,646	76.89
Unsecured loans	101,768,781	26.32	70,203,834	23.11
Gross loan at amortized cost	386,616,456	100.00	303,736,480	100.00

Current banking regulations allow banks with no unbooked valuation reserves and capital adjustments to exclude from non-performing loan (NPL) classification those receivables from customers classified as loss in the latest examination of the BSP which are fully covered by allowance for credit losses, provided that interest on said receivables shall not be accrued.

As of December 31, 2014 and 2013, the Parent's NPLs amounted to P6,821,304 and P7,317,991, respectively.

	Parent	
	2014	2013
Total NPLs	6,821,304	7,317,991
NPLs fully covered by allowance for credit losses	(1,194,923)	(1,312,686)
Net NPLs	5,626,381	6,005,305

Under banking regulations, NPLs shall, as a general rule, refer to loan accounts whose principal and/or interest is unpaid for thirty (30) days or more after due date or after they have become past due in accordance with existing rules and regulations. This shall apply to loans receivable in lump sum and loans receivable in quarterly, semi-annual, or annual installments, in which case, the total outstanding balance thereof shall be considered non-performing. Restructured loans which do not meet the requirements to be treated as performing loans are also part of the Parent's non-performing loans.

### 13. Investment in Subsidiaries

This account consists of the following investments in subsidiaries which are 100 per cent owned by the Parent and are accounted for at cost:

Name	Amount
LBP Leasing Corporation	310,253

Name	Amount
LBP Insurance Brokerage, Inc.	52,500
LBP Resources and Development Corporation	51,467
Masaganang Sakahan, Inc.	24,555
LBP Financial Services, Italy	47,051
	485,826

On 10 January 2011, the LBP Board of Directors under Board Resolution No. 11-029 approved the voluntary closure of LBP Financial Services, SpA, Italy (LFSS). The full repatriation of the LFSS is still on the process of negotiating with the Posteitaliane for the repatriation of the remaining funds to Land Bank.

#### 14. Investment Property

This account consists of:

	Group					
	2014			2013		
	Land	Building	Total	Land	Building	Total
<b>At Cost</b>						
At January 1	6,163,948	2,864,345	9,028,293	5,919,834	2,548,500	8,468,334
Additions (Disposals)	(446,845)	(113,029)	(559,874)	244,114	315,845	559,959
At December 31	5,717,103	2,751,316	8,468,419	6,163,948	2,864,345	9,028,293
<b>Accumulated depreciation and impairment</b>						
At January 1	697,370	1,044,097	1,741,467	601,367	1,005,358	1,606,725
Depreciation	170	117,897	118,067	0	88,258	88,258
Transfers/Adjustment	(96,691)	(112,187)	(208,878)	0	(40,695)	(40,695)
Impairment	326	8,683	9,009	96,003	(8,824)	87,179
At December 31	601,175	1,058,490	1,659,665	697,370	1,044,097	1,741,467
<b>Net book value</b>	5,115,928	1,692,826	6,808,754	5,466,578	1,820,248	7,286,826
	Parent					
	2014			2013		
	Land	Building	Total	Land	Building	Total
<b>At Cost</b>						
At January 1	6,082,982	2,774,037	8,857,019	5,843,808	2,467,317	8,311,125
Additions (Disposals)	(447,544)	(103,905)	(551,449)	239,174	306,720	545,894
At December 31	5,635,438	2,670,132	8,305,570	6,082,982	2,774,037	8,857,019
<b>Accumulated depreciation and impairment</b>						
At January 1	694,308	1,006,727	1,701,035	598,305	970,848	1,569,153
Depreciation	0	114,958	114,958	0	85,399	85,399
Transfers/Adjustment	(96,691)	(111,975)	(208,666)	0	(40,696)	(40,696)
Impairment	0	8,683	8,683	96,003	(8,824)	87,179
At December 31	597,617	1,018,393	1,616,010	694,308	1,006,727	1,701,035
<b>Net book value</b>	5,037,821	1,651,739	6,689,560	5,388,674	1,767,310	7,155,984

Depreciation and amortization of the Group amounting to P118,067 and P88,258 and of the Parent amounting to P114,958 and P85,399 in 2014 and 2013, respectively, are included in depreciation and amortization expense in the statement of comprehensive income.

Investment properties acquired through foreclosure as of December 31, 2014 which are still within the redemption period by the borrowers and with on-going court case amounted to P473,711 and P1,503,979, respectively. Properties amounting to P62,555



are agricultural lands covered by the government's agrarian reform program. As of December 31, 2014 and 2013, the aggregate market value of the investment properties amounted to P8,837,640 and P9,747,624, respectively, for the Group and P8,702,231 and P9,610,693, respectively, for the Parent. Fair value has been determined based on valuations made by independent and/or in-house appraisers. Valuations were derived on the basis of recent sales of similar properties in the same area as the investment properties and taking into account the economic conditions prevailing at the time the valuations were made.

## 15. Property and Equipment

This account consists of:

	Group								Total	
	Building Under Construction		Buildings	Leasehold Rights and Improvements	Transportation and Equipment	Furniture and Office Equipment	Transportation Equipment Under Lease	Others	2014	2013
	Land									
<b>At Cost</b>										
At January 1	548,536	7,088	4,383,936	442,292	90,398	5,323,108	355,929	70,011	11,221,298	10,606,331
Additions	26,519	179,783	82,745	140,841	3,329	847,795	373,115	6,033	1,660,160	1,070,967
Disposals	0	0	(109)	(3,763)	(8,063)	(189,897)	0	0	(201,832)	(244,346)
Transfers	(199)	(46,500)	3,221	(18,726)	(4,238)	(193,965)	(9,602)	(278)	(270,287)	(211,654)
At December 31	574,856	140,371	4,469,793	560,644	81,426	5,787,041	719,442	75,766	12,409,339	11,221,298
<b>Accumulated Depreciation, Amortization &amp; Impairment loss</b>										
At January 1	0	0	1,874,130	193,989	62,834	3,683,584	261,325	61,681	6,137,543	5,833,257
Depreciation & amortization	0	0	91,120	43,761	1,669	340,767	29,222	4,273	510,812	524,792
Disposals	0	0	(83)	(1,122)	(7,755)	(177,586)	0	0	(186,546)	(224,998)
Transfers/Adjustments	0	0	(5,309)	5,545	301	(23,401)	9,576	(6,790)	(20,078)	4,492
At December 31	0	0	1,959,858	242,173	57,049	3,823,364	300,123	59,164	6,441,731	6,137,543
Allow for Losses	0	0	7,214	137	2,825	7,450	0	6,561	24,187	13,923
<b>Net book value</b>	574,856	140,371	2,502,721	318,334	21,552	1,956,227	419,319	10,041	5,943,421	5,069,832

  

	Parent								Total	
	Building Under Construction		Buildings	Leasehold Rights and Improvements	Transportation and Equipment	Furniture and Office Equipment	Transportation Equipment Under Lease	Others	2014	2013
	Land									
<b>At Cost</b>										
At January 1	548,536	7,088	4,303,623	442,119	74,168	5,292,232	295,340	57,878	11,020,984	10,421,728
Additions	26,519	179,783	73,621	140,801	2,165	845,377	0	0	1,268,266	1,054,758
Disposals	0	0	(109)	(3,763)	(8,063)	(187,602)	0	0	(199,537)	(244,134)
Transfers	(199)	(46,500)	3,221	(18,640)	(4,237)	(193,965)	(9,602)	(279)	(270,201)	(211,368)
At December 31	574,856	140,371	4,380,356	560,517	64,033	5,756,042	285,738	57,599	11,819,512	11,020,984
<b>Accumulated Depreciation &amp; Amortization</b>										
At January 1	0	0	1,844,306	193,903	54,078	3,660,195	215,260	57,794	6,025,536	5,729,652
Depreciation & amortization	0	0	87,860	43,653	198	339,223	25,350	0	496,284	516,099
Disposals	0	0	(83)	(1,122)	(7,755)	(176,329)	0	0	(185,289)	(224,958)
Transfers/Adjustments	0	0	(5,522)	5,631	302	(23,402)	9,576	(6,790)	(20,205)	4,743
At December 31	0	0	1,926,561	242,065	46,823	3,799,687	250,186	51,004	6,316,326	6,025,536
Allow for Losses	0	0	7,214	137	2,825	7,450	0	6,561	24,187	13,923
<b>Net book value</b>	574,856	140,371	2,446,581	318,315	14,385	1,948,905	35,552	34	5,478,999	4,981,525

Depreciation and amortization of the Group amounting to P510,812 and P524,792 and of the Parent amounting to P496,284 and P516,099 in 2014 and 2013, respectively, are included in depreciation and amortization expense in the statement of comprehensive income.

Office equipment, furniture and vehicles with carrying amount of P192,191 and P234,534 in 2014 and 2013, respectively, are temporarily idle. The carrying amounts of properties which are held for disposal are P76,198 and P27,736 in 2014 and 2013, respectively.

