1st Valley Bank
A Development Bank

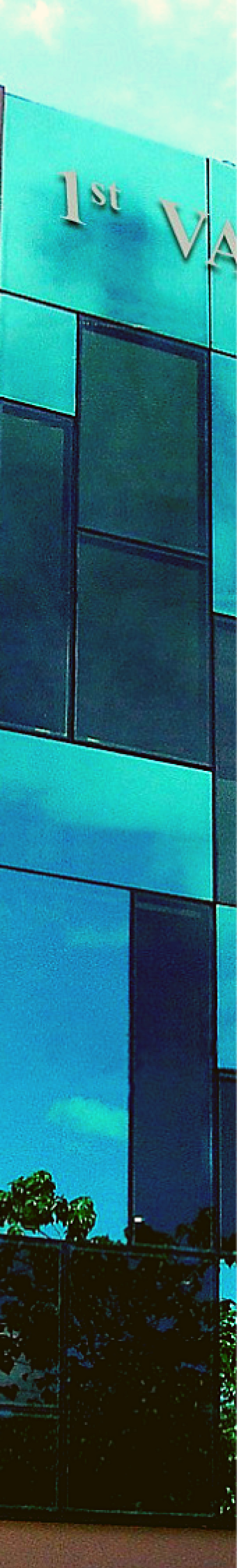
ANNUAL REPORT 2018

EMPOWERING YOUR SUCCESS

ONE DREAM • ONE TEAM • ONE 1VB!

Experience Banking

EXCELLENCE



OUR VISION

To be the preferred banking institution in providing innovative and customer-centered services.

OUR MISSION

- To be one 1st Valley Bank
- To be the go bank for our customers
- To be the top employer for our staff
- To ensure delivery of high returns for our stakeholders
- To promote development in the areas where we operate

OUR CORE VALUES

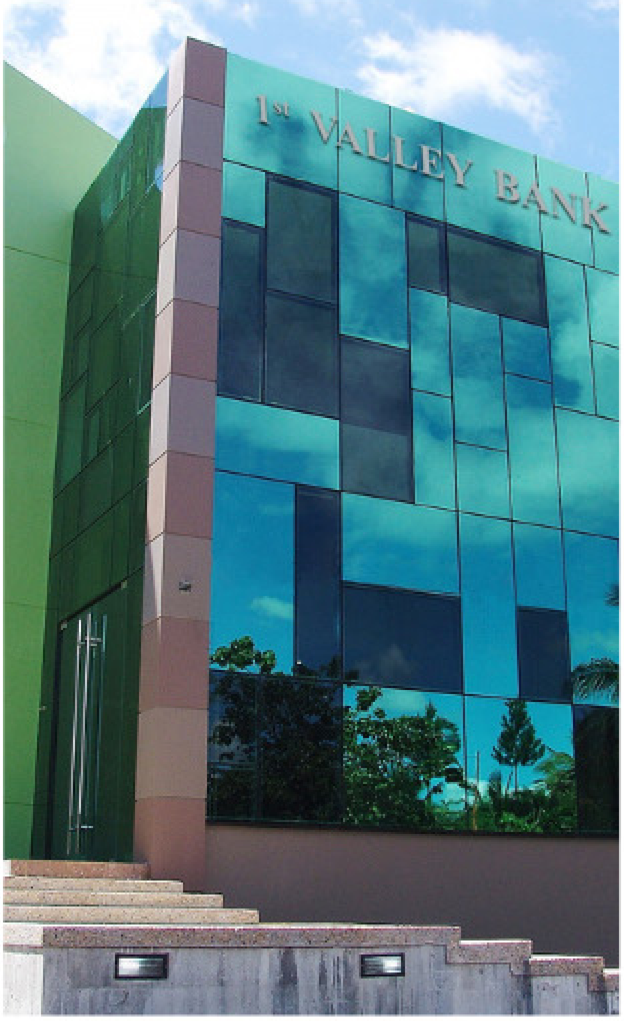
- We conduct our business with integrity, transparency, honesty and the highest ethical standards
- Treating our customers with equality, fairness, and respect is foremost in our delivery of excellent banking services
- We develop our business through innovation, enthusiasm, creativity, and our constant quest for excellence

1ST VALLEY BANK PROFILE

1st Valley Bank, Inc., A Development Bank (1VBDB) is a multi-awarded development bank operating in Mindanao and some areas in the Visayan region.

Its primary clients are farmers, micro-entrepreneurs, and small and medium enterprises. 1VB provides its clients the funds they need to finance their businesses such as the production of coconut, corn, rice and fish, as well as grocery stores, trading, rice business, motor shops among others.

1VBDB also serves the financial needs of public school teachers, LGU and barangay officials.



2018 THE MERGER

2018 was a crucial year for 1st Valley Bank, as it was during this period that it began its merger journey. In the last quarter of 2017, 1VB was able to acquire D' Asian Hills Bank, Inc, (DAHBI). Earlier in 2014, it has acquired Sugbuanon Rural Bank, Inc. (SRBI).

The merger is seen as a strategic move by 1st Valley Bank that will benefit its consumers. With wider network, more consumers will be able to enjoy the following: (a) easy access of the bank's products and services, (b) better interest rates, (c) expanded services that can lead to empowered product decision for consumers.

Our Consumers Come 1st!

How 1st Valley Bank Conducts Its Business

Our Business Model

Key Partners

- BSP, PDIC, & Other Regulatory Agencies
- Nucleus, PLDT, & Globe, Hardware Suppliers
- Bridge

Key Activities

- Branch & Branch Lite Unit Operations
- IT Operations
- Business Development
- Consumer Assistance

Value Proposition

- Personalized Services & Stability: Your Lifetime Friend
- Culture of Excellence: Be 1st!
- Our consumers come 1st!

In developing its business, 1st Valley Bank, Inc., A Development Bank (1VBDB) prioritizes the needs and interests of its consumers. Thus, consumers can be sure that what they get from 1VBDB is what they really need.

1VBDB understands that the needs of its consumers are constantly changing; thus, the bank invests in product innovations to ensure the satisfaction of their consumers.

As the bank strives to give its consumers the best customer journey possible, it therefore designs its products and services circling the intent and needs of its consumers.

THE PRESIDENT SPEAKS

2018 was an auspicious year for us. We were on the verge of experiencing a new phase of our existence.

As you may have already known, we have started the early stages of our merger with the rural banks we have acquired- Sugbuanon Rural Bank, Inc. (SRBI), and D'Asian Hills Bank, Inc. (DAHBI). We expect this process to be completed soon.

Meanwhile, all our three banks continue to grow progressively registering positive figures in both loan and deposit portfolios.

Our growth in 2018 did not come without challenges: growing competition, regulatory compliance, keeping up with consumer demands, ever-changing market dynamics, problems inherent to mergers, and more. Somehow with one team working towards one goal of becoming one 1VB, we are able to overcome these challenges.

As we work towards the completion of our merger, know that each one of us has the power and the ability to contribute immensely to the success of our integration.

In 2018, we have began our journey towards our one dream of becoming a bigger merged bank. We have been expanding and bridging our physical divide working as one team. I'll say this repeatedly: let us not rest on our laurels.

By strengthening our commitment further and working passionately towards our dream, soon we will arrive at our destination as one 1VBDB!

ATTY. NICOLAS J. LIM

1st Valley Bank President

THE FIGURES

9.14 BILLION

TOTAL RESOURCES

7.13 BILLION

TOTAL LIABILITIES

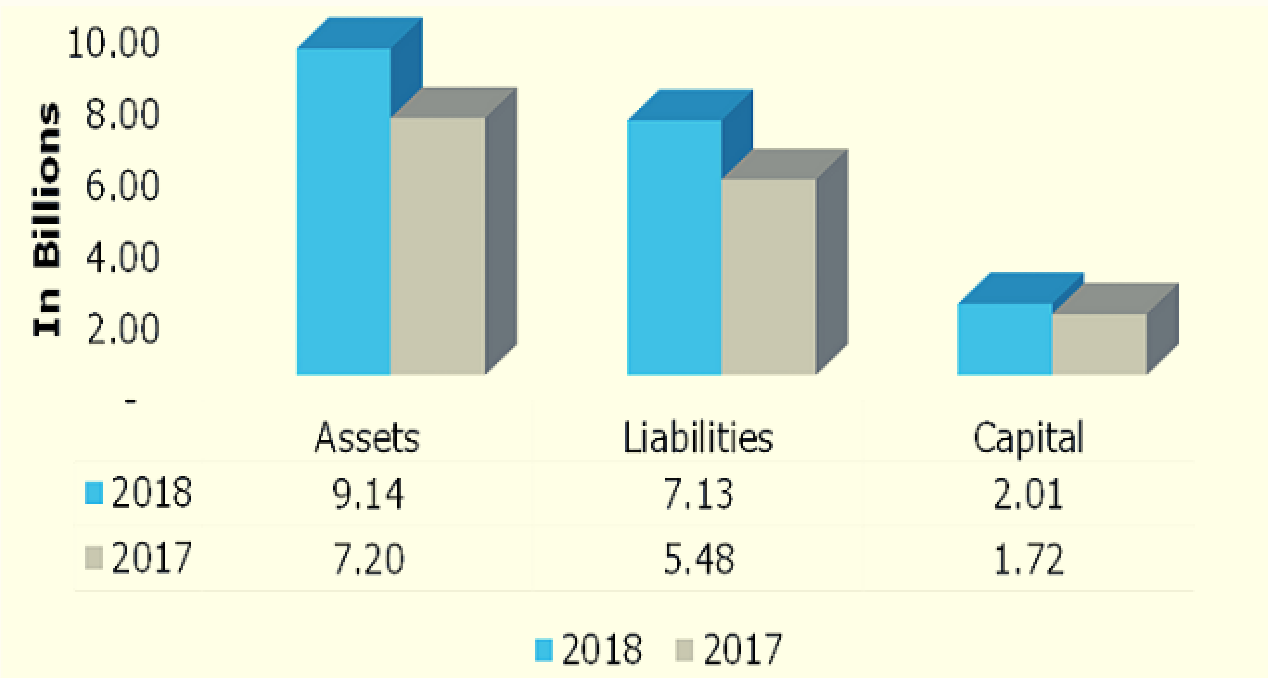
2.01 BILLION

CAPITAL FUNDS

FINANCIAL CONDITION

As of 31 December 2018, 1st Valley Bank has a total resources of Php9,138,465,708, total liabilities of Php7,128,021,264, and capital funds of Php2,010,444,444.

Total Comprehensive Income is at Php263,377,578 while cash and cash equivalents is at Php1,563,165,189.



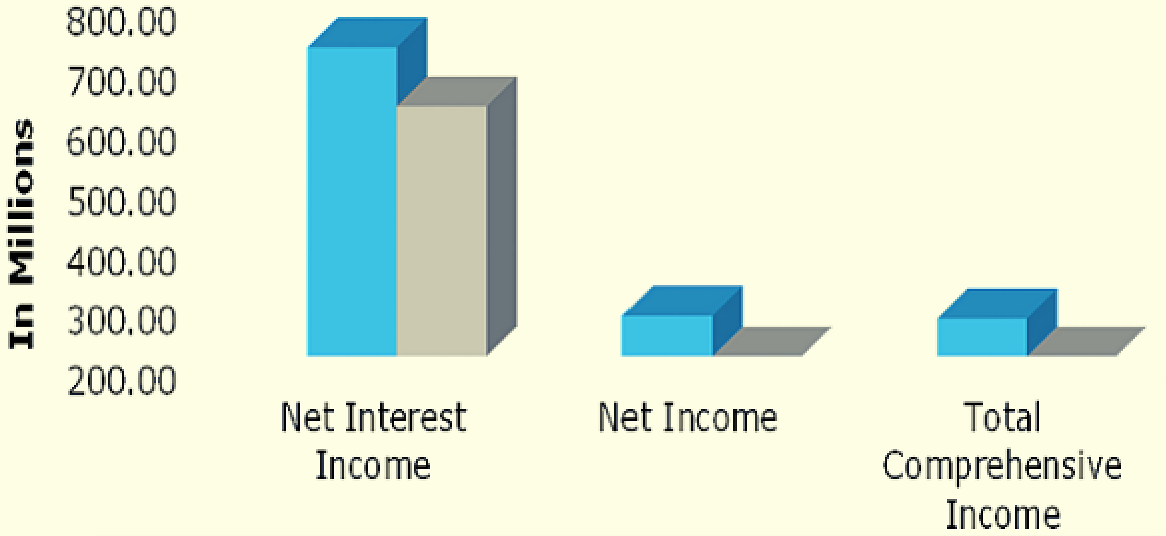
1VB's total assets increased in 2018 due to the increase in loans, mostly from releases to barangay officials, ATM loans for public school teachers, and secured loans (Agri and SME).

Total liabilities increased due to the increase in bills payable as 1VB relied on borrowings to finance these added loans.

Capital accounts, meanwhile, increased due to the increase in the Bank's total comprehensive income.

COMPREHENSIVE INCOME

In 2018, total comprehensive income increased by 54.98% due to: (a) increase in interest income on loans and receivables and (b) interest income on investments securities at amortized cost.



	Net Interest Income	Net Income	Total Comprehensive Income
2018	715.71	267.99	263.38
2017	617.53	173.20	169.94

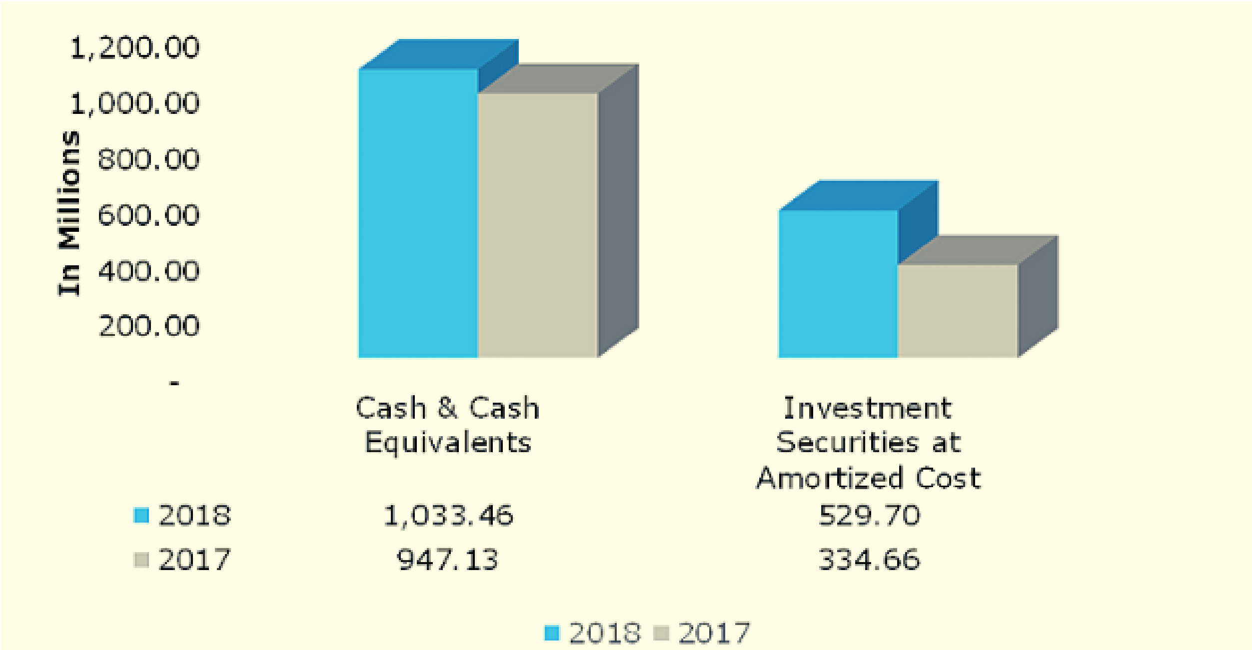
2018 2017

Net interest income would have been higher if the Bank is doing well in its deposit generation activities. Also, the significant increase in the volume of bills payable coupled with an increase in interest rates has led to an increase in the bank's interest expenses.

In spite of the above, 1st Valley Bank still managed to post a 15.9% increase in net interest income from Php617.53 million in December 2017 to Php715.71 million in December 2018.

CASH

The Cash and Cash Equivalents of 1VB is composed of cash and and other cash items, due from Bangko Sentral ng Pilipinas and due from other banks.



Investment Securities at Amortized Cost includes investments in government securities such as treasury bills and retail treasury bonds.

It is a requirement of the Bank's Executive Committee to have the Bank's liquid assets in the form of government securities as these are more profitable compared to Cash and Due from Banks. This strategy enables the Bank to maximize profits of its liquid assets.

AVERAGE EQUITY, AVERAGE RESOURCES & CAPITAL ADEQUACY RATIO

Return on Average Equity is at 11.95%, which is higher compared to 2017's ratio of 10.14%. Return on Average Resources also increased to 2.61% from 2.31% in 2017. Capital Adequacy Ratio decreased from 27.08% in 2017 to 19.34% in 2018 due to the increase in the Bank's risk assets.

LOANS TO DEPOSIT RATIO

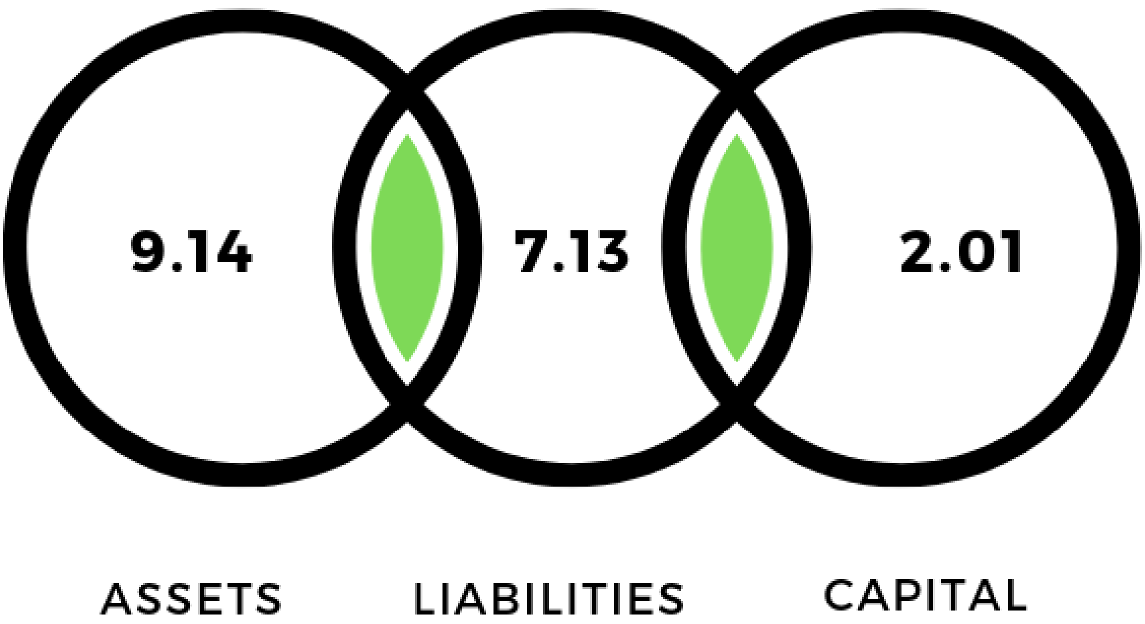
The Loans to Deposit Ratio measures the relationship between the total amount of loans and the total deposit liabilities of the Bank. It determines whether the Bank can depend on its deposits to service the loan requirements of clients or if the Bank needs to borrow money from outside sources. The loans to deposit ratio of the Bank is 167.51%, which when compared to the ratio of 130.76% in 2017 indicates that 1VB should intensify its deposit generation to match loans.

PROFITABILITY

1st Valley Bank's net income grew by as much as 54.72%, from Php173,204,410.00 in 2017 to Php267,986,689.00 in 2018.

	CURRENT YEAR	PREVIOUS YEAR
PROFITABILITY		
Total Net Interest Income	715,712,899.00	617,526,591.00
Total Non-Interest Income	432,672,048.00	330,163,690.00
Total Non-Interest Expenses	643,374,244.00	552,852,719.00
Pre-Provision Profit	**505,010,703.00**	**394,837,562.00**
Allowance for Credit Losses	137,830,191.00	150,479,428.00
Tax Expense	99,193,823.00	71,153,724.00
Net Income	**267,986,689.00**	**173,204,410.00**
SELECTED BALANCE SHEET DATA		
Liquid Assets	1,563,165,189.00	1,281,788,389.00
Gross Loans	6,964,519,184.00	5,583,276,991.00
Total Assets	9,138,465,708.00	7,200,356,903.00
Deposits	4,158,344,512.00	4,269,860,953.00
Total Equity	2,010,444,444.00	1,724,234,019.00
SELECTED RATIOS		
Return on Equity	11.95%	10.14%
Return on Assets	2.62%	2.31%
Capital Adequacy Ratio	19.34%	27.08%

BALANCE SHEET



PERFORMANCE BY THE NUMBERS

6.96B

LOAN PORTFOLIO

63,608

LOAN ACCOUNTS

4.15B

DEPOSIT PORTFOLIO

115,885

DEPOSIT ACCOUNTS

LOAN STATISTICS

Business loans consisting of SME, Microfinance, and Small Business Loans, come second at Php1.63B, Php1.36B of which belongs to SME.

The total loan portfolio of 1st Valley Bank, Inc., A Development Bank in 2018 is at Php6.96B or a 24% increase from the Php5.6B total loan portfolio in 2017.

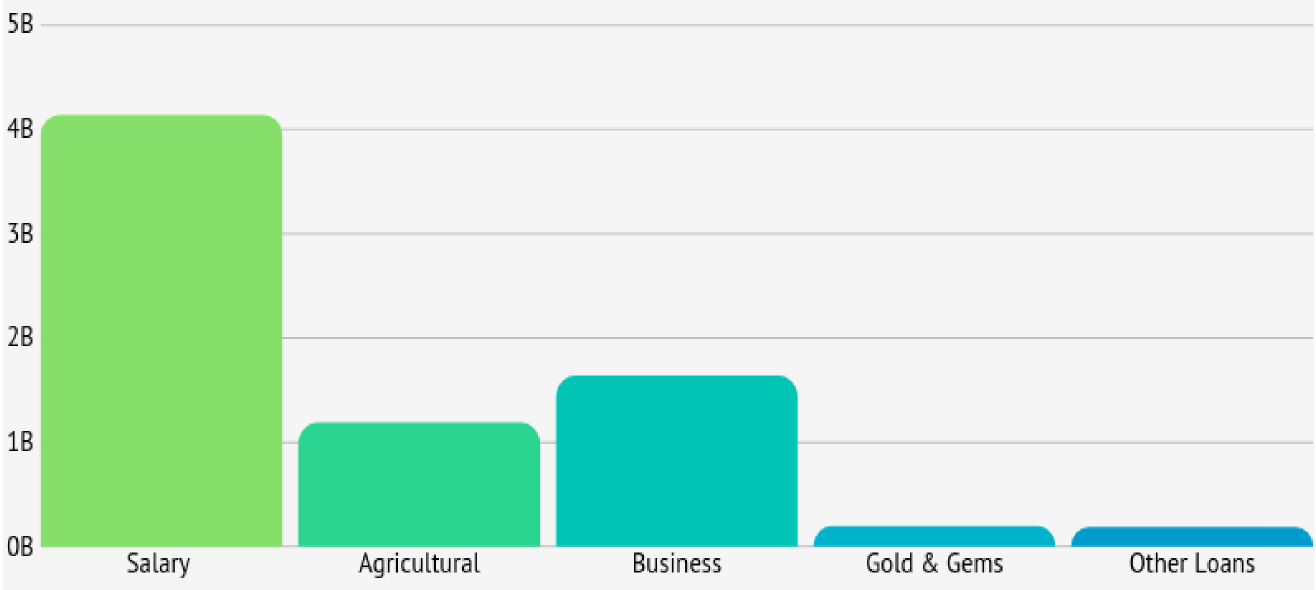
Results from comparative analysis show that the biggest percentage of the loan portfolio belongs to salary loans, and the largest percentage share of these salary loans goes to public school teachers.

6.96B

TOTAL LOAN PORTFOLIO

LOAN PRODUCTS

For five (5) consecutive years, salary loans remain to be on top with business loans, particularly SME, coming in at second.



SAVINGS DEPOSIT PERCENTAGE

48%

low-cost deposit

Regular Savings, Micro Savings, and 1st Checking Account

52%

high-cost deposit

FIXED DEPOSIT PERCENTAGE

Savings Deposit Plus (SD Plus)

HIGHLIGHTS FOR THE YEAR 2018

Free Checkbooks

Kiddie & Teen Savings

ACQUISITION OF DAHBI

THE STRATEGIC ACQUISITION OF DAHBI BY 1ST VALLEY BANK INC., A DEVELOPMENT BANK IN 2018 OPENS MULTIPLE OPPORTUNITIES FOR GROWTH THAT WILL BENEFIT THE CONSUMERS

D'Asian Hills Bank, Inc. (DAHBI) has 16 branches and 4 micro banking offices when 1st Valley Bank, Inc., A Development Bank (1VBDB) took over its management in January 30, 2018. 1VBDB completed its application for acquisition of DAHBI in December 2018.

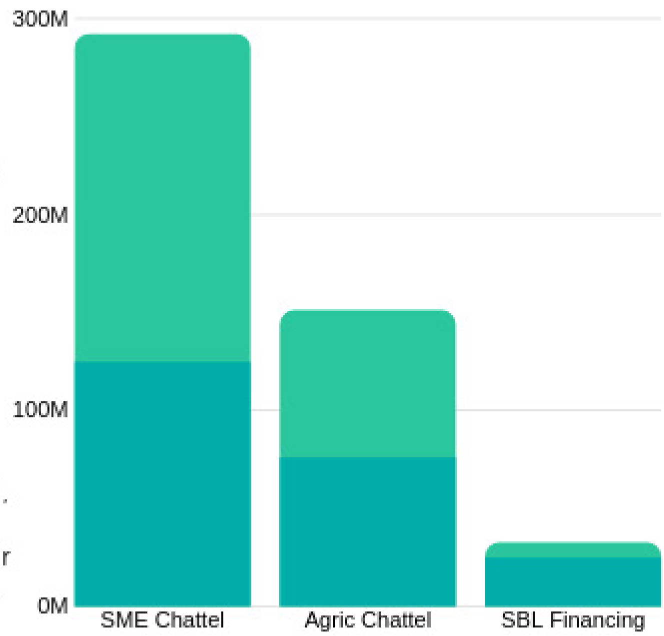
The acquisition paves the way for 1VBDB's ensuring its market stronghold and delivering unparalleled banking services to its consumers.

ACQUIRING DAHBI IS ONE OF THE BIGGEST DECISIONS, BUT 1VBDB KNOWS THAT THIS DECISION WILL IMPACT SIGNIFICANTLY IN DEFINING THE FUTURE OF THE BANK.

VEHICLE FINANCING

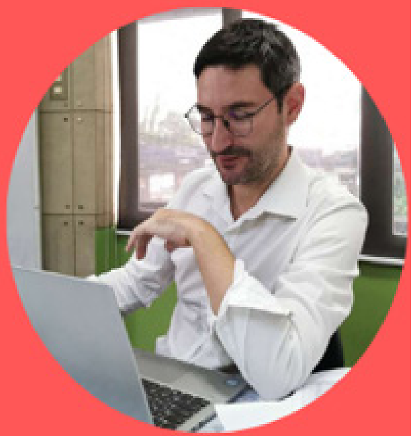
It was in 2018 when the vehicle financing of 1st Valley Bank, Inc., A Development Bank boomed.This can be attributed to the strategic activities initiated by the Business Development Department of 1VBDB.

Clients avail funds from 1VBDB to purchase heavy equipment like trucks or other vehicles they need to grow their business. Depending on their purposes, they can choose to avail any of the following: SME Chattel Financing, Agri Secured Chattel Financing, Individual Secured Chattel Financing, or Small Business Loan Vehicle Financing.



AUTOMATING LOAN DECISIONS

USING TECHNOLOGY TO ARRIVE AT QUICK BUT RELIABLE CREDIT DECISIONS



1VBDB has developed and started to use the automated scorecards in 2018 to determine the credit worthiness of its borrowers. The results are encoded in the database that will allow the Bank to determine and assess its clients' risk profile that in turn will guide decision makers in approving or disapproving loan applications, or refining the terms and conditions of the loan.

This automation also empowers the Bank to customize or personalize the rates, e.g. clients with good repayment behaviors may enjoy lower rates and other privileges. On the part of the Bank, an automated credit decision allows the Bank to grant quality loans within its risk appetite.

The Business Development Team works in close coordination with the IT Team to ensure that the Bank and its consumers benefit from this automated scorecards. These teams strictly monitor the functionality and effectiveness of the technology so that consumers get to benefit from: (a) faster turnaround of loans, (b) consistency in loan underwriting and credit decisions, (c) streamlined loan decision process, and (d) compliance to laws, policies, and regulations.

Refinement of the scorecard is a continuing process based on credit assessment results. Data are also used to determine repricing most suitable for clients.

LANAO

Glenn G. Bagaloyos, Area Manager

Nurturing Relationships with Clients and Government Partners

Baroy-Kapatagan-Maranding-Iligan-Bacolod

DECREASE IN PAR

Making the Most of GFAL

STRENGTHENING PARTNERSHIPS

Marketing Campaigns for Supervised Credit Targeted Audience

PARTICIPATION IN GOVERNMENT ACTIVITIES

Actively Participating in DepEd Activities such as Brigada Eskwela and LGU Activities

In 2018, the Lanao team conducted several unconventional activities that have resulted in the lowering of their portfolio-at-risk (PAR) accounts. Account officers have convinced past-due account holders to avail GFAL at the same time educating them on how to use their loans wisely as well as how to benefit from 1VBDB's products and services. The area's strengthened partnership with PCIC enabled them to a certain extent, resolve SUCRE challenges and market the product to highly targeted audience. Further, Lanao branches continued to deliver personalized services to their clients, and to pay forward through the area's visible and active participation in government-initiated activities such as the Brigada Eskwela.

SIBUGAY 1

Peter M. Alfon, Area Manager

Finding the Best Solutions That Match Client Needs and Wants

Margos-Dumalinao-Pagadian-Buug-Imelda-Aurora-San Miguel

STRATEGIC PARTNERSHIPS

Leveraging on Partnership with Government Agencies and KVI

FOCUS GROUPS

Conduct of Discussions, Fora, Orientations, and Meetings

SOCIAL RESPONSIBILITY

Sharing of Blessings and Sponsorships

Branches under this area channeled much of their efforts in developing and delivering solutions that best match their client needs and wants. They have partnered with LGUs and Kapatagan Ventures, Inc., conducted focus group discussions, fora, seminars, orientations, and meetings meant to educate their consumers as well as to gather relevant data on how to be able to meet their needs and wants. This area believes that by thorough evaluation of their market, they will be able to identify solutions on how to help their clients improve their practices, increase their productivity and income, and improve their lives. To give back to the community, Zamboanga Sibugay 1 branches sponsored several livelihood programs, business and agricultural seminars as well as gift-giving activities.

SIBUGAY 2

Samson Cababan Jr., Area Manager

Promoting the Corporate Culture of Excellence

Ipil-Canelar-Liloy-Guiwan

FINANCIAL LITERACY CAMPAIGNS

Equipping Customers with the Knowledge & Skills to Manage their FInances

OPERATIONALIZING EMPATHY

Understanding Customer Needs and Responding to It with the Right Solutions

DIRECT INTERACTION WITH CUSTOMERS

Identifying Customer Concerns and Challenges Through Face-to-Face Interaction

To provide customer-centered services, the area knows that it must practice customer empathy. Thus, branches in this area have conducted activities meant to understand not just the financial needs but also the emotional needs of their customers. They have facilitated focus group discussions among farmers engaged in the ecosystem of rice production. They have partnered with government agencies such as PCIC, DepEd, DOLE to conduct training courses, seminars, orientations, fun and leisure to targeted audience. These branches have also started the conduct of their intensified financial literacy campaigns to empower their customers to manage effectively their finances. Branch staff are encouraged to always live by the 1VBDB's culture of excellence.

MIS OR-CDO

Jamael M. Dangnan, Area Manager

Daring to Do More For 1VBDB Consumers

CDO-Gingoog-Butuan-Balingasag-Initao-Camiguin-Cabadbaran

FEEDBACK MECHANISM

Identifying Service Issues and Doing Something About It

FOCUS ON QUALITY

Tightening the Client Selection Process to Improve Loan Portfolio Quality and Decrease Past Due

UPSKILLING STAFF

Investing in the Training of Employees to Retain High Performers

Treating their clients as the most important partners for success, branches in Misamis Oriental-Agusan encouraged their clients to provide their feedback. The area used the data collected from feedback to improve and personalize their services. Feedback also allows the branches to determine how they can reduce the waiting time and what product features are most relevant to the needs of the clients. Branches have also tightened their client selection process to minimize unnecessary risks and the probability of the account to become past due. The area coordinated with HR to continuously provide useful training to their employees to learn new skills and make them well-rounded.