## 16. Other Resources

This account consists of:

	Group		Parent	
	2014	2013	2014	2013
Accrued interest receivable	3,223,900	2,483,371	3,223,900	2,483,371
Sundry debits	2,187,835	1,166,090	2,187,835	1,166,090
Prepaid expenses	364,684	253,328	400,426	255,700
Other intangible assets	534,416	379,540	532,006	378,046
Documentary stamps	49,215	19,359	49,215	19,359
Stationery & supplies on hand	123,295	135,665	120,965	134,192
Accounts receivable	126,382	135,752	120,886	129,190
Inter-office float items	2,022	8,175	2,022	8,175
Others	1,186,571	497,970	1,128,726	439,060
	7,798,320	5,079,250	7,765,981	5,013,183

## 17. Allowance for Credit Losses

Changes in the allowance for credit losses of the Parent are as follows:

	2014	2013
Balance at beginning of year:		
Loan portfolio	3,248,889	4,214,884
Other assets	4,116,196	3,873,224
	7,365,085	8,088,108
Provisions charged to operations	45,063	1,463,467
Accounts charged off and others	(560,855)	(936,965)
Transfer/adjustments	490,740	(1,249,525)
	(25,052)	(723,023)
Balance December 31	7,340,033	7,365,085
Balance at end of year:		
Loan portfolio	3,340,369	3,248,889
Receivables from customers and other assets	3,999,664	4,116,196
	7,340,033	7,365,085

With the foregoing level of allowance for credit losses, Management believes that the Parent has sufficient allowance to cover any losses that the Parent may incur from the non-collection or non-realization of its loans and receivables and other risk assets.

The account includes provision for credit losses/impairment losses of P45,063 for the year detailed as follows:

	Parent
Loans and receivables	0
Other loans and receivables	10,073
Property and equipment	4,324
Others	30,666
	45,063

## 18. Deposit Liabilities

This account consists of:

	Group		Parent	
	2014	2013	2014	2013
Domestic				
Demand deposits	392,016,125	348,115,219	392,226,721	348,297,024
Savings deposits	458,518,376	315,781,131	458,673,787	315,892,068
Time certificate of deposits	1,250,401	1,412,692	1,250,401	1,412,692
Long Term Negotiable Certificate of Deposits	5,000,000	5,000,180	5,000,000	5,000,180
	856,784,902	670,309,222	857,150,909	670,601,964
Foreign				
Savings deposit –FCDU/EFCDU	10,744,068	8,235,863	10,750,022	8,242,106
Time certificate of deposit-FCDU/EFCDU	45,050,705	25,214,069	45,050,705	25,214,069
	55,794,773	33,449,932	55,800,727	33,456,175
	912,579,675	703,759,154	912,951,636	704,058,139

Domestic deposit liabilities earn annual fixed interest rates ranging from 0.25 to 3.50 per cent in 2014 and 0.18 to 5.37 per cent in 2013. Foreign deposit rates range from 0.15 to 2.50 per cent and from 0.13 to 2.45 per cent in 2014 and 2013, respectively.

## 19. Bills Payable

This account consists of:

	Group		Parent	
	2014	2013	2014	2013
Bangko Sentral ng Pilipinas	97,860	98,049	97,860	98,049
Domestic borrowings	458,026	838,946	458,026	554,946
Foreign borrowings	19,685,242	22,917,368	19,685,242	22,917,368
	20,241,128	23,854,363	20,241,128	23,570,363

The breakdown of Bills payable (foreign borrowings) is as follows:

Creditor/Funder	2014	2013
World Bank/IBRD	6,932,092	7,949,896
Asian Development Bank (ADB)	613,392	765,434
Japan International Cooperation Agency (JICA)	10,707,813	12,571,958
Kreditanstalt für Wiederaufbau (KfW)	1,431,945	1,630,080
	19,685,242	22,917,368

The total foreign borrowings of P19,685.24 million is guaranteed by the National Government. Foreign borrowings relented in local currency amounting to P15,627.13 million are provided with foreign exchange risk cover (FXRC) by the National Government. This has historical value of P17,533.68 million. The Bank's foreign borrowings from multilateral and bilateral agencies have maturities ranging from 15 to 40 years.

Interest rates on foreign and domestic borrowings in 2014 range from 0.62 to 2.7 per cent and 0.75 to 4.75 per cent, respectively, while for 2013, the rates range from 0.61 to 2.7 per cent and 0.75 to 9.83 per cent, for foreign and domestic borrowings, respectively.

## 20. Unsecured Subordinated Debt

This account consists of:

	Issue Date	Maturity Date	2014	2013
Domestic	June 09, 2009	June 09, 2019	0	6,934,000
	January 27, 2012	January 27, 2022	10,500,000	10,500,000
			10,500,000	17,434,000

## 21. Other Liabilities

This account consists of:

	Group		Parent	
	2014	2013	2014	2013
Accrued interest, fringe benefits, taxes and other expense payable	3,939,867	3,209,570	3,866,231	3,154,252
Accounts payable	7,315,610	6,035,861	7,384,087	6,063,374
Due to Agrarian Reform Fund	204,032	3,489,744	204,032	3,489,744
Sundry credits	3,070,892	936,598	3,070,892	936,598
Unearned income	45,197	59,062	45,306	59,163
Withholding tax payable	233,038	163,334	231,033	161,845
Miscellaneous liabilities	3,626,320	3,137,343	3,722,610	3,223,502
Others	1,417,766	851,967	1,241,856	719,538
	19,852,722	17,883,479	19,766,047	17,808,016

## 22. Income and Other Taxes

Under Philippine tax laws, the Regular Banking Unit of the Parent is subject to percentage and other taxes (presented as Taxes and Licenses in the statement of comprehensive income) as well as income taxes. Percentage and other taxes paid consist principally of gross receipts tax and documentary stamp taxes. Income taxes include the corporate income tax and final withholding tax on gross interest income from government securities, deposits and other deposit substitutes. These income taxes and deferred tax benefits are presented in the statement of comprehensive income either Provision for or (Benefit from) Income Tax.

Based on Republic Act 9337, which was passed into law in May 2005 and amended certain provisions of the National Internal Revenue Code of 1997, the normal corporate income tax rate is 30 per cent effective January 1, 2009. The interest allowed as deductible expense is reduced by an amount equivalent to 33 per cent of the interest income subjected to final tax.

FCDU offshore income (income from non-residents) derived by depository banks under the expanded foreign currency deposit system is exempt from income tax while gross onshore income (income from residents) from other FCDUs and other depository banks under the Expanded Foreign Currency Deposit System, including interest income from foreign currency loans, is subject to 10 per cent final tax. Interest income derived by resident individual or corporation on deposits with other FCDUs and Offshore Banking Units (OBU) are subject to 7.5 per cent final tax.

The provision for/(benefit from) income tax consists of:

	Group		Parent	
	2014	2013	2014	2013
Current:				
Normal income tax (NIT)	1,001,385	2,845,399	913,540	2,769,835
Minimum corporate income tax (MCIT)	0	0	0	0
	1,001,385	2,845,399	913,540	2,769,835
Deferred	142,355	276,427	140,771	277,284
	1,143,740	3,121,826	1,054,311	3,047,119

The reconciliation of the provision for income tax computed at the statutory tax rate and actual provision is as follows:

	Group		Parent	
	2014	2013	2014	2013
Statutory income tax	3,980,985	4,411,686	3,877,796	4,311,123
Tax effects of:				
FCDU income	(577,676)	(536,930)	(577,676)	(536,930)
Tax exempt & tax paid income	(4,014,556)	(3,415,292)	(4,004,024)	(3,404,370)
Other deductible/Non-deductible expense	1,114	336,840	1,114	336,370
Non-deductible interest expense	1,323,537	1,204,892	1,323,537	1,204,892
Deferred tax asset	142,355	276,427	140,771	277,284
Others	287,981	844,203	292,793	858,750
	1,143,740	3,121,826	1,054,311	3,047,119

There was no deferred tax asset recognized by the Parent for CY 2014. Subsidiaries recognized deferred tax assets of P65.171 million and P66.790 million for CY 2014 and CY 2013, respectively.

Below are the temporary differences for which no deferred tax asset is recognized by the Parent since Management believes that it is not probable that future taxable profits will be available against which the asset can be utilized:

	2014	2013
Allowance for credit losses	12,999,720	13,512,037
	12,999,720	13,512,037

**Report on the Supplementary Information Required Under Revenue Regulations (RR) No. 19-2011 and 15-2010**

Supplementary information Under RR No. 19-2011

In addition to the required supplementary information under RR No. 15-2010, on December 9, 2011, the BIR issued RR No. 19-2011 (and as further amended by RR No. 2-2014 dated January 24, 2014) which prescribes the new annual income tax forms that will be used for filing effective taxable year 2011. Specifically, companies are required to disclose certain tax information in their respective notes to financial statements. For the taxable year December 31, 2014, the Parent Company reported the following revenues and expenses for income tax purposes:

Revenues	
Services/operations	18,313,106
Non-operating and taxable other income:	
Trading and securities gain	2,210,065
Service charges, fees and commissions	1,186,680
Profit from assets sold	202,521
Income from trust operations	158,022
Others	736,193
	4,493,481
Expenses	
Cost of services:	
Compensation and fringe benefits	5,746,258
Others	5,571,174
	11,317,432
Itemized deductions:	
Compensation and fringe benefits	1,467,818
Taxes and licenses	2,033,460
Security, messengerial and janitorial	590,748
Communications, light and water	388,309
Information technology expenses	366,144
Depreciation and amortization	247,580
Bad debts	565,750

Repairs and maintenance	188,641
Transportation and travel	174,566
Management and professional fees	181,308
Rent	205,695
Representation and entertainment	100,729
Others	2,692,004
	<b>9,202,752</b>

Supplementary information Under RR No. 15-2010

On November 25, 2010, the BIR issued RR No. 15-2010 to amend certain provisions of RR No. 21-2002 which provides that starting 2010 the notes to financial statements shall include information on taxes, duties and license fees paid or accrued during the taxable year.