CARAGA DAVAO

Frederick I. Paringit, Area Manager

Searching for New Opportunities in Every Situation

Digos-Davao-Tagum-Bayugan-San Francisco

FRONT-RUNNER IN SECURED LOANS

Significant Increase in Secured Loan Portfolio

TAPPING INTO NEW MARKET

Exploring Opportunities to Expand Customer Reach and Capture a Larger Share of the Market

CONNECTING WITH POTENTIAL & EXISTING CLIENTS

Building a Lifetime Relationship with Clients

The area can boast of contributing dramatically to the secured loan portfolio of 1VBDB. One of its branches did not only level up the portfolio quantitatively but also qualitatively with zero past due. This is because they have been relentless in exploring the market seeking for new growth opportunities. They did not mind going to remote areas if this means reaching new and existing customers alike. They treat their clients as their lifetime friends that they serve them well. Engaging their clients, the CARAGA-DAVAO branches always ask their clients about how they can serve them better. One can always count on these branches to walk their talk.

BUKIDNON COTABATO

Heracleo Gaan Jr., Area Manager

Delivering Cost-Effective Financial Solutions to Customers

CDO-Gingoog-Butuan-Balingasag-Initao-Camiguin-Cabadbaran

ALIGNING WITH CUSTOMERS

Helping Customers Meet Their Financial Goals

EFFECTIVE COMMUNICATION CHANNELS

Going Beyond the Basics to Reach Out to Customers

SIMPLIFYING THE PROCESS

Continuously Improve Business Processes to Meet or Exceed Customer Expectations

Bukidnon and Cotabato Branches have taken their time to find out what their customers need and deliver cost-effective solutions to them. They deliver customized loans personally to their clients, and conduct orientations or face-to-face dialogues as may be necessary. They also facilitate required documents to speed up turnaround time. Helping their clients benefit the most from 1VBDB's products and services, this area continually strive to simplify business processing and finding a good mix between urgency and reliability. This results to prompt release of loans, increase in productivity, and immediate action on delinquent accounts. These branches have also maintained their good working relationship with stakeholders.

ZANORTE

Bobbie C. Paye, Area Manager

Implementing a Customer-Centric Approach to Increase Satisfaction

Dipolog-Sindangan-Manukan

CUSTOMER SATISFACTION FIRST

Treating Customers as The Most Important Stakeholder

EMBRACING TECHNOLOGY

Using Technology to Improve Customer Experience

ALIGNING SERVICES WITH CUSTOMER NEEDS

Improving Processes and Services and Increasing Accountability of Staff to Deliver the Best Customer Service

The ZANORTE Branches are committed to do their best in achieving the Bank's strategic goal. In 2018, they have participated in several activities meant to improve their competencies, strengthen their relationship with stakeholders, and use technology to improve their operational efficiencies and to serve their customers well. What is distinct about this area is that they have strengthened their accountability such that everyone is committed to doing their jobs well. One can visit any of the branches, and one will surely appreciate the kind of customer service these branches deliver.

MISAMIS OCC ZAMBO SUR

Hazel O. Geromo, Area Manager

Solidifying Business Growth Through the Lens of the Customers

Ozamis1-Ozamis2-Oroquieta-Molave-Dumingag

INCREASING VISIBILITY IN COMMUNITY ACTIVITIES

Active Participation in Developmental and Social Activities

BUILDING MEANINGFUL PARTNERSHIP WITH THE LOCAL GOVERNMENT

Finding Appropriate Financial Solutions Customized to the Needs of the Local Population

CREATING POSITIVE CUSTOMER EXPERIENCE

Increasing the Commitment of the Staff in Delivering High Quality Customer Service

1VBDB branches in Misamis Occidental-Zamboanga Sur area are known for nurturing client relationship. They don't just stop there as these branches continue to study their market and adjust their services based on what their market needs. They strengthen their linkage such as partnership with the Misamis Occidental Growers Association to address and resolve specific concerns of farmers. They are active members of the Bankers Association, Ozamiz City Chamber of Commerce, and the DTI to create opportunities in solidifying the position of the Bank. They also provide career opportunities for the local population. Excellent customer service has always been the goal of this area.

NEGROS

Romulo P. Fiel, Area Manager

Increasing Customer Value and Retention Through Dedicated Services

Dumaguete-Bayawan-Kabankalan-La Carlota

EMPOWERING CUSTOMERS TO DECIDE

Helping Customers to Choose the Best Solution for Their Needs

PROVIDING MORE CONVENIENT SERVICES THAN THE COMPETITION

Making It More Convenient for the Customers to Benefit from the Products and Services of 1VBDB

PRIORITIZING QUALITY

Making the Customer Journey a Unique and Wonderful Experience

From start to the end of the cycle, customers of 1VBDB Negros branches are assured of dedicated services. These branches empower their customers to decide the most appropriate solutions by providing them all the information and assistance they need. They help farmers choose what is the best remedy for their situations to address problematic accounts. Moreover, branch officers and staff connect with their customers no matter how remote, and they reach out to the unbanked to offer solutions. Negros branches team up with the local government to improve the lives of the residents; 1VBDB actively participates in the clean-up drive as well as in educating public school teachers on how to use their loans prudently. 1VBDB Negros works with their customers all the way to success.

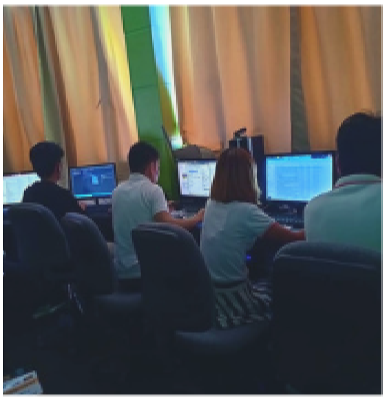
COMPLIANCE

No significant compliance incidents in 2018, ensuring integrity of transactions. The Bank has not been involved in any material legal proceedings or sanctions associated with non-compliance with regulations. Each branch has its own designated compliance officer. The Department was able to endorse six (6) policies to the Board of Directors, three of which are for implementation in 2019. The Department facilitated the opening of two branches, one branch lite unit, and the conversion of one branch lite unit to full-pledged branch.

INTERNAL AUDIT

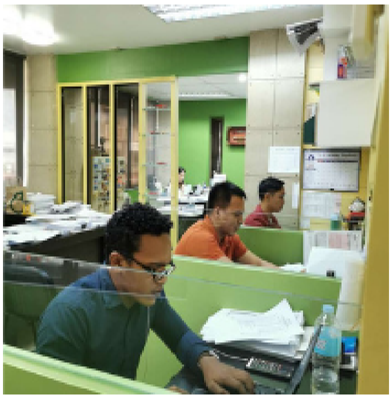
Initiated several training programs meant to increase the levels of awareness and understanding of 1VBDB employees on the role and importance of maintaining strong and effective internal controls. Assisted the Management in communicating the value and benefits of the merger of the three banks namely: 1st Valley Bank, Inc., A Development Bank (1VBDB), Sugbuanon Rural Bank (SRBI), and D'Asian Hills Bank, Inc. (DAHBI).

RISK MANAGEMENT



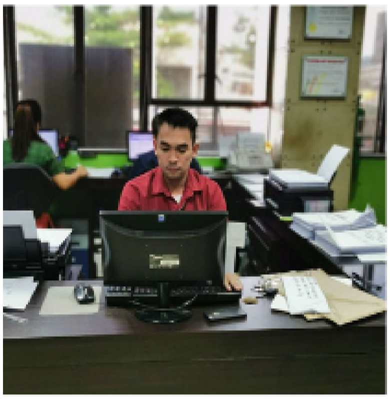
Coordinated with IT Department to secure and protect data. Files are now being uploaded and downloaded from 1VB RS (Reporting System) e-box instead of sending through third party applications. The Department have also started to strengthen managing strategic risk especially since 2018 is the road to a successful merger integration.

BUSINESS DEVELOPMENT



The Business Development group has been cross-checking opportunities for growth to identify potential clients at the same time avoid wastage of time and energy. Thus, the group is able to focus on getting highly targeted leads and positive associations. In developing and presenting solutions to clients, the group aimed at matching the client requirements, preferences, and needs. This way, satisfaction of clients increases.

CREDIT MANAGEMENT



Strengthened relationships with branches and branch lite units resulting with better and faster credit underwriting and approvals. Staff attended and participated in various training programs such as the Borrowers Risk Management held in Manila to enhance competencies. Worked closely with the Business Development Department to ensure that the Bank is able to sustain credit growth and improve the quality of its credit/loan portfolio.

CREDIT COLLECTION

The Credit Collection (CRECOL) group has focused on implementing a streamlined collection process that works effectively to reduce delinquent accounts. Branches are required to observe a strict protocol, as well as coordinate with the Department to stop, avoid, and prevent missed payments. Collection details are communicated to delinquent holders to avoid misinterpretations.

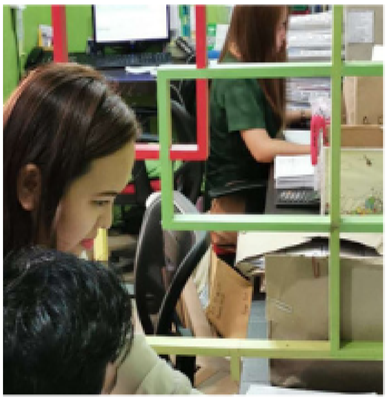
HUMAN RESOURCES

HR Department has designed and implemented the Php3K salary increase to all regular non-managerial employees of the Bank. Nurtured relationships with internal (employees) and external (job applicants) customers by providing useful and relevant information. Initiated the full automation of HR processes such as attendance monitoring, payroll, and benefit distribution and worked closely with the IT Department for such purposes.

CONSUMER ASSISTANCE

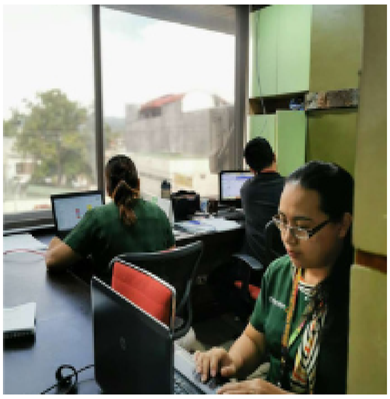
Created the Facebook Group Page at https://www.facebook.com/groups/1VBconsumerassistance/, following the turnover of the official facebook account to the Marketing Team. This page is meant to provide members with informative guidance to empower them to make well-informed financial decisions. The page is also a platform for sharing tips and insights on how to benefit from the products and services of the Bank.

FINANCE



Relationships with other units became more collaborative. The Department continued to strictly monitor the financial resources of the Bank, and ensured that all units stay within their budget. Financial documents are reviewed more carefully and meticulously to guarantee the integrity, accuracy, and reliability of data. Staff are more engaging.

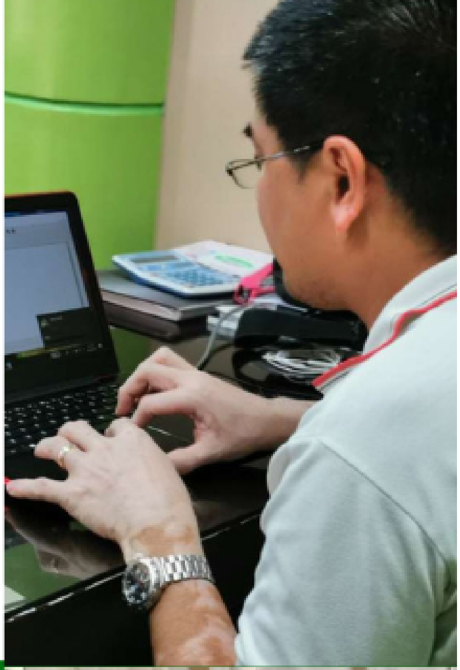
MARKETING



The marketing team took over the management of the social media accounts of 1st Valley Bank, Inc., A Development Bank. The team strictly monitors the chat bot application installed on the official Facebook account at https://www.facebook.com/1stValleyBank/. The chat bot is conceptualized and installed by Bridge Philippines Investments, a strategic partner of the Bank.

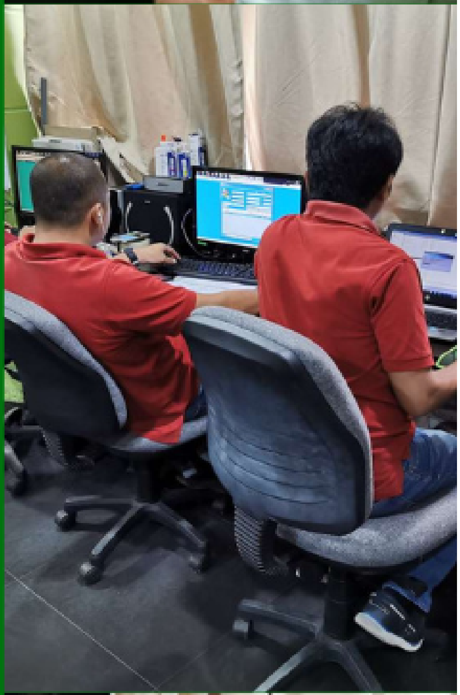
THE IT DEPARTMENT'S RIPPLE EFFECT

- Enables 1VBDB management and branches to receive information speedily and efficiently
- Increase in efficiencies mean reduction in operational costs that in turn increases profitability
- Increase in the trust and confidence of consumers knowing that their data are protected and secured
- Faster transactions with readily available information bring 1VBDB customer service to another level



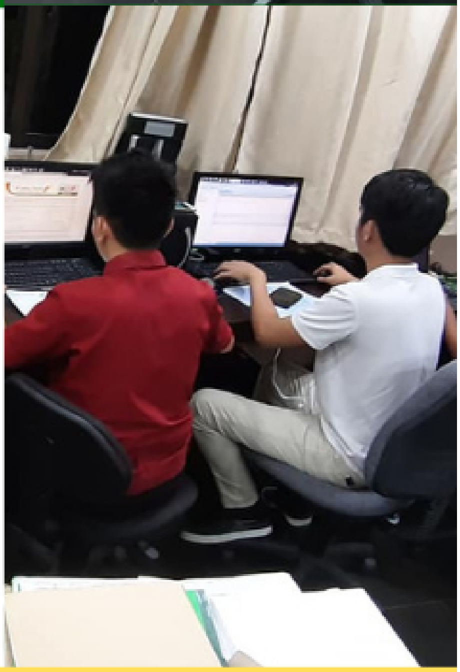
"Information technology empowers 1VBDB consumers to choose the best financial solution and own their choice."

-Felizardo A. Enad, IT Director



Best Practices

- Communicating the technology to all units in a language that they understand best
- Prioritizing IT activities that bring the most benefit to the Bank
- Investing in cost-effective technology and tools
- Upgrading the competencies and upskilling of the IT Staff
- Getting the support and involvement of top management



NEW BRANCHES

KORONADAL·KIDAPAWAN·GUIWAN·MABUHAY

NEW BRANCHES: KORONADAL & KIDAPAWAN

CONVERSION FROM BRANCH LITE UNIT TO BRANCH: GUIWAN

NEW BRANCH LITE UNIT: MABUHAY

CHALLENGES

Just like with any other banks, 1st Valley Bank, Inc., A Development Bank had its share of challenges in 2018.

Most of these challenges can be attributed to the dynamic nature of the banking industry and the ever-changing needs of consumers. If 1VBDB is to achieve its vision, it has to keep up with the growing demands and expectations of its consumers.

MEETING CONSUMER EXPECTATIONS
Consumers have become more demanding and have greater expectations. Not only do they want faster turnaround, but also they want everything to be at their fingertips. As the consumers have a lot of options, 1VBDB has started to focus on innovating and customizing its products and services to meet the demands of its consumers.

REGULATORY COMPLIANCE
Regulatory compliance requirements are constantly evolving, and the Bank has to keep up with its pace. The Bank has to ensure that its systems, policies, and processes are designed to do whatever is necessary to comply with regulations. This requires resources.

BENEFITING FROM TECHNOLOGY
Undeniably, technology such as digitization plays a critical role in sustaining the growth and development of 1VBDB. To benefit the most, the Bank must be able to choose the right technology that is also cost-effective.

RESPONDING TO CHALLENGES

Increase in Interest Rate from Inflation

Borrowers can avail higher funds and personalized services. The Bank has been continually innovating its products and services to address the unique needs of its consumers.

GSIS Financial Assistance Loan

A reduction of at least P500M in the salary loan portfolio can be attributed to GFAL or GSIS buying out salary loans of teachers. To counteract the adverse effect, 1VBDB introduced its ATM product.

Policy Restriction

The strict implementation of the "proof of farm lot" requirement has dealt a big blow to Supervised Credit (SUCRE). The SUCRE team focused on serving eligible farmers to exceed their expectations.

BRIGHT OUTLOOK

What to look forward to in the year to come

The challenges in 2018 have empowered 1st Valley Bank, Inc., A Development Bank to recognize its strengths and do something about its weaknesses. As the year concluded, the Bank is looking ahead to a new year that will usher a successful strategic merger.

1VBDB consumers can look forward to a more personalized experience with enhanced customer-facing services. The Bank will leverage on its resources to provide solutions to its consumers at their point of need. The Bank will continue to empower its staff to do everything in their capacity to help make the clients' lives simpler and easier.

Using technology, the Bank hopes to achieve full automation of processes and complete digitization of customer data by 2019. These will enable the Bank to customize its products and services according to the exact and specific needs and preferences of its clients.

With the merger integration, consumers can count on a bigger network that will bring more convenience, easy access to financial solutions, and better rates. Clients have the assurance that 1VBDB, with its proven stability and culture of excellence, will always deliver relevant solutions to remain worthy of their trust and confidence.

1VBDB CONSUMER ASSISTANCE FACEBOOK.COM/1STVALLEYBANK

STRATEGIC RISK MANAGEMENT

1VBDB has always considered its risk management as a strategic function. Risk management is closely linked with the Bank's strategic plan. Thus, 1VBDB prioritizes risks that can significantly affect or influence the Bank's strategic goals.

Since the Bank is focusing on becoming more customer-centric, its risk management activities are also focused on creating more value for its stakeholders especially its consumers.

The key players in creating and implementing the Bank's risk management strategies are the following: (a) Board of Directors with the Bank's President/CEO as Chief Risk Management Executive; (b) Risk Management Officer; (c) Internal Auditor; and (d) Department Heads and Managers.

The risk management system implemented by 1VB involves the following: (a) formation of independent board committees as primary risk management agents, (b) development and application of risk management tools; (c) implementation of risk-based controls; and (d) full implementation of risk management policy.

Risk Management Empowers 1VBDB to Deliver High Performance

RISK APPETITE TO ACHIEVE GOALS

1VBDB treats its risk appetite as a core tool to align its strategic goals, risk, and allocation of capital. It gives the Bank the opportunity to improve its risk management practices.

The Bank has an overall conservative risk appetite, and a risk tolerance categorized into low, moderate, and high. It will not accept risks that would jeopardize the interests of its stakeholders most especially its consumers.

Low risk tolerance means that controls are effective and risks will not impede 1VBDB to achieve its strategic goals.

With moderate risk tolerance, controls are adequately designed and are generally effective.

Meanwhile, in high risk tolerance, controls are found to be inadequately designed and ineffective. 1VBDB may not be able to achieve its strategic goals unless the Bank addresses this level of risk.

1VBDB only tolerates low to moderate risk exposures.

RISK GOVERNANCE: 3 LINES OF DEFENSE

The three-line defense risk governance structure allows 1st Valley Bank, Inc., A Development Bank to sustain effective oversight and management of risk with each business unit of the Bank owning their risk accountability.

The first line of defense comes from the risk owners. These 1VBDB managers and unit heads are responsible for the day-to-day managing of risks. They must ensure that their risk control activities and procedures are consistent and aligned with the the overall strategic goals and objectives of 1VBDB.

The second line of defense comes from 1VBDB Risk Department composed of well-trained employees that specialize on risk management. They facilitate the implementation of risk management activities and procedures.

The third line of defense is from Internal Audit, that provides 1VBDB the assurance that its first and second lines of defense are working effectively and that the Bank's internal controls and risk management activities are adequate and effective in enabling the Bank to achieve its strategic and business goals.

RISK GOVERNANCE STRUCTURE

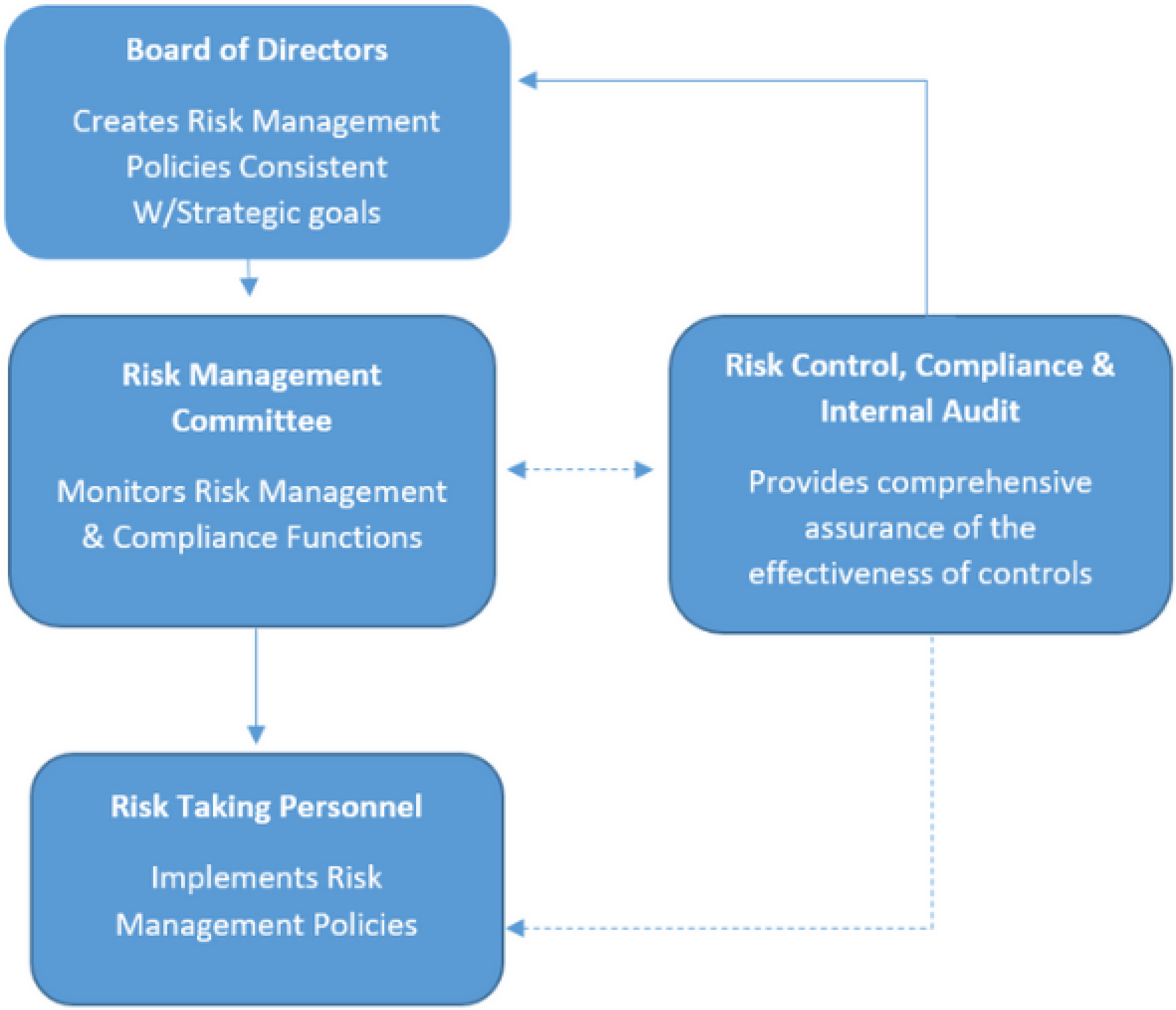
The Board of Directors provides an effective oversight of the three lines of defense. This is to ensure that risks are well-managed, and that risk management policies are strictly implemented and consistent with the Bank's strategy as well as regulations.

Through the Risk Department, the BOD promotes a collaborative risk management environment where everyone across all departments and units owns and participates in the development and implementation of strategies and procedures to identify, monitor, and manage risk.

Senior Management together with the Risk Department is responsible for ensuring that these strategies and procedures are communicated and understood by all employees.

Risk, Compliance, and Internal Audit work jointly to assure the Bank that its governance, risk management, and internal controls are sufficient and effective.

In 2018, 1VBDB through its Risk Department has intensified its campaign on strengthening the Bank's risk-based culture where everyone is accountable in controlling the risks they own.



THE RISK MANAGEMENT PROCESS

The risk management process of 1st Valley Bank, Inc., A Development Bank is aimed at preventing potential losses and maximizing the opportunities and strength of the Bank.

In 2018, the Bank focused on addressing its delinquencies to lower its credit risk exposure. Some of the actions taken to minimize risks were policy changes or amendments, improving business processes, and redesigning loan products.

Most of the delinquencies originated from Salary Loans and Supervised Credit (SUCRE). The increase in the net take-home pay from P3.5K to P5K as well as the prioritization of the GSIS and HDMF (Pagibig) deductions over loans from banks and other lenders have affected the repayment behavior of the salary loan clients; thus, increasing the past due ratio of the Bank.

SUCRE clients especially rice farmers, meanwhile, attributed their failure to harvest to typhoons. Coconut and corn farmers point to the highest cost of farm input and the unfavorable price changes as the culprits for their delinquencies.

With secured loans, 1VBDB has tightened the implementation of cash flow assessment to prevent or minimize delinquencies. For accounts classified as past due, in-depth evaluation is conducted to determine root and then strict implementation of the foreclosure follows as applicable.

1VB has intensified the promotion of its secured loans- SME and Agricultural loans that are seen to increase the Bank's profitability.

RISK MANAGEMENT ACTIVITIES

Risk activities conducted by 1VBDB in 2018 centered on identifying, analyzing, monitoring, and controlling risks. The Risk Department in coordination with the Human Resources Department facilitated several training programs to upgrade the competencies of the risk owners.

In 2018, the Department focused on preventing and addressing the Bank's operational risks. These risks involve risk of loss due to breaches, errors, damages, and business disruptions or interruptions.

Risk staff intensified their branch visits to ensure: (1) employees are performing their tasks accurately; (2) processes are working efficiently; (3) system is fully functional; (4) readiness of the branches to continue its business against unforeseen events.

COMPREHENSIVE APPROACH

In addressing operational risks, the Risk Department looks into three (3) areas: technology, people, and regulation.

TECHNOLOGY. Risk and IT staff ensured that all branches and branch lite units are compliant with security measures such as creating and maintaining strong passwords, updating of security programs, and connecting to the internet for official purposes and only when necessary.

PEOPLE. Together with Compliance, Internal Audit, and Human Resources Department, Risk staff monitors and verifies the reliability of employees in performing their duties against policies and regulations.

> “
> *Risk staff monitors and verifies the reliability of employees*

REGULATION. The BSP and other regulatory agencies have been issuing a number of rules and regulations that 1VBDB must follow. Thus, the Risk Department works with Compliance Department in ensuring that all units comply with both internal and external regulations.

On top of these things, Risk and HR Departments provide continuous training to remind employees of the roles they play in achieving the strategic goals.

RISK & COMPLIANCE: STRENGTHENING THE AML CULTURE

1st Valley Bank, Inc., A Development Bank believes that a strong culture of anti-money laundering (AML) will enable the Bank to address gaps and shortcomings and to stop the problem before it gets blown out of proportion.

Risk and Compliance departments are responsible for building and promoting a strong AML culture that will shield the Bank against money launderers and terrorists.

Everyone in the Bank is committed to do their part in managing the risks of money laundering and terrorist financing and to implement integrated effective controls to achieve compliance objectives.

The 1VBDB AML/ATF (Anti-Money Laundering/Anti-Terrorists Financing) Program consists of the following: strong acceptance and KYC policies, systematic customer risk profiling, due diligence, consistent and reliable reporting of covered and suspicious transactions, and strict compliance to regulations.

Risk and Compliance departments together with HR Department are holding continuous training on AML and ATF that aim to increase the understanding of employees on how they can contribute to the AML/ATF campaigns of the Bank.

Risk and Compliance staff monitor AML/ATF compliance of the operational units of the Bank. These departments also ensure that AML/ATF compliance is part of the everyday business of the branches and branch lite units.

Risk department is tasked to maintain the balance between 1VBDB's profitability on one hand and its compliance to regulations on the other.

"Everyone in the Bank is committed to do their part in managing the risks of money laundering and terrorist financing"

AML GOVERNANCE: STRENGTHENING TRANSACTION MONITORING

in 2018, 1VBDB focused on strengthening its AML transaction monitoring. The system maintained by IT Department allows the Bank to detect and monitor suspicious and covered transactions. The IT network manager generates all AML reports and forwards the same to the Compliance Department.

Compliance Department validate the integrity of the data. Together with Risk Department, Compliance staff go around the branches and branch lite units to check their adherence to AML/ATF policies.

From the data gathered, Compliance Department works to fine-tune the process of detecting and monitoring transactions. This is to ensure that the operational units of the Bank are able to cover and monitor red flags.

Compliance Department also coordinates with HR and other units to determine and fill in AML training gaps. The training courses held in 2018 were targeted to promote the AML culture by increasing the understanding of employees on AML concepts and requirements.

AML/ATF Governance is a complex process and filled with multiple challenges. The 1VBDB Compliance Team, as the lead unit, has gained headway in promoting an AML culture within the Bank and strengthening the monitoring of AML transactions.

AML RISK MANAGEMENT FRAMEWORK

1st Valley Bank implements an integrated risk-based approach to prevent the use of the Bank for money laundering and terrorist financing, where the focus in 2018 is strict monitoring and assessment of transactions. The goal is not just merely to comply with regulations, but also to promote and embed a pro-active AML/ATF culture among all employees of the Bank.

Within their authority, the Audit & Compliance Committee (ACC) oversees the creation and implementation of the Bank's Money Laundering and Terrorist Financing Prevention Program (MTPP). The Committee shall see to it that the MTPP policies and procedures are in compliance with the provisions of the AMLA (as amended), its implementing rules and guidelines, and BSP's regulations to prevent the use of BSFIs as a vehicle for money laundering and terrorist financing.

Senior Management and Compliance Department work together in ensuring the proper implementation of MTPP, promoting a culture of compliance to policies, procedures, rules and regulations.

Middle Management is accountable for ensuring compliance of their staff to the MTPP.

Risk Department manages risks associated with the MTPP, while Internal Audit evaluates the implementation of the program and the effectiveness and adequacy of internal controls in addressing risks and promoting compliance to MTPP.

The technological tools to ensure full compliance to the MTPP rest on the shoulders of the IT Department.

In preventing the Bank to become a channel for money laundering and terrorist financing, all employees are required to perform due diligence such as but not limited to: conduct of proper KYC (Know Your Customer), watch-list verification, risk-profiling of clients, validation of accounts, strict compliance to policies and procedures especially in handling new clients, and monitoring of existing clients

Protecting Stakeholders

At the heart of 1st Valley Bank's corporate governance is its goal to protect the interests of its stakeholders - consumers, partners, shareholders, employees, and the communities where the Bank operates.

1st Valley Bank, Inc., A Development Bank is committed to sustain the Bank's stability and good financial health for the benefit of its stakeholders. The Bank recognizes the importance of an effective risk management that will empower the Management to make well-informed decisions, the foundation of good governance.

To achieve this, the board of directors and senior management ensure that a sound system of oversight and control is in place and that risk management procedures are appropriate and effective.

1VBDB executes five (5) essential forms of oversight to ensure appropriate checks and balances: (1) oversight by the board of directors or supervisory board;
(2) oversight by individuals who are not involved in the day-to-day running of the various business areas; (3) direct line supervision of different business areas; (4) independent risk management, compliance and audit functions; and (5) assurance that key personnel are fit and proper for their jobs.

Selecting The Board of Directors

STRATEGIC **THINKERS**

As 1st Valley Bank, Inc., A Development Bank moves closer to achieving its medium term strategic goal, its Board of Directors will definitely take a critical role in steering the Bank to its intended destination of success.

Thus, it is equally important that the Board is composed of strategic thinkers. These members have the ability to see beyond the present, and maximize all possibilities and opportunities.

While expertise in banking is a factor, it is not the sole determinant in selecting board members. The Bank prioritizes persons whose integrity are unquestionable, who are able to commit to their financial responsibility, and those who have a deeper sense of accountability.