I. The documentary stamp tax (DST) on loan instruments and other transactions subject thereto for the tax period 2014 are as follows:

<b>Documents / transactions</b>	<b>DST Paid</b>
Debt instruments, bonds, certificate of time deposits	1,785,553
Mortgages, pledges, deed of assignments/trust	28,433
Foreign bills of exchange, letters of credit	28,487
Acceptance of bills of exchange payable in the Philippines	13,988
Bank, checks, drafts and telegraphic transfer/others	3,827
	<b>1,860,288</b>

II. All other taxes, local and national, paid for 2014:

<b>National</b>	
Percentage taxes (GRT)	1,940,951
Fringe benefits tax	8,738
National taxes	784
	<b>1,950,473</b>

<b>Local</b>	
Real estate tax	40,697
Local business tax	24,971
Mayor's Permit/Municipal License/Other Regulatory Fees/License Permit	54,951
Other local taxes	6,274
	<b>126,893</b>
	<b>2,077,366</b>

III. The amount of withholding taxes paid/accrued for the year amounted to:

Tax on Compensation and benefits	835,175
Creditable withholding taxes	136,659
Final withholding taxes	1,169,757
	<u>2,141,591</u>

IV. Taxes withheld by client on their income payments to the Bank were claimed as tax credits:

Tax Credits against Income Tax	1,603,284
Tax Credits against Gross Receipts Tax	96,908
	<u>1,700,192</u>

### 23. Retirement Cost

The Parent has separate funded contributory defined contribution retirement plans covering all its officers and regular employees. Under the retirement plans, all concerned officers and employees are entitled to cash benefit after satisfying certain age and service requirements. Total expenses charged against operations in 2014 and 2013 amounted to P560.965 million and P552.988 million, respectively.

### 24. Lease Contracts

Operating lease commitments – as lessee

Future minimum rentals payable under non-cancellable operating leases as at December 31 are as follows:

	Parent	
	2014	2013
Within one year	363,752	340,920
After one year but not more than five years	704,098	693,031
More than five years	261,818	232,162
	<u>1,329,668</u>	<u>1,266,113</u>

Operating lease commitments – as lessor

Future minimum rentals receivable under non-cancellable operating leases as at December 31 are as follows:

	Parent	
	2014	2013
Within one year	17,552	24,735
After one year but not more than five years	11,954	10,151
More than five years	6,692	510
	<u>36,198</u>	<u>35,396</u>



## 25. Related Party Transactions

In the ordinary course of business, the Parent has loan transactions with certain directors, officers, stockholders and related interests (DOSRI). Existing banking regulations limit the amount of individual loans to DOSRI, 70 per cent of which must be secured by their respective deposits and book value of their respective investments in the Parent. In the aggregate, loans to DOSRI generally should not exceed the respective total unimpaired capital or 15 per cent of total loan portfolio, whichever is lower, of the Parent.

BSP Circular No. 547 dated September 21, 2006 prescribed the DOSRI rules for government borrowings in government-owned or controlled banks. Said circular considered as indirect borrowings of the Republic of the Philippines (ROP), loans, other credit accommodations and guarantees to: (a) Government-Owned and Controlled Corporations (GOCCs); and (b) Corporations where the ROP, its agencies/departments/bureaus, and/or GOCCs own at least 20 per cent of the subscribed capital stocks.

Total outstanding DOSRI loans of the Parent as of December 31, 2014 amounted to P72,508 million of which P71,673 million are government borrowings covered by BSP Circular No. 547.

The following are the significant transactions of the Parent with related parties:

	2014				2013			
	Key Management Personnel	Subsidiaries	Others (GOCCs, Provident Fund and Rural Banks)	Total	Key Management Personnel	Subsidiaries	Others (GOCCs, Provident Fund and Rural Banks)	Total
Receivables from customers	30,033	2,411,294	71,673,465	74,114,792	24,758	1,911,545	64,439,892	66,376,195
Deposit liabilities	0	371,961	0	371,961	0	298,985	0	298,985
Other liabilities	0	551,593	0	551,593	0	472,500	0	472,500
	30,033	3,334,848	71,673,465	75,038,346	24,758	2,683,030	64,439,892	67,147,680

The following are the significant transactions with subsidiaries:

	2014	2013
Sales/(Purchases)	(26,242)	(24,168)
Interest income	70,488	65,639
Interest expense	(166,795)	(169,755)
Lease expense	(44,553)	(45,907)
Other income	1,404	1,657
Other expenses	(336,573)	(32,139)
	(502,271)	(204,673)

Transactions with other related parties:

Compensation of key management personnel:

	Group		Parent	
	2014	2013	2014	2013
Short-term employee benefits	133,614	121,113	115,809	106,421
Post-employment benefits	32,821	31,141	27,754	26,189

	Group		Parent	
	2014	2013	2014	2013
Other long-term benefits	45,243	37,428	45,243	37,428
	211,678	189,682	188,806	170,038

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, 2014 and 2013, 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.

## 26. 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 P80,852,721 and P57,263,059 as at December 31, 2014 and 2013, respectively.

Summary of Assets under Management is as follows:

	2014	2013
Special Purpose Trust	2,424,237	3,246,336
Other Fiduciary Accounts	15,691,151	9,193,862
Agency	22,298,110	24,850,846
Trust	40,439,223	19,972,015
	80,852,721	57,263,059

In compliance with the requirements of the General Banking Law, government securities with total face value of P950,000 in 2014 and P950,000 in 2013 are deposited with BSP as security for the Parent's faithful performance of its fiduciary obligation.

## 27. Derivative Financial Instruments

For 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, 2014, the outstanding notional amount of the currency sell forward/swap agreements with maturity of less than six months amounted to P19,006.00 million with market value of P19,027.35 million while the currency bought amounted to P670.80 million with a market value of P671.47 million.

### *Over the Counter Interest Rate Option Contract Bought*

As of December 31, 2014, the outstanding notional amount of the debt warrants bought to mature on November 29, 2032 amounted to P68.91 million with market value of P83.34 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 statement of comprehensive income. As of December 31, 2014, the outstanding notional amount of the FX risk cover amounted to US\$7.77 million and JPY8,392.67 million.

## Embedded Derivatives

### *Embedded Credit Derivatives*

This includes credit default swaps embedded in host debt instruments and with credit linkages to reference entities.

### *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.

## **28. 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	
	2014	2013
Trust Department accounts	80,852,721	57,263,059
Commitments	63,655,672	57,319,997
Standby/commercial letters of credit	15,850,626	8,456,839
Derivatives	23,208,712	11,558,208
Outstanding guarantees	88,521	387,637
Spot exchange contracts	1,207,440	1,331,850
Late deposits received	563,482	426,750
Outward bills for collection	53,336	54,782
Others	784,704	866,960
	186,265,214	137,666,082

## 29. Financial Performance

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

	2014	2013
Net interest margin ratio	3.44%	3.67%
Return on average assets	1.35%	1.56%
Return on average equity	17.20%	14.33%

## 30. Capital Funds

The Parent complies with the provision of RA No. 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 April 28, 2014, the Parent remitted cash dividends to the National Government in the amount of P6.0 billion covering its CY2013 net income.

For CY2014 net income, the Parent remitted P6.0 billion cash dividend on March 31, 2015.

### 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.

The Bank adopted BASEL 3 CAR computation pursuant to BSP Circular No. 781 effective January 31, 2014. INMES and AFS Equity were included as regulatory adjustments/deduction to Tier 1 capital.

	(Amounts in Millions)			
	Group		Parent	
	2014	2013	2014	2013
Tier 1 Capital	75,217	54,969	75,217	55,029
Tier 2 Capital	14,703	24,819	14,682	24,800
Gross Qualifying Capital	89,920	79,788	89,899	79,829
Less: Required Deductions	20,368	1,272	22,283	2,556
Total Qualifying Capital	69,552	78,516	67,616	77,273
Risk Weighted Assets	469,533	387,282	466,591	384,440
Adjusted Tier 1 Capital ratio	11.68%	14.03%	11.35%	13.98%
Total Capital Adequacy Ratio (CAR)	14.81%	20.27%	14.49%	20.10%

The regulatory qualifying capital of the Parent consists of Tier 1 (core) capital, which comprises paid-up common stock, retained earnings, current year profit less required deductions such as unsecured credit accommodations to DOSRI, deferred income tax, other intangible assets, equity investments and investment in non-marketable securities. The other component of regulatory capital is Tier 2 (supplementary) capital, which includes unsecured subordinated debt and general loan loss provision.

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

## **31. Financial Risk Management**

### **RISK MANAGEMENT ORGANIZATION**

#### **Risk Management and Good Governance**

Risk Management is an integrative component of good governance which endeavors to ensure adequacy of policies, systems and procedures to manage risks. Risk management at Land Bank of the Philippines (LBP) completes the triumvirate that takes a close look at the controls of the Bank. Together with internal audit and compliance, the synergy of the three functions provides credence to the role of the Bank's corporate governance in implementing an effective control framework.

Oversight on all risk-related functions is a responsibility of the LBP Board of Directors (BoD). This responsibility is rendered by the Board through the Risk Oversight Committee (RiskCom), which evaluates and approves the Bank's risk management framework, policies and effectiveness of controls.

#### **Risk Management Philosophy**

LBP is a financial institution involved in providing banking products and services that expose it to a plethora of risks. While it recognizes all risks inherent in a financial institution, it manages closely those that have significant bearing on its balance sheet accounts. Risk management is embedded in all the business processes of the Bank and it ascertains that risk-taking is commensurate with its risk appetite. The management of risks is anchored on the Bank's vision, mission and strategic objectives, as well as its organizational structure, Information Technology (IT) infrastructure, control and communication processes, among others.