Nominees will have to undergo stringent assessment to determine their competence, character, and risk profile. These will have to match the strategic direction of the Bank. Each board member must be able to make a significant impact on the Bank's journey to success.

In 2018, 1st Valley Bank's Board of Directors consists of 11 members, 3 of who sit as independent directors. Selection is through nomination and subsequent casting of votes.

BOD Main Responsibilities

01

GENERAL OVERSIGHT

The Directors are responsible for ensuring the overall good financial health condition of 1VBDB. The BOD delegates power and authority to manage the Bank to Senior Management.

02

CORPORATE LEADERSHIP

It is the duty of the BOD to set 1VBDB's strategic direction, and to lead the organization to get there. Part of this leadership is to establish the Bank's corporate core values and to ensure, through Senior Management, that all employees live these values.

03

EFFECTIVE GOVERNANCE

The BOD is accountable to stakeholders and regulators in ensuring that the Bank's corporate governance is effective. Thus, the Directors must have a clear understanding of their duties and responsibilities as well as their accountability.

04

ACHIEVEMENT OF STRATEGIC GOAL

It is the duty and responsibility of the BOD to hold Senior Management accountable in meeting the strategic goal and objectives of 1VBDB. Both must ensure that the Bank is operating profitably and complying with laws and regulations.

ROLE & RESPONSIBILITIES

EXECUTIVE DIRECTOR

The executive director of 1st Valley Bank, Inc., A Development Bank has management responsibility in running the business. He oversees the development and implementation of the strategic plan, risk management, as well as bank programs and activities.

It is the duty and responsibility of the executive director to keep the board updated and to provide feedback as to the progress of the strategic plan. He also serves as the face of 1st Valley Bank.

Executive Director: **ATTY. NICOLAS J. LIM**

NON-EXECUTIVE DIRECTOR

Unlike the executive director, the non-executive director does not have any management responsibility; however, he is responsible for monitoring and challenging the CEO and senior management and holding the latter accountable.

The non-executive director brings independent perspective, protects the interests of the Bank's stakeholders, and takes responsibility for the board's committees.

Non-Executive Directors: **NELSON L. TE, HON. ALLAN J. LIM, CELESTE MARIE V. LIM, HAZEL S. TE, PAUL F. KOCOUREK, ANGUS J. POSTON, ARTURO V. MENDIZABEL**

INDEPENDENT DIRECTOR

The independent director is not in any way dependent on the bank, but plays a critical role in maintaining the objectivity of board decisions.

The main role of the independent director is to build and sustain the credibility of the Board, and his main responsibility is to improve the standards of corporate governance.

Independent Directors: **ATTY. WILFREDO B. DOMO-ONG, JOVEN D. REYES, ANTONIO M. DUMALIANG**

1VB BOARD COMPOSITION & ROLE OF CHAIRPERSON

The Board consists of eleven directors- 1 executive, 7 non-executive, and 3 independent directors. This number is determined by the Board as commensurate to the size and complexity of 1VBDB's operations.

These members are committed to guide the Bank to achieve its medium term strategic plan of 2016-2021. The Chairman of the Board, providing leadership, ensures that the Board fulfills its duties to its stakeholders.

The quality and effectiveness of the corporate governance of 1VBDB rest on the composition of the Bank's Board of Directors.

BOARD COMPOSITION

Name of Director	Type of Directorship	Director Since	Till	Years Served	Shares Held	% of Shares Held
Nelson L. Te	Non-executive Director	25/02/2012	31/12/2018	6	3,710,257	4.84%
Atty. Nicolas J. Lim	Executive Director	25/02/2012	31/12/2018	6	6,886,336	8.98%
Allan J. Lim	Non-executive Director	25/02/2012	31/12/2018	6	2,645,578	3.45%
Celeste Marie V. Lim	Non-executive Director	25/02/2012	31/12/2018	6	2,307,005	3.01%
Hazel S. Te	Non-executive Director	25/02/2012	31/12/2018	6	2,009,932	2.62%
Paul F. Kocourek	Non-executive Director	03/03/2014	31/12/2018	4	1	0.00%
Angus J. Poston	Non-executive Director	03/03/2014	31/12/2018	4	2	0.00%
Arturo V. Mendizabel	Non-executive Director	18/02/2017	31/12/2018	1	26	0.00%
Atty. Wilfredo B. Domo-ong	Independent Director	24/02/2011	31/12/2018	7		
Joven D. Reyes	Independent Director	09/05/2015	31/12/2018	3	26	0.00%
Antonio M. Dumaliang	Independent Director	18/02/2017	31/12/2018	1	26	0.00%

ATTENDANCE

Committee	Position	Name of Director	Attendance/ Meetings	%
Risk Management Committee	Chairman	Antonio M. Dumaliang*	3/3	100%
	Member	Hazel S. Te	4/4	100%
	Member	Arturo V. Mendizabel	4/4	100%
	Member	Joven D. Reyes	3/4	75%
Executive Committee	Chairman	Angus J. Poston	10	100%
	Member	Atty. Nicolas J. Lim	10	100%
	Member	Nelson L. Te	9	90%
	Member	Paul F. Kocourek	7	70%
	Member	Celeste Marie V. Lim	9	90%
Audit and Compliance Committee	Chairman	Atty. Wilfredo B. Domo-ong	4/4	100%
	Member	Arturo V. Mendizabel	3/4	75%
	Member	Antonio M. Dumaliang	4/4	100%
	Member	Allan J. Lim	4/4	100%
Corporate Governance Committee	Chairman	Joven D. Reyes	5/5	100%
	Member	Atty. Wilfredo B. Domo-ong	2/5	40%
	Member	Antonio M. Dumaliang	5/5	100%
	Member	Celeste Marie V. Lim	5/5	100%
	Member	Paul F. Kocourek	5/5	100%
Board of Directors	Chairman	Nelson L. Te	5/5	100%
	Member	Atty. Nicolas J. Lim	5/5	100%
	Member	Allan J. Lim	5/5	100%
	Member	Celeste Marie V. Lim	5/5	100%
	Member	Hazel S. Te	5/5	100%
	Member	Paul F. Kocourek	5/5	100%
	Member	Angus J. Poston	5/5	100%
	Member	Arturo V. Mendizabel	5/5	100%
	Member	Atty. Wilfredo B. Domo-ong	5/5	100%
	Member	Joven D. Reyes	5/5	100%
	Member	Antonio M. Dumaliang	5/5	100%

QUALIFICATIONS

The members of the Board of Directors have passed the strict eligibility requirements including qualification standards set by the BSP.

1ST VALLEY BANK, INC., A DEVELOPMENT BANK
Vamenta Blvd., Carmen, Cagayan De Oro City
List of Board of Directors as of December 31, 2018

NAME	POSITION	BIRTH DATE	AGE	EDUCATIONAL ATTAINMENT	NATIONALITY	WORKING EXPERIENCE
1. Nelson L. Te	Chairman	12-Apr-42	76	AB/BS Commerce	Filipino	• Ozamiz A+ Credit Corp. - Treasurer • Mindar Trading Corp. - Area Manager • Omar Ali Distributor Inc. - Area Manager
2. Atty. Nicolas Jagman Lim	President	28-Oct-48	70	AB/LLB/MDP	Filipino	• Bacnotan Consolidated Inc. - Legal Counsel/Corporate Secretary (1976-1996) • Kalayaan Commodities Corp. - Legal Counsel / Corporate Secretary (1976-1996) • Central Cement Corp. - Legal Counsel / Corporate Secretary (1979-1996)
3. Allan Jagman Lim	Member	25-Jan-52	66	BS Engineering	Filipino	• LGU of Lala – Municipal Mayor (Present)
4. Hazel Saavedra Te	Member	22-May-71	47	BS Computer Science	Filipino	• Ozamiz A+ Credit Corp. - Treasurer (2012-2015) • Ozamiz A+ Credit Corp. - Director (2002 - 2015) • Paradigm Diversified Res., Inc. - Corporate Secretary (1995-2015)
5. Celeste Marie Valencia Lim	Member	9-Sep-76	42	BSBA Accounting & Economics/MBA	Filipino	• Metrobank Card Corporation - Head of Merchant Acquiring and Payments, FVP (2012-2016) • Metrobank Card Corporation - Head, Merchant Acquiring and Payments, VP (2009-2012) • Metrobank Card Corporation - Merchant Acquiring Marketing Head, VP (2006-2009)
6. Paul Francis Kocourek	Member	14-Sep-50	68	BS Education/MBA Finance & Accounting	Irish	• Bridge Advisory Services – CEO (2007-2013) • Cenveo Corporation – Director (2004-2008) • Booz & Co – Senior Partner (1987-2007)
7. Angus James Poston	Member	21-Aug-71	47	MA Psychology/Philosophy/ Economics Management	British	• Amret Microfinance (Cambodia) – Director (2014-2015) • Barclays Bank PLC – Co-Head of Strategy (2008-2009) • Barclays Bank PLC – Independent Banking Consultant (2005-2007)
8. Arturo Villamor Mendizabel	Member	15-Aug-45	73	BS Commerce/MBA	Filipino	• Sugbuanon Rural Bank Inc., - Independent Director (2016-2017_ • 1st Valley Bank Inc. – Independent Director (2011-2017) • 1st Valley Bank Inc. – Board of Advisors (2015)
9. Joven Deriquito Reyes	Independent Director	29-Jan-51	67	BS Math/MBA	Filipino	• Philippine Veterans Bank – Independent Director (2012-2013) • AIG PHILAM SAVINGS BANK – Director (2009) • AIG PHILAM SAVINGS BANK – President and CEO (2007-2009)
10. Atty. Wilfredo Borreros Domo-ong	Independent Director	19-Mar-40	78	BS Commerce/LLB	Filipino	• Bangko Sentral ng Pilipinas – Director – Department of Rural Banks (1994-2005)
11. Antonio Montehermozo Dumaliang	Independent Director	6-Jun-53	65	BSBA/Masters in Management	Filipino	• Holcim Philippines Inc. Formerly Union Cement Corp. - VP Internal Audit, Member Of Management Committee (2002-2009) • Bacnotan Consolidated Industries, Inc. - AVP - Group Internal Audit (1998-2002)

EXECUTIVE COMMITTEE

ANGUS J. POSTON (Chairman) | Members: ATTY. NICOLAS J. LIM, NELSON L. TE, PAUL F. KOCOUREK, and CELESTE MARIE V. LIM

Assists the BOD in the fulfillment of its statutory , fiduciary, and regulatory responsibilities.

RISK MANAGEMENT

ANTONIO M. DUMALIANG (Chairman) | Members: HAZEL S. TE, ARTURO V. MENDIZABEL, JOVEN D, REYES | Observers: ANGUS J. POSTON, PAUL F. KOCOUREK

Oversees the development and implementation of 1VBDB's risk management program.

AUDIT & COMPLIANCE

ATTY. WILFREDO B. DOMO-ONG (Chairman) | Members: ARTURO V. MENDIZABEL, ALLAN J. LIM, ANTONIO M. DUMALIANG

Oversees 1VB's financial reporting and control as well as the internal and external audit functions.

CORPORATE GOVERNANCE

JOVEN D. REYES (Chairman) | Members: ATTY. WILFREDO B. DUMO-ONG, ANTONIO M. DUMALIANG, CELESTE MARIE V. LIM, and PAUL F. KOCOUREK

Deliberates and provides input on the composition of the officers of the Bank through ensuring that the proper conduct of the selection process is observed.

SENIOR MANAGEMENT

ATTY. NICOLAS J. LIM, President | **VIVIAN V. LIM**, HR Director | Vice Presidents: **NICOLETTE V. LIM-GICA** (Operations), **GLENN A. MENDEZ** (Chief of Staff), **ANAVIC A. SARSALE** (Finance), **EMILY E. ENAD** (Risk Management), **ONISIMO L. PRADO** (Internal Audit) | Assistant Vice Presidents: **ANNIE LISA G. ESTRERA** (Credit), **FELIZARDO A. ENAD** (Information Technology) | **ALFREDO F. GIRBES,** Business Development Officer | **CAROLINE L. PONGOL**, Chief Compliance Officer | **ATTY. CARLO MAGNO N. CALINGIN**, Chief Legal Officer | **ESTRELLA E. FLORIDA**, Comptroller | **ATTY. ZARA TEODORA B. CABANLET**, Corporate Secretary

HEAD OFFICE OFFICERS

BENEDICT M. MUTIA, Consumer Assistance & Marketing | **RAY I. GICA**, Security | **JOAR B. EYAS & MELANIE U. FAMOR**, Compliance Managers | **JAN RHOSIDY G. VILLA**, Business Continuity Coordinator | **ANALISA M. EYAS & SHEILA G. PANGLIMA**, Internal Audit Managers | **MICHAEL C. CIMAFRANCA**, Credit Manager | **ERNIE L. RUDINAS**, Collections Head | **ROSENDO B. ROCES**, Central Clearing Head | **GERALD A. BURLAT**, Management Information System Head | | **ATTY. SAMUEL RYAN C. RUDINAS**, Collections-Legal | **MERNADETH M. MEMIS**, Financial Analyst | **ENGR. ELAINE AGUSTIN**, General Services & Procurement Head| **GLENDA MAR L. DANGNAN**, Printing Coordinator | **MA. LOURDES P. PIQUERO**, ROPA Manager

PRODUCT MANAGEMENT

JUBAL Y. YU, Salary Loans & LGU/Barangay Loans | **BERNARD C. PADERES**, SME Loans | **ERROL C. DIOSO**, Supervised Credit | **MUAMAR CARBA**, Agricultural Loans | **ANDRE M. ATES**, Small Business Microfinance & Jewelry Loans | **BOBBIE C. PAYE**, Deposits

OPERATIONS MANAGEMENT

AREA MANAGERS: **PETER M. ALFON, GLENN G. BAGALOYOS, ROMULO P. FIEL, FREDERICK I. PARINGIT, HAZEL O. GEROMO, JAMAEL M. DANGNAN, HERACLEO J. GAAN JR., & SAMSON S. CABABAN JR.**

BRANCH MANAGERS: **JAMES J. ALFON, NERI B. BLISS, ARVIN C. LIM, ROSERUBY L. MENDEZ, JOEL S. ALIA, EDSEL B. MANLANGIT, GIA AMABELLE B. CATILOC, ARDEE WARREN P. ARNEJO, JOPHET D. DAUG, JONIEL L. GALO, RUTH C. ROCAMORA, RAY C. ADALA, CECIL C. PALENZUELA, ARLINOVE M. MONTEALTO, NORMAN F. FLORIDA, MIKEL RONALD L. MAGDULA, ZANY C. PATRICIO, LARRY R. SOMOSA, JAIME S. MONTEALTO JR, JONATHAN S. GORRA, JEFFREY M. NABLO, SHEILA M. MANDANTES, BHEBIE JHOY B. CARBAJAL. GELBERT M. DIZON, JOHN PAUL B. JAYO, MITCHEL B. OROCIO, DESIREE M. SALARDA, ED GLENN P. TECSON, ROXAN A. ANGHAY, PERCIVAL G. CRUZ, HIPOLITO N. LANDICHO JR. , JOEL P. SALUNA, JESSIE J. GAAN, ROSALITO D. SOON, ELIEZER G. PANANGLITAN, JEFFREY B. TIMAGOS, JOSELITO A. JANDOMON, FILMOR M. GUTANG, EDGAR LOU G. DEMAYO, RAPSODE P. CIELO, JEYPE A. PEREZ**

BRANCH LITE UNIT MANAGERS: JESSIERIE DELA PEÑA, ANGELO D. CALAPIZ, ALBERT M. ALEGADO, LEOPOLDO C. ERASMO JR., REGIEL S. VERGARA, GIRLIE A. PEPITO, CHESTER JULY S. JUGAN

MEASURING 1VBDB PERFORMANCE

In 2018, 1st Valley Bank, Inc., A Development Bank has started to implement a comprehensive approach in measuring the Bank's performance. The main objective in performance assessment is to determine and ensure the Bank's capability to sustain its profitability. This is important as the measure of profitability is the Bank's first and critical defense against unforeseen losses.

The Bank considers the following factors in measuring its profitability: operational efficiencies, product line revenues, stress test results, corporate governance, intellectual resources, and risk appetite on top of the conventional return on equity (RoE) metrics.

COMPREHENSIVE ANALYSIS

The Bank is now focusing on a more comprehensive analysis of all its business lines. Senior management and business managers have intensified their communications, as part of the performance assessment, to enhance the Bank's corporate governance and risk management program.

EMPLOYEE PERFORMANCE APPRAISAL

The employee performance appraisal of 1VBDB is not just an assessment of how well employees perform their duties and responsibilities. It also determines how committed employees are in achieving the strategic goal of the Bank.

Formal appraisal is done quarterly. During the assessment, both the immediate superior (rater) and the staff (ratee) discuss the ratings including the plan for improvement.

A prescribed format is used to document the rating and the ensuing discussion.

The ratee is also given the opportunity to perform a self-assessment of his performance.

The goal of the performance assessment is always to help the employee grow, develop his potentials, and contribute productively to the attainment of the Bank's strategic plan.

BASIC BANKING ORIENTATION

Part of the on-boarding program is the conduct of the basic banking orientation for new employees. The orientation allows new employees to familiarize themselves with their new environment and master the basics of banking operations.

It is also through the basic banking operations program that new employees get to understand their duties and responsibilities and experience the culture of excellence of 1st Valley Bank, Inc., A Development Bank.

CONTINUING TRAINING PROGRAM

The continuing training program of 1VBDB is meant to enable the employees to:

(1) upgrade their knowledge and skills necessary to perform their job excellently;

(2) acquire new skills to meet any changes such as but not limited to regulations, laws, new policies, or new business lines.

1VBDB HR's Career Development Division coordinates with all the units to perform an inventory of skills and competence, evaluate and identify the training needs of the staff.

HR then arranges for the staff to attend either internal or external training courses, whichever is relevant, to ensure that the staff remains competent.

1VBDB is strongly committed to providing its employees continuing training for career growth.

RETIREMENT BENEFITS

Employees for retirement get to enjoy the following benefits: one month of current remuneration multiplied by the number of years in service, and other cash benefits deemed appropriate by the management.

Retirement in 1VBDB is classified as follows: early retirement at 55 years old, normal retirement at 60 years old, and late retirement at 65 years old.

The Bank also provides cash benefits for the following: death, total and permanent disability, as well as voluntary separation.

THE NEXT LEADERS

Succession in 1VBDB is heavily based on merit. The succession plan of the Bank ensures that in any situation or circumstances, 1VB is ready to refill any role.

HR Department is responsible for communicating clearly to employees their job responsibilities and management expectations. The hiring process must be careful, thorough, and deliberate to be able to attract and get high quality employees.

With continuous training as part of the leadership development program and other career development interventions, 1VBDB is assured of qualified employees ready to fill roles and take on the responsibilities.

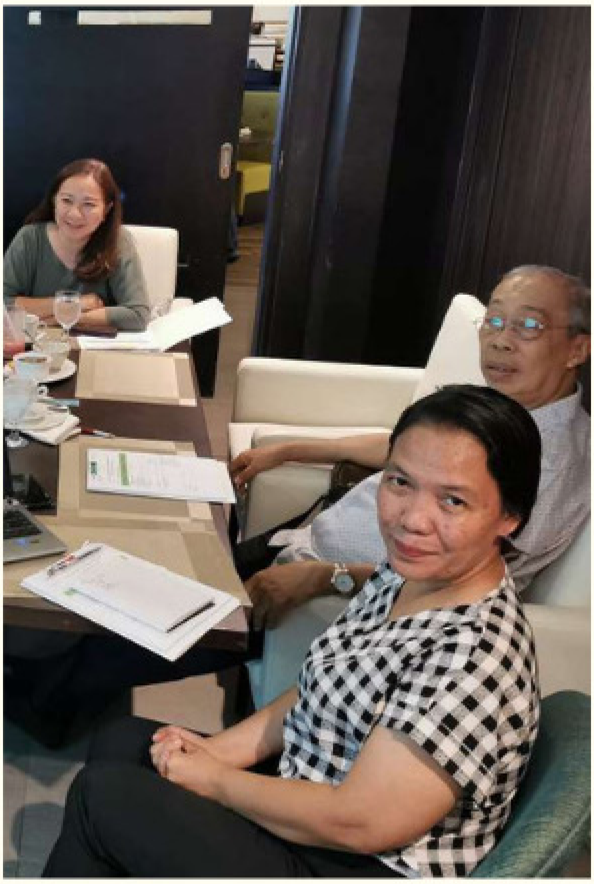
SALARY

1st Valley Bank's compensation package is competitive. The remuneration of the BOD and Senior Management is based on qualifications, merits, and performance.

Regular employees receive their monthly compensation consisting of (a) base salary, and (b) rice allowance. On top of the monthly salary, regular employees also receive (a) guaranteed 15th month pay, (b) productivity pay, and (c) other cash bonuses and incentives.

Yearly, the Bank implements up to 10% salary increase based on merit and length of service. In the last quarter of 2018, management carried out a Php3K-salary increase to non-managerial staff.

Employees must keep their salary information confidential, as compensation is one of the tools to retain high performers.



DIVIDEND

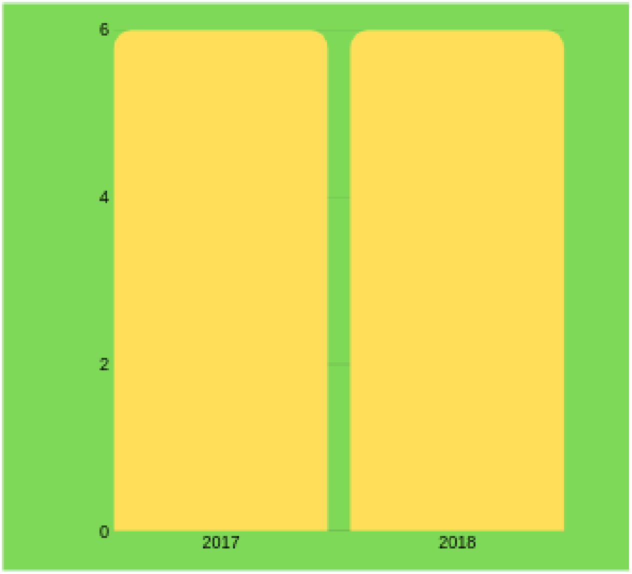
It is the mandate of the Board of Directors to make prudent decisions to ensure stability and sustainable growth for the Bank. In 2017, the BOD declared stock dividends of PHP 127,744,180 which was booked in 2018 resulting in the increase of paid-up capital.

RELATED PARTY TRANSACTIONS

The policies and procedures for transactions between the Bank and its related parties are reviewed, approved and ratified by the Board of Directors. Dealings of the Bank with any of its directors, officers, stockholders, and related parties are strictly based on the following:

Arm's Length Rule

RPTs are treated the same way the Bank treats its regular transactions. They must pass the criteria and requirements set by the Bank and applications will undergo due diligence just as regular transactions do. Branches are prohibited to extend favorable economic terms.



No Conflict of Interest

Applications and all its attachments are fully disclosed to the Board of Directors. No board member or officer is allowed to participate in any deliberation or approval of RPT applications. The application must pass the approval or consent of the majority of the non-conflicted members of the Board.

CY 2018

7.4M

AMOUNT OF RPT

Procedure for Related Party Transactions

Processing of RPTs

The Office of the Vice President for Operations (VPO), upon receipt of documents for related party transaction, provides the Executive Committee of the same seeking approval of the transaction.

The Executive Committee perusing the documents, deliberates on the matter ensuring that the deliberation is properly documented. For transactions that are beyond their threshold, these are endorsed by the Committee to the Board of Directors for their deliberation. The Board either approves or disapproves the endorsed transactions and provides the VPO documentation of their decision.

Upon receipt of the approval and its documentation, the VPO facilitates the transactions. For its part, the Compliance Department prepares the report, along with all the required attachments and submits it to the BSP within the reglementary period.

1VBDB also strictly observes disclosure requirements such as documentation of all related party transactions including accommodation and guarantees, submission of quarterly report on material exposures, reporting of lease and other contracts, as well as securing the approval of the Monetary Board prior to writing off loans, other credit accommodations, advances, and other assets covered by related party transactions.

Related party transactions are disclosed in the Bank's audited financial statements and other applicable filings in accordance with the relevant rules and regulations, issuances of the BSP, SEC and other regulatory bodies.

SELF ASSESSMENT

2018 Annual Self-Assessment

PARTICULARS	AVERAGE RATING
BOARD OF DIRECTORS	4.53
BOD PERFORMANCE	4.63
CORPORATE SECRETARY	4.50
EXECUTIVE AND AUDIT COMMITTEE	5.00
INTERNAL AUDITOR	5.00
EXTERNAL AUDITOR	5.00
COMPLIANCE OFFICER	4.00
COMPLIANCE SYSTEM & OTHERS	4.94

RATING SCALE:
1 – Practice/Principle is not adopted in the company's Manual of Corporate Governance
3 – Practice/Principle is adopted and compliance has been made but with MAJOR deviations.
4 – Practice/Principle is adopted and compliance has been made but with MINOR deviations.
5 – Practice/Principle is adopted in the Manual and full compliance with the same has been made.

EVALUATING THE EFFECTIVENESS OF THE BOARD

1VBDB Board of Directors, through the Corporate Governance Committee, performs an annual assessment to determine their effectiveness and efficiency in the discharge of their duties and responsibilities.

The bank evaluates the performance of the board as a governing body, its board-level committees and individual directors by using a standard self-assessment. The Corporate Governance Committee processes the result of the evaluation and reports them to the Board promptly. Any identified gaps or weaknesses are discussed by the Board, and then they act on these accordingly.

COMPLIANCE

The Audit and Compliance Committee (ACC) is responsible for defining the Bank's compliance function, standing authority and independence. It sets up the Compliance Department consisting of a Chief Compliance Officer, Compliance Managers, and Compliance staff. The team works to ensure that all units are compliant to both internal and external policies and regulations. Together with the Risk Department, the Compliance Team identify risk exposures and implement appropriate controls to protect the Bank from such risks. The ACC oversees the performance of the Compliance Department and evaluates the effectiveness and adequacy of the Compliance Program. The Committee is also responsible and accountable for ensuring that Senior Management is effectively addressing compliance issues based on the reports submitted by the Compliance Department.

INTERNAL AUDIT

Internal Audit is under the supervision of the ACC with the latter ensuring that both Audit and Compliance Departments have full, free, and unrestricted access to any and all operating and financial records, information, and system and applications, physical properties, activities, and personnel relevant to the performance of their duties. The Department must conduct fair, objective, and comprehensive engagements. They must be able to provide sound advice and recommend solutions to any problems or challenges that they may encounter or identify during the course of their audit engagements.

EFFECTIVE INTERNAL CONTROL

The Board of Directors, through the Audit Compliance Committee, has the overall responsibility in determining and measuring the effectiveness of the Bank's internal control system. The Bank implements the 3-step approach: (1) reviewing and evaluating the policies of the Bank, (2) assessing the adequacy and effectiveness of internal controls, and (3) measuring bank efficiency.

The BOD performs a regular review and evaluation of existing policies if these are sufficient and strong enough to ensure that the Bank is protected against risks and compliant to industry laws and regulations. In determining adequacy and effectiveness of the internal control system, the three departments- Risk, Compliance, and Internal Audit work together to perform tests and measurement and based on the results, decide whether to reduce or add, upgrade or downgrade controls. Then the 3rd step involves measuring the impact of the controls to: (a) operational efficiency and effectiveness; (b) compliance of the Bank with laws and regulations; and (c) risk management. The Bank recognizes that to achieve its strategic plan, its internal control system must be strong and effective.

MEETING GOALS AND OBJECTIVES

An effective and sound internal control system ensures that 1VBDB meets its goals and objectives. The Board of Directors must actively monitor the effectiveness and adequacy of the system and ensure that any problems or gaps are addressed promptly and appropriately.

It is also important for both the BOD and Senior Management to promote a culture of accountability. All employees must understand and value their role in maintaining effective internal controls.

BRIGADA ESKWELA

1st Valley Bank, Inc., A Development Bank Pays It Forward

HELPING CLEAN THE SURROUNDINGS

Brigada Eskwela is a nationwide initiative by DepEd that mobilizes various sectors to volunteer in doing maintenance work, clean-up, or repairs of public schools.

DISTRIBUTING SCHOOL SUPPLIES

1st Valley Bank, Inc., A Development Bank, has been a consistent partner of DepEd to ensure the success of the program. 1VBDB employees volunteer their resources, skills and time to participate in the program.

SPONSORING THE FEEDING PROGRAM

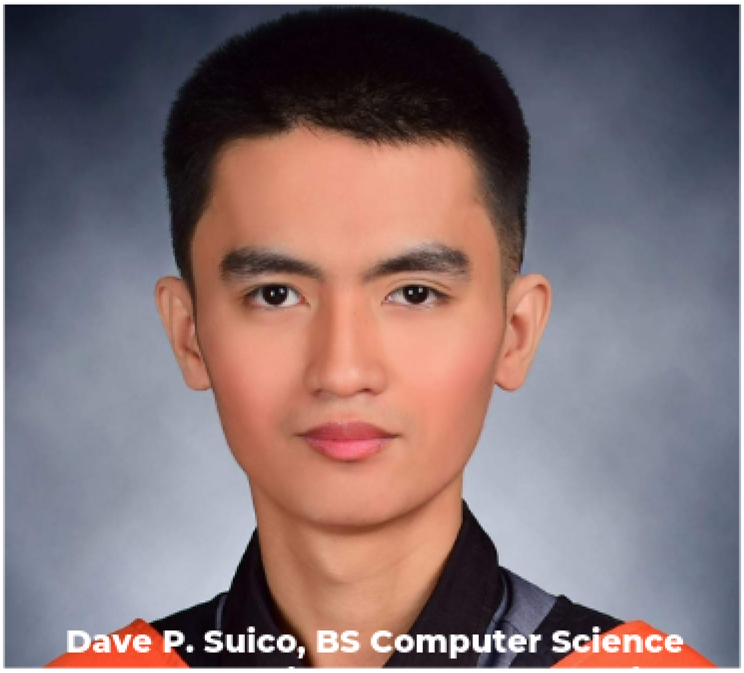
Aside from assisting in the clean-up, repairs, and maintenance, 1VBDB also sponsors feeding programs and the distribution of school supplies to the students.

Making Their Dreams Come True

THE GIYONG & NENE LIM FOUNDATION

1VBDB, through the Giyong & Nene Lim Foundation, grants full college scholarship to deserving students empowering them to make their dreams come true. In 2018, three of the eight scholars have graduated from their preferred degree- Dave P. Suico, John Adriel C. Paraguya, and Russel O. Pantalita. Dave and Russel are now gainfully employed by the Bank while John is currently reviewing for the board examination.

Russel Jane O. Pantalita, BS Business Administration (Financial Management)



Dave P. Suico, BS Computer Science

It has always been the dream of Dave P. Suico to become a software developer. Since the time he first entered school as kindergarten at four (4) years old up to when he graduated from college at 20 years old, Dave has managed to maintain good grades.

This isn't surprising as both his father, Dindo L. Suico, who is presently an officer of 1VBDB's Maranding Branch, and his aunt, Ervie E. Cane, formerly head of the Microfinance, are both achievers. Genes and diligence are potent combination.

Dave was able to secure the foundation's scholarship grant on his own merit. He proved to be worthy, as he was able to earn his degree in Computer Science from Christ the King in Maranding Lala Lanao del Norte en route to being a software developer, his dream.

"I am grateful to 1st Valley Bank and to the foundation for financing my college degree. This is a big help for me and my family. As we didn't have to worry about my tuition fees, I was able to focus on my studies. Thank you for the scholarship. It is a once in a lifetime opportunity to achieve my dream."

-Dave P. Suico

John Adriel Paraguya, meanwhile, is diligently reviewing for the board examination, as this is his key to realize his dream of becoming a certified public accountant.

For John Adriel's family, the scholarship was a blessing as without it, they would find it difficult and challenging to send him to school to reach his dream. Money was their greatest predicament, especially when John's Father suffered from debilitating arthritis which constrained him to give up his job. Thus, John's mother had to take over as the breadwinner of the family.

Luck is on John's side, however, as he came to know 1st Valley Bank and applied for the Giyong and Nene Lim foundation's scholarship. John was able to qualify for a full grant which enabled him to complete his course without burdening his family, particularly her mother.

For her part, Russel Jane O. Pantalita looks back at her scholarship with much gratefulness. Like John, Russel could hardly enter college and make her dream come true due to her family's tight financial situation.

Thanks to good fortune and her earnest desire to earn her degree, Russel was able to secure a full grant scholarship from the Giyong and Nene Lim foundation. Now, Russel is working as a teller of 1VBDB's Maramag Branch and she helps meet the financial needs of her family through her salary.

Dave, John, and Russel are just three of the many scholars whose lives have changed for the better. 1VBDB, through the Giyong and Nene Lim Foundation, continues to grant scholarships and create a difference in the lives of deserving students.