The Bank's approach to risk management is as follows:

- The LBP Board, through the RiskCom, exercises oversight on all risk-related functions and activities of the Bank based on a top-down structure;
- 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). RMG reports functionally to the RiskCom and administratively to the President & Chief Executive Officer (CEO) of the Bank; and
- The Bank adopts the Integrated or Enterprise-wide approach in managing risks. Enterprise Risk Management (ERM) views the group-wide risks of the Bank from the top and analyzes and addresses identified risks together with the authorized risk taking units. Through ERM, risk analysis is strengthened as it takes a cross-functional perspective that reveals the interdependencies of the risks and facilitates risk treatment at the source.

#### **Risk Exposures and Assessment**

LBP recognizes the following risk exposures, the same exposures articulated in its 2014 Internal Capital Adequacy Assessment Process (ICAAP) Document.

RISK	DESCRIPTION
1. Credit Risk	<ul style="list-style-type: none"> <li>➤ A considerable percentage of the Bank's funds are deployed to credit, being its core business. Credit risk arises from the failure of a counterparty to meet the terms or perform within the bounds of its contract with the Bank. Credit risk to LBP takes the form of Counterparty Credit Risk-Loans and Counterparty Credit Risk-Investments.</li> </ul>
2. Market	<ul style="list-style-type: none"> <li>➤ LBP treasury activities generally deal with Government Securities (GS) and Foreign Securities, Equities, and Foreign Currencies that are classified as Held For Trading (HFT) or as Available For Sale (AFS). The values of these assets are subject to Mark-To-Market (MTM) or daily valuation to align with prevailing market prices and rates. These adjustments could result to a gain or loss for the Bank.</li> </ul> <p>It is the risk of loss, immediate or over time, due to adverse fluctuations in price or market value of instruments, products, and transactions in the Bank's overall trading and investment portfolio. Failure to anticipate and manage fluctuations in the values of the Bank's investments could lead to economic losses.</p>
3. Operational Risks	
a. People Risk	<ul style="list-style-type: none"> <li>➤ Under the Bank's ERM, People Risk consists of three risk components, particularly defined as follows: <ul style="list-style-type: none"> <li>1. <b>Recruitment &amp; Retention Risk</b> - Difficulty of the Bank to attract and retain competent employees that might lead to organizational dysfunction and low morale;</li> <li>2. <b>People Development &amp; Performance Risk</b> - Difficulty to <b>develop</b> and enhance employee skills and provide a sound employee performance management system that may reduce employee motivation and may adversely impact the achievement of desired performance and conduct; and</li> <li>3. <b>Succession Planning Risk</b> - Failure to create and <b>implement</b> a feasible continuance plan for key Bank positions and employees that might adversely affect the stability of organizational leadership and business continuity.</li> </ul> </li> </ul>
b. Process Risk	<ul style="list-style-type: none"> <li>➤ Basel Committee defines Operational Risk as the risk of loss resulting from inadequate or failed internal processes, people, and systems. Process Risk, as one of the sources of Operational Risk, is the risk of loss caused by, but not limited to, inadequate or failed execution of the Bank's business processes, human error or negligence, fraud and malice.</li> </ul>

- c. System or MIS Risk ➤ IT Risk refers to the business risk associated with the use, ownership, operation, involvement and adoption of IT within the Bank. The following are the categories of IT Risk:
1. **IT Management** - Failure to effectively adopt identified IT initiatives and administer IT resources may lead to lost business and hinder the achievement of the Bank's goals and objectives.
  2. **IT Confidentiality** - Failure of information system to adequately protect both IT data and IT infrastructure leads to or allows unauthorized access, or leads to destruction of information and information systems of the Bank.
  3. **IT Availability or Continuity** - Failure to ensure uninterrupted operations and immediate recovery from systems and implementation failures lead to losses of the Bank.
  4. **IT Integrity** - Failure of information system to provide accurate, reliable and timely financial and non-financial information when needed leads to operational inefficiencies or lost business opportunities.
  5. **Technology Implementation** - Failure to adopt and implement the appropriate approved system and technology to support business processes or major initiatives may lead to costly investments and work inefficiencies and may compromise product or service delivery. Not in LBP Risk dictionary but included in IT Risk Management Plan.
4. Strategic Risk ➤ Current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes. This risk is a function of the compatibility of an organization's strategic goals, the business strategies developed to achieve these goals, the resources deployed against these goals, and the quality of implementation.
- The resources needed to carry out business strategies are both tangible and intangible. They include communication channels, operating systems, delivery networks, and managerial capacities and capabilities. The organization's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environmental changes (BSP Circular No. 510, Series of 2006).



5. Concentration and Contagion Risk
- The Concentration and Contagion Risks which are considered by the Bank as Pillar 2 risks are hereby defined as follows:
    1. **Credit Concentration Risk** - 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.
    2. **Contagion Risk** - An adverse condition that may affect companies within a holding or parent company, resulting to an adverse effect on the financial performance of the parent company itself, or to its other subsidiaries and affiliates. It could also affect a portion, or an entire portfolio of a bank creditor, or at worse, the entire industry from which that particular distressed company belongs to.
6. Liquidity Risk
- Failure to properly manage the Bank's cash flows that could affect its ability to settle its obligations as they become due and could lead to insolvency and regulatory sanctions.
7. Interest Rate Risk
- Inability to appropriately plan for and react to fluctuations in interest rates which leads to market value losses on investment securities or cash flow shortfalls resulting from re-pricing of loans or obligations. It is the risk that the Bank will experience deterioration in its financial position as interest rate moves over time.
- These losses impact the earnings and economic value of capital.
8. Counterparty Risk
- Counterparty risk refers to a class of credit risks that occur from transactions where reciprocal obligations are made between the Bank and counterparties or customers. It is the risk associated with the grant of facilities, whether by way of actual financing with outlay of funds or by actual engagement in a commitment by a borrower to fulfil an actual or contingent obligation to the Bank.
- Based on the above definition, credit risk is inherent in banking activities whether for loans or investments, including activities in the banking book and in the trading book, and both for on-balance and off-balance sheet. Thus, LBP classifies Counterparty Credit Risk as pertaining to both Loans and Investments.

The Bank defines Counterparty Credit Risk on loans as the inability to review and analyze the credit quality of potential or existing borrowers to serve as basis for loan approval (at application) and to determine the probability of default (on an on-going basis), that could lead to economic losses.

Other than loans, LBP is facing credit risk (counterparty risk) on various financial instruments, and is an element in virtually every product and service that the Bank provides such as acceptances, interbank transactions, trade financing, foreign exchange transactions, financial futures, swaps, bonds, equities, options, and in the extension of commitments and guarantees, and the settlement of transactions. Thus, Counterparty Credit Risk on investment is referred to by the Bank as the failure to anticipate and manage the risk of counterparty default (for investment securities and derivatives) might lead to severe financial and economic losses for the Bank.

Counterparty Risk on loans for ICAAP, except for Interbank Loans, is captured under the Credit Risk Category of the LBP ICAAP Document. Thus, discussions of credit risk under this section shall refer to counterparty and the concentration risk exposure related to trading or investments. And counterparty would refer to an entity with which the Bank engages in trading or treasury related activities, typically, but not necessarily always with other financial institution.

9. Compliance Risk ➤ Compliance Risk is defined as the current and prospective risk to earnings or capital arising from violations of, or non-conformance with laws, rules and regulations, prescribed practices, internal policies and procedures or ethical standards. (BSP Circular No. 510, Series of 2006).

Compliance risk also arises in situations where the laws or rules governing certain bank products or activities of the bank clients may be ambiguous or untested. This risk exposes LBP to fines, payment of damages and the voiding of contracts.

Compliance risk can lead to diminished reputation, reduced franchise value, limited business opportunities, reduced expansion potential and lack of contract enforceability.

Recently, the compliance framework has been redefined with the issuance of BSP Circular No. 747, Series 2012 which mandates the establishment of a strong, responsive and appropriate bank-wide Compliance System designed to focus on the mitigation of business risk. The circular defines business risks as “conditions which may be detrimental to the Bank’s business model and its ability to generate returns

from operations, which in turn erode its franchise value”.

Providing delineation between the risk program and the compliance program, BSP Circular No. 747, Series of 2012 refers to the risk program as covering “financial risks that arise from the balance sheet exposures of the institution”. On the other hand, compliance program will deal with business risks which shall include, but not limited to the following:

1. Reputation risk resulting from internal decisions that may harm the Bank’s market standing.
2. Reputation risk resulting from internal decisions or practices that will eventually have an impact on the public’s trust.
3. Legal risks insofar as changes in the interpretation or provisions of the regulations will unswervingly affect the Bank’s business goals.
4. Compliance risks resulting from bank activities that:
  - contradict existing regulations and identified best practices
  - reveal weaknesses in the implementation of codes of conduct and standards of good practice

The categories of Compliance Risk are:

- Regulatory Compliance Risk

Imposition of the appropriate sanction shall be based on the assessment of the strength and responsiveness of the whole compliance system to address business risks. A compliance system which shall be found to be significantly insufficient shall be considered as unsafe and unsound banking practice.

- Anti-Money Laundering (AML) Compliance Risk

Enforcement of actions shall be imposed on the basis of the over-all assessment of the Bank’s AML risk management system. Whenever a Bank’s AML compliance system is found to be grossly inadequate, this may be considered as unsafe and unsound banking practice that may warrant initiation of prompt corrective action.

10. Reputation Risk ➤ Failure to establish and maintain an image of integrity and competence in doing business may result to loss of customers and even key employees.

In assessing the risk, the following factors were considered:

- level of inherent risk (high, moderate or low)
- adequacy of risk management (strong, acceptable or weak)
- trend or direction of risk (decreasing, stable or increasing)

The impact of scenarios in Reputation Risk occurs through various degrees of loss of business, particularly in the loss of clients (depositors and borrowers) as well as the ability to generate new business and to raise needed capital. The impact can also be in the cost of doing business.

11. Event Risk ➤ Loss resulting from damages due to natural calamities such as typhoon, earthquake, flood and other weather disturbances and manmade risk events such as fire, vandalism and tampering of Automated Teller Machine (ATM), terrorism and holdup or robbery.

12. Legal Risk ➤ Unenforceable contracts or defective contracts, lawsuits and adverse judgments that may lead to financial losses to the Bank. The three categories of Legal risk are:

1. Contract – an agreement between two or more persons which creates an obligation to do or not to do a particular thing.

A contract entered into by the Bank becomes a risk if it is contrary to law, if it has technical defects and/or if parties entering into the contract lack legal capacity to do so.

2. Lawsuit – a process in law instituted by one party to compel another to do him justice.

The following situations present in a lawsuit may eventually lead to an adverse judgment and could become a legal risk:

- varying interpretations
- loss of evidence
- delaying tactics of litigants
- late or non-submission of required pleadings
- failure to appear in proceedings
- unexpected adverse consequences from legal proceedings

3. Adverse Judgment - unfavourable judgments against the Bank. The term may also include judgments, though favourable to the Bank, cannot be enforced or executed due to the following reasons:
  - enforcement subject to potential difficulties
  - failure or refusal of judgment obligor to honour obligations
  - judgment award not capable of satisfaction or execution

13. Trust Operations Risk ➤ Covers a wide array of potential risks that may arise from a trustee's fiduciary duties predicated on the principle of exercising utmost care and prudence in handling the business affairs of other people (trustors). A trust entity does not own the assets which its clients assign for proper management. Contracts clearly state that trust arrangements are not covered by the Philippine Depository Insurance Corporation (PDIC) and except for wilful fraud, gross negligence and evident bad faith, all losses with regard to the trust entity's investments are for the account of its clients.

All arrangements in Trust are contractual in nature and therefore, LBP - Trust Banking Group's (LBP-TBG's) operation is exposed to legal risk per client. In addition, due to the trustee's fiduciary duties, numerous rules and regulations have been imposed by the BSP to improve controls and set basic standards in fiduciary practices. Further, the continuing additional and evolving rules, regulations and circulars from regulators such as, the BSP, the Securities Exchange Commission (SEC), the Insurance Commission (IC) and the Bureau of Internal Revenue (BIR), expose LBP-TBG operations to compliance and strategic risks.

Because a trust entity's operations are similar to a bank, all areas of risk associated with commercial banking operations in terms of operational and investment risks are also applicable to trust banking.

14. Subsidiaries Risk ➤ Risk on earnings and assets of LBP (direct impact) arising from reduced or decline in net income of LBP subsidiaries (sub-group basis).

## **CREDIT RISK MANAGEMENT**

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur financial losses. Overall credit risk management oversight is a function of the Board-level RiskCom.

### **Credit Risk Assessment**

Credit risk assessment is a function of the Bank's lending sector and is guided by established policies and procedures which are regularly reviewed and enhanced. In close coordination with the lending units, RMG issued twenty-five (25) credit policies, bulletins and executive orders in 2014, to complement update or enhance existing credit policies and guidelines.

Consistent with good corporate governance, LBP manages credit risk by setting limits for individual borrowers and group of borrowers and industry segments. The Bank also monitors credit exposures, and continually assesses the credit quality of counterparties. Assessment of credit quality considers credit ratings of counterparties given by external credit assessment institutions such as Moody's, Fitch, Standard & Poor's and PhilRatings. The use of external credit ratings adheres to the BSP guidelines on the Implementation of the Revised Risk-Based Capital Adequacy Framework." For foreign and financial institution accounts, the Bank downloads available extra credit ratings from Bloomberg.

For all client types, credit risk management is supplemented by credit rating systems which were developed for Corporations, Small & Medium Enterprises, (SME), Financial Institutions, Cooperatives and Local Government Units (LGU). The ratings of clients are being used, among others, as basis for determining the credit worthiness of loan clients, independent review of the ratings after approval is done by RMG to support the Internal Credit Risk Rating System (ICRRS) ratings as required by BSP. For 2014, RMG completed the post-validation of five hundred sixty-five (565) ICRRS ratings of corporate clients.

### **Implementation of the Credit Risk Engine System (CRES)**

The Credit Policy & Risk Management Department (CPRMD) was able to obtain approval for recalibration of the credit rating scorecard for corporate clients from the Credit Committee (CRECOM) and the Investment & Loan Committee (ILC). The credit rating scorecard will be deployed upon due approval of the proposed implementing guidelines currently under review by lending units. The CPRMD is also conducting recalibration of the LGU credit rating scorecard to ensure its predictive capability following some changes in set parameters.

Moreover, CPRMD continued the scoring of new livelihood accounts through the automated process from February 2014 onwards, albeit it likewise presented the recalibrated Livelihood Loans scorecard to the Branch Operations Committee (BOC) for its approval last 19 December 2014 to address parameter changes for Department of Education (DepEd) Livelihood Loan accounts.

## Credit Risk Exposure and Credit-related Commitments

Credit risk with respect to derivative financial instruments is limited to those instruments with positive fair values, which are included under "Other Assets". The Bank also makes available to its customers guarantees which may require LBP to make payments on behalf of these clients. Such payments are collected from customers based on the terms of the Letter of Credit. These guarantees expose the Bank to similar risks as loans and these are mitigated by the same control processes and policies. As a result, the maximum credit risk without taking into account the fair value of any collateral and netting arrangements is limited to the amounts on the balance sheet plus commitments to customers.

The table below shows the maximum exposure to credit risk for the components of the Balance Sheets, including derivatives. The maximum exposure is shown net, after the effect of mitigation through the use of master netting and collateral arrangements.

	Group		Parent	
	2014	2013	2014	2013
<b>On-Balance sheet financial assets</b>				
Cash and balances with BSP (excluding				
Cash on hand)	229,608,752	249,858,094	229,607,442	249,774,284
Due from banks	6,385,039	3,196,281	6,285,385	3,140,487
Interbank loans receivable	17,243,602	7,036,608	17,243,602	7,036,608
Securities purchased under agreements to resell	56,390,000	6,122,000	56,390,000	6,122,000
Financial assets at fair value through profit or loss-Held for trading	14,812,840	2,347,077	14,812,840	2,347,077
Available-for-Sale Investments	191,341,109	179,836,155	191,341,109	179,836,155
Held-to-maturity Investments	95,814,860	40,904,585	95,025,587	40,101,183
Loans and receivables	402,186,672	322,410,939	401,265,229	321,002,300
	<b>1,013,782,874</b>	<b>811,711,739</b>	<b>1,011,971,194</b>	<b>809,360,094</b>
<b>Off-Balance sheet items</b>				
Financial guarantees	3,243,426	3,161,981	3,243,426	3,161,981
Loan commitments and Contingent liabilities	76,351,393	63,002,492	76,351,393	63,002,492
	<b>79,594,819</b>	<b>66,164,473</b>	<b>79,594,819</b>	<b>66,164,473</b>
<b>Total Credit Risk Exposure</b>	<b>1,093,377,693</b>	<b>877,876,212</b>	<b>1,091,566,013</b>	<b>875,524,567</b>

Where the 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 change 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 2014, the Parent's qualifying capital covering credit risk is P67.616 billion. Based on the BSP definition, the Parent has set the benchmark for large exposures at P3.86 billion.

On the other hand, the Parent's Single Borrower's Limit (SBL) is pegged at P19.432 billion for direct lending and P27.386 billion for wholesale lending.

Overall credit risk management oversight 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.

The BSP considers that credit concentration exists when total loan exposure to a particular industry exceeds 30 per cent of total loan portfolio. As of 31 December 2014 and 2013, the Parent does not have credit concentration in any particular industry.

As of December 31, 2014 and 2013, information on the concentration of credit as to industry based on carrying amount is shown below:

	<b>Parent</b>			
	<b>2014</b>		<b>2013</b>	
	Amount	%	Amount	%
Financial intermediation	45,463,808	11.8	31,254,583	10.3
Agriculture, hunting and forestry	64,446,378	16.7	53,637,349	17.7
Real estate, renting and business activities	48,350,833	12.5	40,405,973	13.3
Public administration and defense	40,297,169	10.4	42,427,725	14.0
Manufacturing	28,367,821	7.3	23,191,570	7.6
Community, social and personal services	7,035,615	1.8	10,908,453	3.6
Electricity, gas and water	56,315,845	14.6	46,781,383	15.4
Wholesale & retail trade, repair of motor vehicles, motorcycles & personal and household goods	26,155,457	6.8	17,768,695	5.8
Transport, storage and communication	31,430,663	8.1	20,487,987	6.7



	Parent			
	2014		2013	
	Amount	%	Amount	%
Construction	16,268,608	4.2	9,492,208	3.1
Private households	14,553,282	3.8	1,136,886	0.4
Hotel and restaurant	2,656,522	0.7	2,052,275	0.7
Others	5,274,455	1.3	4,191,393	1.4
	<b>386,616,456</b>	<b>100.0</b>	<b>303,736,480</b>	<b>100.0</b>
<b>Allowance for losses</b>	<b>(3,340,369)</b>		<b>(3,248,889)</b>	
	<b>383,276,087</b>		<b>300,487,591</b>	

### 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 GS, real estate properties, inventory, chattel; and
- For retail lending – mortgage over residential properties.