John Adriel C. Paraguya, BS Accountancy

"The scholarship was a great help during my college years. If not because of it, I wouldn't be who I am today. It was the turning point that I will always remember, and I am proud to say that I am a product of 1st Valley Bank's Giyong and Nene scholarship."

Agribusiness Executive Program

THE PROGRAM

1VBDB sent two of the best management executives to University of the Asia & Pacific (UA&P) to complete the The Agribusiness Executives' Program. They graduated in 10 November 2018.

This program is designed to develop the managerial, analytical, and strategic thinking skills of executives and managers. The Bank shouldered the cost inclusive of all expenses necessary to complete the program.

CREDENTIALS

The credentials of Yu and Alfon are both impressive, that empowered them to qualify for the program on a full grant.

Peter M. Alfon, a known disciplinarian, is a consistent top achiever in leading his branches to meet or exceed their targets. Yu, meanwhile, is a proven high performer extolled for his work ethics.

BENEFITS TO CONSUMERS

1VBDB regularly sends their employees to continuing and specialized programs not only to advance their careers, but also to benefit the Bank's consumers. Through enhancing their employee's capabilities and competencies, 1VBDB is able to assure their consumers that only the best products and services are delivered to their doorsteps.

CONSUMERS COME 1ST!

For 1st Valley Bank, serving the needs of consumers is at the core of its existence.

1st Valley Bank Consumer Protection & Assistance

CONSUMER PROTECTION

1K+ QUERIES ENTERTAINED

10/12 COMPLAINTS RESOLVED

2 COMPLAINTS ESCALATED TO LEGAL

In 2018, the Bank has created its Consumer Assistance group page on Facebook (https://www.facebook.com/groups/1VBconsumerassistance/) aimed at helping 1VBDB consumers make well-informed financial decisions. This is on top of the Bank's official Facebook page (https://www.facebook.com/1stValleyBank/).

Consumers may at any time approach the 1VBDB Consumer Protection team, any staff, or use the Bank's social media accounts to get the information they need to make prudent decisions, clarify issues, or to get solutions for their complaints.

They may also accomplish the form at https://www.1stvalleybank.com.ph/concern.php for their concerns.

1st Valley Bank Consumer Protection & Assistance

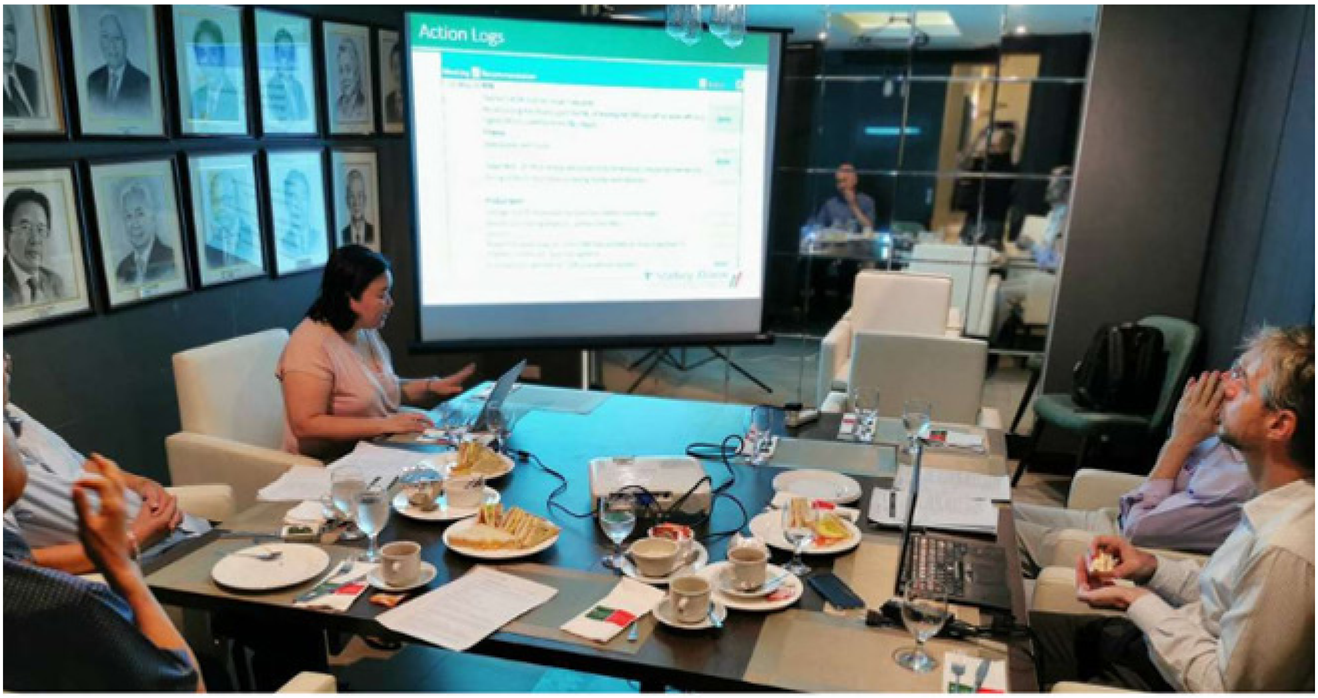
Different Customer Experience

Delivering a different customer experience is integral to 1st Valley Bank, Inc., A Development Bank. It strives to keep its customers happy and satisfied through building a seamless customer experience.

What 1VBDB Did in 2018:

- The Bank prioritized the needs of consumers. The Consumer Assistance Department created the Facebook group page to provide consumers easy access to solutions and information they need to make prudent financial decisions.
- The IT Department enhanced the system to capture relevant customer data that will enable the Bank to level up their customer journey and experience.
- The HR Department provided continued training on customer service to upgrade the skills of the employees.
- Branches have conducted their respective financial literacy campaigns to educate their consumers on how to: (1) benefit from the products and services of the Bank; (2) manage their finances and prevent over-indebtedness.

WWW.1STVALLEYBANK.COM.PH



BOARD OF DIRECTORS

The Board of Directors provides the overall oversight of all consumer protection and assistance programs. It has to ensure that the Bank is running effective programs to address and protect the rights of the Bank's consumers: right to information, right to choose, right to redress, and right to financial education. The Board must see to it resources are available for the successful implementation of consumer protection and assistance activities.

SENIOR MANAGEMENT

Senior Management directly supervises the Consumer Protection and Assistance Department in implementing the policies and programs meant to protect financial consumer rights. Part of this supervision is to strictly monitor the effectiveness of the consumer protection risk management system. The system must be able to address and prevent risks to both the consumers and the Bank. Senior Management is accountable for the Bank's compliance to financial consumer protection laws, rules and regulations.

CONSUMER RISK MANAGEMENT

Consumers can trust that 1st Valley Bank, in conducting its business, has their best interests

Together with the Risk Department, the Consumer Protection and Assistance Department of 1VBDB identifies existing and potential consumer risks to prevent, avoid, or address consumer compliance issues. Risk identification allows management to be proactive in managing risks before these will have adverse effect on the Bank's condition.

In 2018, 1VBDB focused on consumer compliance risk management for social media. The Risk Department has communicated to all employees the Bank's social media policy along with data privacy policy.

The consumer risk management system of the Bank consists of: (a) governance structure, (b) policies and procedures, (c) consumer compliance training, (d) risk, compliance, and audit monitoring of consumer risks, (e) effective process to resolve complaints, (f) feedback mechanism, and (g) documentation including consumer protection manual.

The social media accounts of 1VBDB is a platform that allows consumers to submit their feedback or send their concerns to management. Facebook administrators are responsible for responding to messages and for routing messages that can be best resolved or answered by specific department, unit, or staff. End of year statistics showed that 99% of messages have been responded.

https://www.facebook.com/1stvalleybank

CONSUMER ASSISTANCE MANAGEMENT SYSTEM

The Consumer Assistance Department is the lead unit in finding the most appropriate resolution for complaints, issues, and concerns of 1VBDB consumers. All customer-facing employees, however, are required to assist clients to the best of their ability.

Consumers have several ways to send their concerns and feedback: (1) website at www.1stvalleybank.com.ph, (2) facebook account and group page, (3) email at info@1stvalleybank.com, and (4) approach staff at branch locations.

Facebook administrators are tasked to provide fast answers and solutions to all inquiries sent through the page. Branch staff handles complaints of their clients and escalate to the Consumer Assistance Department if necessary.

HOW 1VBDB HANDLES COMPLAINTS

Clients are advised to accomplish the prescribed form to send their concerns or file their complaints. The Consumer Assistance Department of the Bank handles the written complaints.

Upon receipt of the complaint, the Consumer Assistance Department isolates the problem and determines the root cause. Then the Department coordinates with all concerned to come up with the best solution to the problem within reasonable time. Otherwise, the Department communicates with the complainant to set expectations.

As soon as the resolution is ready and executory, the Consumer Assistance Department notifies the complainant.

> *The Department coordinates with all concerned to come up with the best solution to the problem within reasonable time*

The Bank has also installed a chatbot application to its Facebook page to ensure that all messages are attended to 24/7. A live staff talks to consumers from 8 in the morning until about 6 in the afternoon from Mondays to Saturdays, or as requested by consumers. Consumers may also get all the basic information they need about their financial solutions through the Bank's social media accounts. It is always the goal of 1st Valley Bank, Inc., A Development Bank to keep its consumers satisfied.

Eat Today? Thank a Farmer!

BY IVY MAE A. RODRIGUEZ

Food is one of our essential needs to survive. Regardless of who we are, our body requires a variety of nutrients that we can get from food. Isn't this reason enough to be grateful to our farmers who supply us with the food our body needs?

Mario B. Cataylo, a 50-year old farmer married to Anita B. Cataylo with 3 children and residing at Brgy. Banay-Banay, Bayawan City, is one of our Bayawan Branch's pioneer Supervised Credit (SUCRE) clients.

Farming is the only source of living for the Cataylo family, even when he was still single. The four (4)-hectare farm land that Mario is cultivating now was inherited from his father, also a farmer.

"Ang rice financing sang 1st Valley Bank perti gid kanami, indi na maglingin ang amon ulo kung sa diin kami makakita panggasto sa talamnan namon, dako gid nabulig sa amon kabuhi!"
- Mario Cataylo

Life then was difficult for the Cataylo's considering the meager income they get from farming. In fact, Mario wasn't able to complete his primary studies since their income at that time was just sufficient to sustain their basic needs.

At an early age of 19, Mario entered his married life with income from farming as their source of living. It wasn't easy especially with low harvest and challenges brought by calamities. On top of these, he needed funds to sustain his farming activities.

This is where 1st Valley Bank or 1VB has made a difference in his life. On June 2015, the then newly opened branch in Bayawan conducted its Supervised Credit (SUCRE) orientation program at Barangay Agricultural Development

Continuation of Eat Today, Thank a Farmer

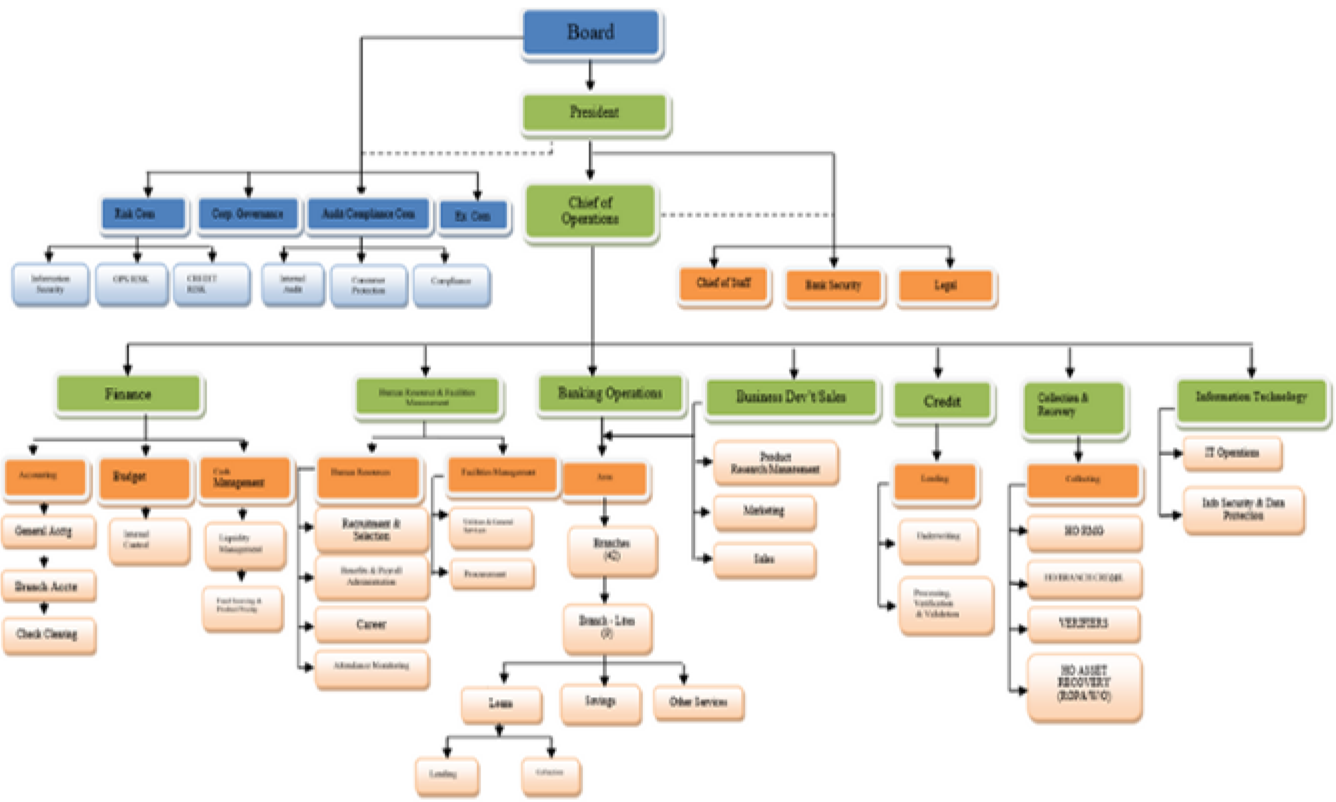
Center or BADC. The orientation venue is about 31 kilometers from the Branch. Mario attended the orientation. Satisfied with the product features, he decided to avail the loan immediately.

At present, Mario is on his 6th cycle as responsible borrower of the SUCRE loan. Through the funds, he was able to acquire the following equipment: 1 thresher, 1 hand tractor, and a water pump. Further, Mario received 2.75 hectares of rice field under Arrendo (lease/contractual) Agreement from his neighbor. He then purchased an IZUZU 10 wheeler truck financed by 1VB's Bayawan Branch.

"*Ang Rice financing sang 1st Valley Bank perti gid kanami, indi na maglingin ang amon ulo kung sa diin kami makakita panggasto sa talamnan namon, Dako gid nabulig sa amon kabuhi*" (The rice financing of 1st Valley Bank is so beneficial that we no longer experience any difficulty in finding the funds to sustain our farm production and activities. It has helped us tremendously.), Mario quips.

Additionally, he said that "*Kag ang mga empleyado sa bangko indi gid kahuyaan, malapitan gid namon dayon, MADAMO GID NA SALAMA*T (The employees of the Bank are friendly and accommodating that you will not hesitate to approach them for your funding needs. Thank you very much).

There's food on your table because of farmers like Mario Cataylo. It's just fitting that we also thank them! ��



ORGANIZATIONAL STRUCTURE

1st Valley Bank, Inc., A Development Bank (1VBDB) maintains a dynamic and flexible organizational structure. From time to time, the core management reviews the structure to simplify it. Simplifying the structure will empower the Bank to increase its operational efficiencies, improve compliance with regulatory requirements, and save on cost.

The 2018 organizational structure of the Bank was designed to match the Bank's strategic needs. While Compliance remains to be a priority, 1VB management has also restructured Risk, Internal Audit, IT, and Consumer Protection to ensure the achievement of its strategic goals.

STOCKHOLDERS

1VBDB stockholders have important roles in ensuring the growth and development of the Bank.