The Bank also obtains guarantees from corporations which are counter-guaranteed by the Philippine National Government and other corporations accredited by LBP. In the case of agricultural and agri-related loans that are vulnerable to the effects of climate and weather disturbances, borrowers are encouraged to avail of guarantee and insurance mechanisms to shield them, as well as the Bank, from risk events.

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 the 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 arrangements with counterparties.

### Credit Stress Testing

The Bank regularly conducts stress testing on its loan portfolio covering various scenarios arising from risk events with high probability of occurrence. Utilizing such scenarios, tests were done to determine their impact on the Bank's loan portfolio quality, credit risk weighted assets, and ultimately on its Capital Adequacy Ratio (CAR). The stress tests enabled the Bank to adopt applicable courses of actions to mitigate the resulting risks as well as to comply with regulatory requirements.

## Credit Risk Weighted Assets (CRWA)

Gross CRWA as of 2014 aggregated to P418,189.230 million broken down as follows:

<b>Nature of Items</b>	<b>Amount</b> (In million pesos)
Total Risk Weighted Assets (RWA) On-Balance Sheet	380,778.932
Total RWA Off-Balance Sheet	37,223.884
Total Counterparty RWA in the Banking Book (Derivatives & Repo-style Transactions)	0.000
Total Counterparty RWA in the Trading Book	186.414
Total Risk-Weighted Amount of Credit Linked Notes in the Banking Book	0.000
Total Risk-Weighted Securitization Exposures	0.000
	<b>418,189.230</b>

LBP's Gross CRWA net of General Loan Loss Provision of P416,315.897 million. CRWA constituted 89.23 per cent of the aggregate RWA of P466,591.145 million Capital Adequacy Ratio (CAR). The stress tests enabled the Bank to adopt applicable courses of actions to mitigate the resulting risks as well as to comply with regulatory requirements.

## **MARKET RISK MANAGEMENT**

Market risk is the risk of financial loss arising from exposure to adverse changes in values of financial instruments caused by changes in market prices or rates, including interest rates, Foreign Exchange (Fx) rates, or stock prices that can change the value of financial products held by the Bank.

Risk exposures differ depending on whether the exposures are calculated for financial accounting or under International Financial Reporting Standards (IFRS). The standardized approach is used in the calculation of capital charge for all risk exposures. The Basel II Pillar 3 disclosures are generally based on the measures of risk exposure used to calculate the regulatory capital required.

The table below provides a breakdown of Market Risk Weighted Assets for market risk portfolio exposures calculated using the standardized approach.

## **Market Risk Weighted Assets (MRWA)**

As of 31 December 2014, the MRWA of the Bank stood at P6,043.368 million, broken down as follows:

<b>Nature of Items</b>	<b>Amount</b> (In million pesos)
Interest Rate Exposure	1,778.538
Equity Exposure	83.300
FX Exposure	647.167
Options	3,534.363
	<b>6,043.368</b>

The total MRWA represents 1.30 per cent of the aggregate RWA of P466,591.145 million.

### **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 GS and other debt instruments, equity, Fx 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, Fx or index). LBP exposure on derivatives is currently limited to currency swaps and currency forwards to manage Fx 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 BoD, RiskCom and the Asset & Liability Committee (ALCO), define and set the various market risk limits for each trading portfolio. The Treasury & Investment Banking Sector (TIBS) particularly the Financial Markets Group (FMG), which manages the Bank's trading units and the Asset & Liability Management Group (ALMG), which manages the Bank's liquidity and reserve positions, conduct risk-taking activities within limits at all times and ensures that breaches are escalated to senior management for appropriate action.

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. Macaulay and Modified Duration are used to identify the interest rate sensitivity of the Bond Portfolio of the Bank. Moreover, Re-pricing Gap, Earnings-at-Risk (EaR) and Economic Value of Equity-at-Risk (EVE) are used to measure interest rate risk in the banking book.

### **Managing Market Risk Components**

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

#### **1. Fx Risk Management**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in Fx 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:

	<b>Position Limit</b> (In millions)	<b>Management Loss Alert</b> Monthly	<b>Stop loss Limit</b> Monthly
Foreign Exchange Trading	\$50	\$320,000	\$430,000
Foreign Securities	\$20	\$298,000	\$398,000

LBP had the following significant exposures denominated in foreign currencies as of December 31, 2014:

	<b>US\$</b>	<b>Others</b> (In thousands pesos)	<b>Total</b>
<b>Assets</b>			
Foreign Currency & Coins on Hand /Cash & other cash items	623,096	32,424	655,520
Due from banks	5,742,371	492,911	6,235,282
Held for trading	483,309	0	483,309
Available for sale investments	24,791,688	554,242	25,345,930
Held to Maturity	22,646,176	0	22,646,176
Interbank loans receivable	16,367,520	526,083	16,893,603
Loans and receivables	10,663,049	3,468,074	14,131,123
Investment in subsidiaries	33,952	13,574	47,526
<b>Total Assets</b>	<b>81,351,161</b>	<b>5,087,308</b>	<b>86,438,469</b>
<b>Liabilities</b>			
Deposit liabilities	54,868,745	931,982	55,800,727
Bills payable	662,902	0	662,902
Others	11,410,503	16,309,787	27,720,290
<b>Total Liabilities</b>	<b>66,942,150</b>	<b>17,241,769</b>	<b>84,183,919</b>

## 2. 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 MTM and controlled through risk limits such as position, VaR, Management Alert and Stop Loss.

## 3. Interest Rate Risk in the Banking Book

The Bank continues to manage interest rate risk in trading activities through the use of an effective and independently validated VaR methodology. For interest rate risk in the banking book, a key component of the Bank's asset and liability policy is the management of interest rate sensitivity. Interest rate sensitivity is the relationship between market interest rates and net interest income due to the maturity or re-pricing characteristics of interest earning assets and interest bearing liabilities. For any given period, the pricing structure is matched when equal amounts of such assets or liabilities mature or re-price in that period. Any mismatch of interest earning assets and interest bearing liabilities is known as a gap position. A positive gap normally means that an increase in interest rates would have a positive effect on net interest income, while a

negative gap normally means that a decrease in interest rates would have a negative effect on net interest income.

The Bank establishes initial rates of interest for most of its loans based on a spread over its internal base rate, which reflects the Bank's average cost of funds which is generally reset at the beginning of every week. The spread charged for particular loans varies depending on a number of factors, such as the type of customer, the credit worthiness of the borrower, the type and maturity of the loan, the type of security offered, if any, the amount of the borrower's deposits with the Bank, potential fee-based business from the customer, competitive considerations and other factors. Interest rates on floating rate loans are typically reset every 30 to 90 days. For deposits, regular savings account rates are set by reference to prevailing market rates, while rates on time deposits are usually priced below rates applicable to Philippine Treasury Bills with similar maturities.

The Bank manages interest rate risk based on approved policies and guidelines, established limit setting procedures and interest rate risk limits, application of interest rate risk measurement models and reporting standards such as re-pricing gap, EaR, and EVE reports. The assumptions employed include deposit and loan pricing volatilities and reasonability of asset prepayment. It also include determining functional life of non-maturing deposit accounts which is necessary for comparing the accounts with alternative funding sources of the same duration to determine their relative value. Other assumption includes non-maturing deposits price sensitivity and decay rates and the key rate drivers for each interest rate shock scenario. Cash flows from floaters are bucketed according to their next re-pricing, if fixed rate, these shall be bucketed according to residual maturity. Non-maturing deposit accounts are classified in the '1 to 30 days' bin.

The two interest rate risk perspectives adopted by LBP in measuring Interest Rate Risk in the Banking Book are as follows:

**a. Earnings Perspective** - The Bank uses the EaR Model to estimate changes in net interest income (NII) under a variety of rate scenarios over a one year horizon. Interest related assets, liabilities and off-balance sheet items are classified by maturity bucket to determine re-pricing gaps that are essential indicator of the level of interest rate risk in the banking book. It is a simulation method that analyzes the interest rate risk in the banking book in terms of earnings (accrual basis). The re-pricing gap is multiplied by a change in interest rate or rate shocks to determine EaR or the potential increase or decrease in NII resulting from changes in interest rates. EaR measures the decline in NII resulting from upward or 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.

The following table sets the re-pricing gap position of the LBP as of 31 December 2014 and the increase (decline in earnings for upward and downward interest rate shocks in the banking book):

	2014 Change in Interest Rates							
(In Php Million)	-300/-15	-200/-10	-100/-5	-50/-2.5	+50/+2.5	+100/+5	+200/+10	+300/+15
Earnings-at-Risk	14,194.32	9,462.88	4,731.44	2,365.72	(2,365.72)	(4,731.44)	(9,462.88)	(14,194.32)

Financial Items	Due within 1 month	Due in more	Due in more	Due in more than 6 months
		than 1 month to 3 months	than 3 months to 6 months	
(in Php Millions)				
<b>Financial Assets</b>				
Due from BSP	0	0	0	0
Total Loans	135,868.19	114,076.59	40,402.46	18,003.84
Total Investments	1,035.96	1,142.19	7,467.27	936.59
Sales Contract Receivables	27.65	6.01	5.45	14.89
Total Financial Assets	<b>136,931.80</b>	<b>115,224.79</b>	<b>47,875.18</b>	<b>18,955.32</b>
<b>Financial Liabilities</b>				
Deposits	634,375.02	137,539.50	17,525.40	13,930.21
Bills Payable	0	1,162.80	5,719.78	662.90
Others	45.03	0	0	0
Total Financial Liability	<b>634,420.05</b>	<b>138,702.30</b>	<b>23,245.18</b>	<b>14,593.11</b>
<b>Off-Balance Sheet</b>				
Derivatives	(17,888.00)	(447.20)	0	0
Commitments	0	0	0	(46,467.05)
Total Off-Balance Sheet	<b>(17,888.00)</b>	<b>(447.20)</b>	<b>0</b>	<b>(46,467.05)</b>
<b>Repricing Gap</b>	<b>(515,376.25)</b>	<b>(23,924.71)</b>	<b>24,630.00</b>	<b>(42,104.84)</b>

**b. Economic Value Perspective** - The Bank uses the 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.

EVE is calculated by valuing all assets and liabilities, plus or minus off-balance sheet transactions in the theoretical base rate environment, then revaluing the balance sheet based on a forecasted change in interest rates, and calculating the change. The base case scenario is run using theoretical forecast. Alternate scenarios are run against the base case. The percentage changes between the base case and the alternate scenario measure the changes in the values of the balance sheet.

The next table shows the increase (decline) in economic value for upward and downward rate shocks using the EVE Model to measure interest rate risk in the banking book.

**2014 Change in Interest Rates  
(In million pesos)**

Basis Points	-300	-200	-100	-50	+50	+100	+200	+300
EVE	5,764	3,813	1,891	942	(935)	(1,862)	(3,696)	(5,502)

Both viewpoints are assessed to determine the full scope of the Bank's interest rate risk exposure. Moreover, interest risk in the Bank is not managed in isolation. Interest risk measurement systems are integrated into the Bank's general risk measurement system and the results from models used are interpreted in relation with other risk exposures.

The interest rate risk exposures of the LBP are measured and reported to the ALCO and RiskCom at least on a monthly basis under the earnings perspective through EaR Model and quarterly for the economic value perspective using EVE Model.

**Market Risk Measurement and Validation Models**

**1. VaR Analysis**

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 99.00 per cent confidence level, assuming a static portfolio. This level implies that on 99 trading days out of 100, the MTM 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 MTM of the portfolio will likely decrease in value by an amount that will exceed the VaR estimate.

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.

The VaR disclosure for the trading activities is based on Historical Simulation Model. Also for Equities, Fx and Foreign Securities trading portfolio, the internally developed Historical Simulation VaR Calculation Model is being used. The Bank however 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 VaR limit for the trading activities of LBP-FMG was set at P319 million (with a 99.00 per cent confidence level, and a one-day holding period) throughout 2014.

**2. 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 capability of the risk models. 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. If MTM and trading loss exceeds the result of the model-generated risk measure, it is considered as an exception. The number of exceptions is noted and the model is classified into one of the three zones as follows:

ZONE CLASSIFICATION	NUMBER OF EXCEPTIONS
safe/green zone	0-4 exceptions
non-conclusive/yellow zone	5-9 exceptions
problematic/red zone	10 or more exceptions

Back-testing results are presented to the ALCO which serves as the LBP senior management level and the RiskCom, a Board level RiskCom. The Committees analyze actual performance against VaR measures to assess model accuracy and to enhance the risk estimation process in general.

### 3. 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 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 that may influence the portfolio strongly and which market variables may trigger these scenarios to be able to come up with sound portfolio risk management strategies. PSA uses various approaches for scenario identification such as the use of data based on market sentiments, replication scenario based on historical events that occurred in the past or extreme value approach using hypothetical scenarios to take account of plausible changes or future developments that have no historical precedent. The Bank also conducts reverse stress testing to identify and simulate the events that can lead the Bank to a particular tail event.

Results of PSA are also simulated to CAR of the Bank to be able to assess its impact on the CAR compliance set at 10.00 per cent and the Common Equity Tier 1 (CET1) ratio of at least 6.00 per cent.



## **LIQUIDITY RISK MANAGEMENT**

### **Liquidity Risk Management Framework**

The LBP Board exercises oversight through RiskCom and delegated the responsibility of managing the overall liquidity of the Bank to the ALCO. This Committee meets twice a month or more frequently as required by prevailing situations. It 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 TIBS based on specific practices and limits established in governing treasury operations. The RMG through the Treasury Risk Management Department (TRMD) is responsible for the oversight of the Bank's liquidity risk positions and ensures that reports on the Bank's current risk are prepared and provided to ALCO and RiskCom in a timely manner.

LBP's liquidity risk management process is consistent with the general risk management framework of the Bank covering risk identification, measurement and analysis, monitoring and control. 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 fund availability 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 ALMG submits to the TIBS Head and the President various daily Treasury Reports (which include the Bank's cash or near cash investments and other data related to liquidity) to 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 crisis and models using hypothetical events.

### **Liquidity Risk Measurement Models**

The Bank considers liquidity risk based on Market and Funding Liquidity Risk perspective.

Trading or market liquidity risk refers to inability to unwind positions created from market, exchanges and counterparties due to temporary or permanent factors. The Bank cannot easily eliminate or offset a particular position because of inadequate liquidity in the market. This may be associated with the probability that large transactions may have a significant effect on market prices that lack sufficient depth, or associated with structured or complex investments as the market of potential buyers is typically small. It is also the risk of an unexpected and sudden erosion of market liquidity as a result of sharp price movement or jump in volatility, or internal to the Bank such as loss of market confidence. This scenario is captured through stress testing or scenario analysis.

Funding liquidity risk refers to current and prospective risk arising from the inability to meet investment and funding requirements arising from cash flow mismatches without

incurring unacceptable losses. It occurs from the mismatch of asset, liability, exchange contract and contingent commitment maturities. Funding liquidity risk is being monitored and controlled through the classification of maturities of assets and liabilities over time bands and across functional currencies as reflected in the LGR. This report is prepared to provide Senior Management and the Board timely appreciation of the Bank's liquidity position.

The ALCO and the TIBS are responsible for the daily implementation and monitoring of relevant variables affecting LBP's liquidity position. ALCO reviews the Bank's assets and liabilities position on a regular basis and, in coordination with the TIBS, recommends measures to promote diversification of its liabilities according to source, instrument and currency to minimize liquidity risks resulting from concentration in funding sources.

As of 31 December 2014, P205.79 billion or 19.35 per cent of LBP's Total Assets were represented by Net Loans with remaining maturities of less than one year and P36.23 billion or 3.43 per cent of LBP's Total Assets were invested in trading and investment securities with remaining maturities of one year or less. The Bank's trading and investment securities account includes securities issued by sovereign issuers, primarily government treasury bills, fixed rate treasury notes, floating rate treasury notes and foreign currency denominated bonds issued by the government. Due from BSP and Other Banks amounted to 22.30 per cent of LBP's Total Assets. Deposits with banks are made on a short-term basis with almost all being available on demand or within a month.

Although the Bank pursues what it believes to be a prudent policy in managing liquidity risk, a maturity gap does, from time to time, exist between the Bank's assets and liabilities. In part, this comes about as a result of the Bank's policy to seek higher yielding assets, a policy which will generally lead to the average maturity of its financial assets exceeding that of its liabilities.

### Liquidity Gap Report (LGR)

The table presents the assets and liabilities based on the contractual maturity, settlement and expected recovery dates:

	PARENT					
	2014			2013		
	Due Within One Year	Due Greater than One Year	Total	Due Within One Year	Due Greater than One Year	Total
<b>Assets</b>						
Cash and Other Cash Items	24,247,689	0	24,247,689	20,354,849	0	20,354,849
Due from BSP	229,351,507	0	229,351,507	249,497,118	0	249,497,118
Due from Other banks	6,284,410	975	6,285,385	3,138,986	1,501	3,140,487
Interbank loan receivable	17,243,602	0	17,243,602	7,036,608	0	7,036,608
Security Purchased Under agreement to resell	56,390,000	0	56,390,000	6,122,000	0	6,122,000
Loans and Receivables	132,153,291	269,111,938	401,265,229	95,697,641	225,304,659	321,002,300
Investments	36,225,870	265,439,491	301,665,361	19,287,347	203,482,894	222,770,241
Other Assets	2,770,327	17,387,787	20,158,114	1,457,647	15,701,861	17,159,508
<b>Total Assets</b>	<b>504,666,696</b>	<b>551,940,191</b>	<b>1,056,606,887</b>	<b>402,592,196</b>	<b>444,490,915</b>	<b>847,083,111</b>

PARENT						
	2014			2013		
	Due Within One Year	Due Greater than One Year	Total	Due Within One Year	Due Greater than One Year	Total
<b>Liabilities</b>						
Deposits						
Demand	392,226,721	0	392,226,721	348,297,024	0	348,297,024
Savings	469,423,769	40	469,423,809	324,134,174	0	324,134,174
Time	46,276,487	24,619	46,301,106	26,183,654	443,107	26,626,761
LTNCD	0	5,000,000	5,000,000	0	5,000,180	5,000,180
Bills Payable	2,182,814	18,058,314	20,241,128	2,275,469	21,294,894	23,570,363
Unsecured Subordinated Debt	0	10,500,000	10,500,000	0	17,434,000	17,434,000
Due to BTr, BSP, & MCs/PCIC	1,755,387	117,078	1,872,465	1,373,523	115,561	1,489,084
Due to Local Banks & Others	8,621	0	8,621	5,101	0	5,101
Other Liabilities & Payables	8,329,210	20,022,669	28,351,879	1,175,956	19,394,318	20,570,274
<b>Total Liabilities</b>	<b>920,203,009</b>	<b>53,722,720</b>	<b>973,925,729</b>	<b>703,444,901</b>	<b>63,682,060</b>	<b>767,126,961</b>

The Bank performs liquidity gap analysis using the 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 RMG through TRMD assists ALCO in its function by preparing PESO, Fx Regular, Foreign Currency Deposit Unit (FCDU) and Consolidated LGR on a monthly basis.

### Core Deposit

The Bank also determines Core Deposit which is calculated based on Net Withdrawal Pattern. Core Deposit looks at deposit levels which incorporates the offsetting effect of withdrawal patterns on deposits. It serves as a buffer that protects the Bank's assets, which are subject to interest rate risks. Core Deposit level is computed to determine the lowest deposit level that is expected to be retained under normal operating conditions. The computation involves determining the Deposit Mix comprising of Volatile and non-Volatile or Core Deposits.

### Non-maturity deposits

Regular Savings (Total Savings less High Yield Savings Accounts) and demand deposits are non-maturity deposits. An analysis made to proximate scenario is to simulate behavioral withdrawal pattern. This is done by observing pattern of deposit decays of the total end of-day data for demand deposit account based on a five-year historical demand deposit data. The highest withdrawal percentage change is determined for each tenor bucket. The percentages are used as basis for slotting the non-maturity deposit amount under the different tenors.

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 2014 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
(In million pesos)						
<b>Financial Assets</b>						
Cash and Due from Banks	202,560	0	57,324	0	1	259,885
Total Loans	130,400	51,508	23,879	81,026	188,086	474,899
Total Investments	15,753	6,874	13,598	89,157	176,283	301,665
Other Assets	2,188	0	582	0	17,388	20,158
<b>Total Assets</b>	<b>350,901</b>	<b>58,382</b>	<b>95,383</b>	<b>170,183</b>	<b>381,758</b>	<b>1,056,607</b>
<b>Financial Liabilities</b>						
Deposits	384,711	18,717	15,993	652	492,879	912,952
Borrowings	2,373	474	1,100	6,764	11,411	22,122
Other Liabilities and Unsecured Subordinated Debt	249	0	8,080	0	30,523	38,852
<b>Total Capital</b>					<b>82,681</b>	<b>82,681</b>
<b>Total Liabilities &amp; Capital</b>	<b>387,333</b>	<b>19,191</b>	<b>25,173</b>	<b>7,416</b>	<b>617,494</b>	<b>1,056,607</b>
<b>Asset &amp; Liabilities Gap Position</b>	<b>(36,432)</b>	<b>39,191</b>	<b>70,210</b>	<b>162,767</b>	<b>(235,736)</b>	

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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 Maximum Cumulative Outflow (MCO) limit set by the BoD is one of the tools 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.

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 or leverage limits. The following table sets out the Bank's liquidity ratios as of the dates indicated:

	31 December	
	2014 (Prudential)	2013 (Audited)
	<i>(In million pesos, except percentages)</i>	
Liquid Assets <sup>(1)</sup>	625,897.34	502,534.78
Financial Ratios:		
Liquid Assets to Total Assets	59.55%	59.33%
Liquid Assets to Total Deposit	68.46%	71.38%

1. Note: Liquid Assets include Cash and other Cash Items, Interbank Loans, Government Securities and Tradable non-Government securities and commercial paper

### Liquidity Stress Test

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 Model. 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 TIBS through the ALMG and overseen by the RMG through TRMD.

LBP performs a comprehensive liquidity risk measurement and control using as tool the Consolidated LGR covering the entire LBP Group. Risk models used in liquidity risk management are subjected to independent model validation. The Internal Audit Group (IAG) is tasked to do model validation. An independent validation is also being done by the Basel Officer for Market who reports directly to the Head of the RMG. For this year, incorporated were latest enhancements made on the model as a result of independent model validation by a third party auditor.

#### **Liquidity Coverage Ratio (LCR)**

LCR is designed to ensure banks maintain an adequate level of unencumbered high quality liquid assets to meet liquidity needs under an acute 30-day stress scenario. Under the Basel Committee's Basel III LCR rules, the LCR is to be calculated by dividing the amount of unencumbered cash and highly liquid, unencumbered government, government-backed and corporate securities by estimated net outflows over a stressed 30-day period. The net outflows are calculated by applying assumed outflow factors, prescribed in the rules, to various categories of liabilities, such as deposits, unsecured and secured wholesale borrowings, unused commitments and derivatives-related exposures, partially offset by inflows from assets maturing within 30- days.

Pending issuance of BSP Circular and Guidelines for LCR, the Bank used an internally developed LCR model. In the meantime, the Bank has started mapping accounts that may be classified as "High Quality Liquid Assets" based on Basel III Requirements. The Bank has institutionalized other measures to properly manage liquidity risk as follows:

1. *Active 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 or funding policy (targets), risk limits.
2. *Liquidity Risk Management Governance* - The Board defines LBP's risk appetite and other key metrics that set the levels of acceptable liquidity risk that can be taken by the Bank. The Board also provides the final validation of proposed organizational and reporting structures for the management of liquidity risk. It is also responsible for ensuring that liquidity risk management strategies are implemented and followed. It

ensures that risk appetite is respected and delegates to ALCO the management and optimization of the bank's liquidity risk position.

The ALCO optimizes results within the risk appetite limit set by the Bank and takes decisions to manage liquidity risk and allocate resources to manage this risk. ALCO is responsible for ensuring that liquidity risk management strategies are applied. It reviews liquidity risk reports and monitors compliance with agreed risk appetite limits. It monitors the adequacy of the risk infrastructure, pre-validates (as well as maintains) risk indicators and models. The TIBS is responsible for managing the liquidity risk exposure that the bank generates.

The TIBS ensures that ALCO decisions pertaining to the management of liquidity risk are implemented. The FMG and the ALMG take assets and liabilities positions by executing ALCO's decision. They also develop, calibrate and maintain LBP's liquidity risk indicators. The RMG through TRMD independently performs oversight function related to liquidity risk identification, measurement and analysis, monitoring and control. TRMD reports on the Bank's market risk exposure to ALCO and the RiskCom.

The Financial Accounting Department (FAD) and Treasury Operations Department (TOD) provide the backroom support and are responsible in generating and reconciling LBP balance sheet. As such, FAD and TOD provide figures and various relevant reports to FMG, ALMG, and TRMD.

3. *Liquidity Risk Approving Authorities* – The Bank has identified approving levels and authorities in the formulation of risk management policies and procedures, risk measurement methodologies, limit setting and ratification of limit allocation, monitoring and control procedures.

4. *Organized liquidity management methods* – The Bank has established adequate internal guidelines as well as administrative, accounting and review procedures. Each operating unit of the Bank is mandated to come up and regularly review and update its Operations Manual.

5. *Documented Liquidity Risk Management Policies and Procedures* – The Bank has established and documented all risk management policies and procedures which are subject to regular review and revised as needed.

6. *Diversified funding sources* – The Bank utilizes diversified funding sources that includes Government and Private deposits, Loans from multilateral and bilateral institutions (World Bank<sup>[WBI]</sup>, Asian Development Bank<sup>[ADB]</sup>, Japan Bank for International Cooperation<sup>[JBIC]</sup> etc.), inventory of GS under AFS, credit lines with other banks, among others.

7. *Statutory deposit with BSP* – Under existing BSP regulations, non-FCDU deposit liabilities of the Bank are subject to unified reserve equivalent to 20.00% effective 30 May 2014 (Under BSP Circular #832). Government deposits are subject to an additional 30.00 per cent liquidity floor requirement for total reserves of 50.00 per cent.

8. *Acquisition of an Asset and Liability Risk Management System (ALRMS) for full automation of ALRMS processes* – The Bank has approved the acquisition of the ALRMS which would be facilitated with the hiring of an external consultant to assist the

Bank in the system development and production. The system when implemented shall allow the Bank to optimize the use of a dynamic system to manage not only liquidity risks but also other risks associated with the investment functions of the Bank.

9. *Liquidity Contingency Plan (LCP)* - To ensure that the Bank has sufficient liquidity at all times, the Bank formulated a liquidity contingency plan using extreme scenarios of adverse conditions and evaluates the Bank's ability to withstand these prolonged scenarios. The contingency plan focuses on the Bank's strategy for coordinating managerial action during a crisis and includes procedures for making up cash flow shortfalls in adverse situations.

The plan details the amount of funds (such as unused credit facilities) the Bank can access and the scenarios under which it could use them. This provides guidance for managing liquidity risks in the following market scenarios:

- a. *Ordinary course of business* - In the ordinary course of its business activities, the Bank typically manages its liquidity risk by seeking to roll-over its deposited funds through the offering of competitive rates of interest, drawing upon its interbank credit lines or the early termination of Government Securities Purchased Under Reverse Repurchase Agreements (GSPURRA).
- b. *Seasonal or Intermediation duration* - The Bank manages its liquidity risk in the longer-term via the liquidation of marketable AFS category securities, the solicitation of government deposits and the use of derivative instruments in the swap market.
- c. *Acute or institution specific* – In acute or institution specific circumstances, the Bank will seek to manage its liquidity risk by the proportional liquidation of AFS and HTM-GS, the non-renewal of maturing short-term loans, borrowings from the BSP and the PDIC using eligible securities as collateral and generating cash infusions through large deposits and the Government.

The LCP likewise contains guidelines on Business Resumption Plan towards a transition to normal liquidity condition. This plan defines expectations from various sectors during the transition period from crisis to normal condition.