Name	Nationality	No. of Shares	Percentage	Voting Status
Lim Family Group	Filipino	33,312,276	43.46	*
Bridge Philippines Investment Pte. Ltd	Singaporean	26,826,278	35.00	*
Te Family Group	Filipino	11,989,624	15.64	*
Diaz Family Group	Filipino	2,615,880	3.41	*
Others	Filipino	1,902,450	2.49	*
TOTAL		**76,646,508**	**100.00**	

*eligible to vote

WEBSITE & FACEBOOK

Official website of the Bank at https://www.1stvalleybank.com.ph Facebook page is at facebook.com/1stvalleybank

www.1stvalleybank.com.ph

facebook.com/1stvalleybank

PUSH PRODUCTS

SUPERVISED CREDIT

Farmers in possession of agricultural land can avail funds for their crop production. Aside from the provision of funds, this product also extends technical assistance to increase the client's chances to harvest profitably.

These are just some of the benefits of the product: increase in crop production and yield, sustainable farming, access to low-cost farm input, market linkage enabling higher selling price of crops.

Product Head: Errol C. Dioso

SME LOANS

These loans provide funds to small and medium entrepreneurs engaged in legitimate wholesale or retail businesses. Clients may avail SME loans (1) to get funds for their business, (2) to acquire trucks or other vehicles through a chattel mortgage, and (3) for trade check discounting.

Experience utmost convenience and accessibility through 1VBDB's extensive branch networks. Clients can save significantly from lower interest rate and flexible terms of the loan.

Product Head: Bernard C. Paderes

PUSH PRODUCTS

MICROFINANCE

This loan program provides micro-entrepreneurial poor and low-income individuals the access to affordable funds they need to grow their business. Those who have limited or no access to banking services will benefit the most from any of these microfinance products: FAME (Financial Assistance to Micro Entrepreneurs), MAP (Micro Agri Product), HOME (Home Ownership for Micro Entrepreneurs), and MICRO PLUS (a special loan for existing clients).

Product Head: Andre M. Ates

JEWELRY BUSINESS LOANS

Clients who need immediate funds will only have to submit their jewelry items to get the cash they need to expand their business.

For personal purposes, clients may avail 1VBDB's Gold & Gems regular loan at the most affordable interest rate. The Bank guarantees the safety of the jewelry items while in their possession.

Product Head: Andre M. Ates

PUSH PRODUCTS

SMALL BUSINESS LOANS

These affordable multi-purpose loans for business owners allow them to secure funds for their business. Clients may borrow up to P300K for as low as 1.67% monthly interest on diminishing balance payable within 12 months or up to one (1) year.

Product Head: Andre M. Ates

AGRICULTURAL LOANS

These are low-interest secured loans that enable farmers to manage their farms more efficiently. Farmers can use the funds to expand their farm lot, cover for their operating expenses, purchase equipment they need, or to increase their production yield.

Farmers may borrow from P100K up payable up to five (5) years. Interest rate starts at 12% to 16% per annum on diminishing balance. There is no need for co-makers but the client has to submit collateral to secure the loan.

Product Head: Muamar Carba

SALARY LOANS

PAYROLL DEDUCTION

This type of salary loan is granted to public school teachers with a regular appointment from the Department of Education (DepEd) and whose regions have an existing memorandum of agreement with 1VBDB. Repayment of the loan is through automatic payroll deduction authorized by DepEd.

Product Manager: Jubal Y. Yu

ATM + BONUS LOANS

These are salary loans granted to public school teachers with a regular appointment from the Department of Education (DepEd) charged against their ATM and Bonuses.

To avail the loan, borrowers must surrender their ATM cards to their 1VBDB servicing branch. They can choose to avail: (1) ATM loan only, or (2) ATM + Bonus loans. To qualify for Bonus loan, they must first qualify and avail 1VBDB's ATM loan.

For existing clients, they can get as much as P215K or P145K ATM and up to P70K for Bonus loans.

Product Head: Jubal Y. Yu

SALARY LOANS

BARANGAY LOANS

These loans are granted to elected (chairman, kagawad) and appointed (treasurer, secretary) barangay officials whose agencies have entered into a memorandum of agreement with 1VBDB.

Borrowers can get up to P200K amortized monthly through payroll deduction payable within two (2) years at 1.8% monthly interest.

Product Head: Jubal Y. Yu

LGU LOANS

These loans are for regular employees of local government units that have existing memorandum of agreement with us.

Borrowers can avail up to P500K amortized through payroll deduction. Interest rate is at 1.53% monthly with the total amount of interest and principal payable in three (3) years.

Product Head: Jubal Y. Yu

SAVINGS DEPOSIT

REGULAR SAVINGS

Savings account that earns modest interest per annum. Initial deposit is P1K while maintaining balance is also at P1K to earn interest. This account comes with a passbook.

Product Head: Bobbie C. Paye

SPECIAL SAVINGS

These savings accounts earn higher interests and some accounts are required for:

SD MICRO are savings deposit accounts for micro-entrepreneurs who are enrolled under the program.

SSD MICRO is a contractual savings account that forms part of the microloan guarantee.

HANDOG SAVINGS is a deposit program for microfinance and supervised credit clients. The minimum deposit is P500 or 1% of the loan amount for supervised credit and SSD pledge of P10K for microfinance.

SSD REGULAR is a build-up savings deposit that forms part of the regular loans of the clients. Initial deposit is from Php 300 to Php 1,000 that builds up every loan renewal.

Product Head: Bobbie C. Paye

SAVINGS DEPOSIT

TIME DEPOSIT

SD PLUS is a time deposit account that earns interest higher than regular and special savings deposits. Evidenced by a passbook, deposits can earn up to 4.5% per annum on a 3-year term. The interest rate varies depending on the amount and term of the deposit.

	Below P1M	P1M-Above
90-DAY	2.75%	3.00%
180-DAY	3.00%	3.25%
1-YEAR	3.50%	4.00%
2-YEAR	3.75%	4.25%
3-YEAR	4.00%	4.50%

Product Head: Bobbie C. Paye

DEMAND DEPOSIT

1st CHECKING ACCOUNT is an interest-bearing current account that comes with a passbook. Maintaining balance is only at P5K, but to earn interest, maintaining balance must be at P10K up.

Initial deposit is at P2K for a personal account and P5K for business account. All account applications are subject to evaluation and completion of requirements.

Product Head: Bobbie C. Paye

SERVICES

ATM

1VBDB provides a highly secure and effective wireless automated teller services 24/7 interconnected with BANCNET, MEGALINK, and EXPRESSNET that allow ATM holders to self-manage their transactions such as withdrawal, checking of real-time balances.

MOBILE BANKING

Using the G-Cash platform, 1VBDB offers the revolutionary power of mobile commerce. Users enjoy the convenience, mobility, and security that come with the platform. Clients can use the service for bills payment, two-way remittances, deposits, cash withdrawals, transfer loads, anywhere anytime.

BRANCH NETWORKING

Clients can conveniently transact businesses such as deposits, withdrawals and check encashment in any 1VBDB branches.

DIRECTORY

Branch:	Aglayan
Address:	Sayre Highway Purok 1, Aglayan, Malaybalay City, Bukidnon
Contact Number:	(088) 813-0933, 0955 139 2431, 09759457883
Email Address:	aglayan@1stvalleybank.com

Branch:	Aurora
Address:	National Highway Cor Bonifacio St. Aurora, Zamboanga del Sur
Contact Number:	(062) 331-2408, 0917 819 5696
Email Address:	aurora@1stvalleybank.com

Branch:	Bacolod
Address:	Purok 3, Poblacion Bacolod, Lanao del Norte
Contact Number:	(063) 227-2197, 09178496946
Email Address:	bacolod@1stvalleybank.com

Branch:	Baroy
Address:	National Highway, Poblacion, Baroy, Lanao del Norte
Contact Number:	(063)-227-7242, 0908 865 5076, 0935 821 1705
Email Address:	baroy@1stvalleybank.com

Branch:	Balingasag
Address:	National Highway, Linggangao, Balingasag, Misamis Oriental
Contact Number:	0926 567 7633
Email Address:	balingasag@1stvalleybank.com

Branch:	Bayawan
Address:	G/F LCJ Bldg. Natl Highway,Pob. Bayawan City, Negros Oriental
Contact Number:	(035) 430-0498, 0995 957 5803
Email Address:	bayawan@1stvalleybank.com

DIRECTORY

Branch:	Aglayan
Address:	Sayre Highway Purok 1, Aglayan, Malaybalay City, Bukidnon
Contact Number:	(088) 813-0933, 0955 139 2431, 09759457883
Email Address:	aglayan@1stvalleybank.com

Branch:	Aurora
Address:	National Highway Cor Bonifacio St. Aurora, Zamboanga del Sur
Contact Number:	(062) 331-2408, 0917 819 5696
Email Address:	aurora@1stvalleybank.com

Branch:	Bacolod
Address:	Purok 3, Poblacion Bacolod, Lanao del Norte
Contact Number:	(063) 227-2197, 09178496946
Email Address:	bacolod@1stvalleybank.com

Branch:	Baroy
Address:	National Highway, Poblacion, Baroy, Lanao del Norte
Contact Number:	(063)-227-7242, 0908 865 5076, 0935 821 1705
Email Address:	baroy@1stvalleybank.com

Branch:	Balingasag
Address:	National Highway, Linggangao, Balingasag, Misamis Oriental
Contact Number:	(088) 333-5966
Email Address:	balingasag@1stvalleybank.com

Branch:	Bayawan
Address:	G/F LCJ Bldg. Natl Highway,Pob. Bayawan City, Negros Oriental
Contact Number:	(035) 430-0498, 0917-848-2630
Email Address:	bayawan@1stvalleybank.com

DIRECTORY

Branch:	Bayugan
Address:	Santiago Bldg. Purok 15 Rotonda, Poblacion Bayugan City
Contact Number:	(085) 303-0401, 0909-436-2807, 0917-819-6510
Email Address:	bayugan@1stvalleybank.com

Branch:	Butuan
Address:	G/F PS Arcade, Gov. J. Rosales Ave. Imadejas, Butuan City
Contact Number:	(085) 816-1151, 0912-705 4856, 0995-275-5343
Email Address:	butuan@1stvalleybank.com

Branch:	Buug
Address:	National Highway, Pob. Buug, Zamboanga Sibugay Province
Contact Number:	09178498457, 09171607745
Email Address:	buug@1stvalleybank.com

Branch:	Cabadbaran Branch Lite
Address:	A. Curato St., P-2, Brgy -8, Cabadbaran City
Contact Number:	(085) 818-5595, 9079041046, 0917-819-6691
Email Address:	cabadbaran@1stvalleybank.com

Branch:	Calamba Branch Lite
Address:	Purok 4, Barangay Don Bernardo, Calamba, Misamis Occidental
Contact Number:	(088) 564 8135, 0948-777-3949, 0965-583-8801
Email Address:	calamba@1stvalleybank.com

Branch:	Camiguin Branch Lite
Address:	EbarleBuildingLacasPoblacionMambajao,CamiguinProvince
Contact Number:	(088) 387-0582, 09178482579
Email Address:	camiguin@1stvalleybank.com

DIRECTORY

Branch:	Cagayan de Oro (CDO)
Address:	Vamenta Boulevard corner Lirio Street, Carmen, CDO
Contact Number:	(088) 858-4196, 088-850-1871, 0908 865 5084, 0956-536-7899
Email Address:	cdo@1stvalleybank.com

Branch:	Clarin Branch Lite
Address:	Rizal St. Poblacion II, Clarin, Misamis Occidental
Contact Number:	((088) 521-2997, 0917 538 8293 , 0912 286 6231
Email Address:	clarin@1stvalleybank.com

Branch:	Davao
Address:	FLM Bldg.185 Door 3 & 4, G/F, Iñigo St, Davao City
Contact Number:	(082) 222-8032, 0997 391 2005, 0998 961 2347
Email Address:	davao@1stvalleybank.com

Branch:	Digos
Address:	Rizal Avenue corner Doña Aurora St. Digos City, Davao del Sur
Contact Number:	082-237-6347, 082-333-0402, 0927 524 2313
Email Address:	digos@1stvalleybank.com

Branch:	Dipolog
Address:	Juan Luna corner Osmeña Street, Dipolog City
Contact Number:	(065) 212-4952/4961, 09171094750
Email Address:	dipolog@1stvalleybank.com

Branch:	Dumaguete
Address:	Martinez Bldg., Daan Taytayan Road, Calindagan, Dumaguete City
Contact Number:	(035) 422-5096, 0917 849 7112
Email Address:	dumaguete@1stvalleybank.com

DIRECTORY

Branch:	Dumalinao
Address:	National Highway, Paglaum, Dumalinao, Zamboanga del Sur
Contact Number:	(062) 945-0530, 0917 819 5398
Email Address:	dumalinao@1stvalleybank.com

Branch:	Dumingag
Address:	Magsaysay, Ave., cor. Lapu-Lapu St. Brgy. San Pedro, Dumingag
Contact Number:	09303442725, 0998 966 8571
Email Address:	dumingag@1stvalleybank.com

Branch:	Gingoog
Address:	Militante Bldg. National Highway, Gingoog City
Contact Number:	(088) 861-3098, 0917-816-3872
Email Address:	gingoog@1stvalleybank.com

Branch:	Guiwan
Address:	MCLL Highway, Guiwan, Zamboanga City
Contact Number:	(062) 984-1261, 09178498413
Email Address:	guiwan@1stvalleybank.com

Branch:	Iligan
Address:	Celestina Bldg. Roxas Ave. cor De Leon St. Iligan City, Lanao del Norte
Contact Number:	(063) 221-3862, 09178497131
Email Address:	iligan@1stvalleybank.com

Branch:	Imelda
Address:	Clark Rizal, Poblacion, Imelda,Zamboanga Sibugay Province
Contact Number:	(062) 955-2388, 0907-496-5608 / 0935-676-2781
Email Address:	imelda@1stvalleybank.com

DIRECTORY

Branch:	Initao
Address:	Uy Bldg. Purok 14, Poblacion, Initao, Misamis Oriental
Contact Number:	(088) 555-0593, 0908-865 5100 / 0995-957 5789
Email Address:	initao@1stvalleybank.com

Branch:	Ipil
Address:	National Highway, Sanito, Ipil, Zamboanga Sibugay Province
Contact Number:	(062) 955-2379, 09178497181
Email Address:	ipil@1stvalleybank.com

Branch:	Jimenez Branch Lite
Address:	Agora Market, Butuay Jimenez, Misamis Occidental
Contact Number:	(088) 545-0155, 0908 865 5080
Email Address:	jimenez@1stvalleybank.com

Branch:	Kabankalan
Address:	Centrum Bldg. Negros South Road cor Guanzon St., Kabankalan City
Contact Number:	(034) 471-0173, 0995 395 8246
Email Address:	kabankalan@1stvalleybank.com

Branch:	Kalilangan Branch Lite
Address:	Purok 4, West Poblacion, Kalilangan Bukidnon
Contact Number:	0936-762-2268, 0995-957-5773 , 0998-843-7011
Email Address:	kalilangan@1stvalleybank.com

Branch:	Kapatagan
Address:	National Highway, Poblacion, Kapatagan, Lanao del Norte
Contact Number:	(063) 382-8025, (063) 227-9588, 09088655077, 09952755348
Email Address:	kapatagan@1stvalleybank.com

DIRECTORY

Branch:	Koronadal
Address:	PA Building General Santos Drive cor CASA Subd Koronadal
Contact Number:	(083)-310-0865, (083)-877-6243
Email Address:	koronadal@1stvalleybank.com

Branch:	La Carlota
Address:	Burgos St. Corner Gurrea St., La Carlota City, Negros Occidental
Contact Number:	(034) 454-1943, 0946 967 5119 / 0995 957 5793
Email Address:	lacarlota@1stvalleybank.com

Branch:	Liloy
Address:	Chan Building Baybay, Liloy, Zamboanga del Norte
Contact Number:	09178390855, 09266088094
Email Address:	liloy@1stvalleybank.com

Branch:	Manukan
Address:	Caridad Town Center, Pob. Manukan, Zamboanga del Norte
Contact Number:	0998 868 8399
Email Address:	manukan@1stvalleybank.com

Branch:	Maramag
Address:	Quezon Ave., South Poblacion, Maramag, Bukidnon
Contact Number:	0975 331 0452
Email Address:	maramag@1stvalleybank.com

Branch:	Maranding & Lala Branch Lite
Address:	National Highway, Maranding, Lala, Lanao del Norte
Contact Number:	(062) 991-2388, 0908 865 5085, 09177231524
Email Address:	maranding@1stvalleybank.com

DIRECTORY

Branch:	Margosatubig
Address:	Jose Rizal St., Poblacion, Margosatubig, Zamboanga del Sur
Contact Number:	09178497038/ 09297737477
Email Address:	margosatubig@1stvalleybank.com

Branch:	Molave
Address:	Mabini St. Cor. Abad Santos St., Brgy. Madasigon Molave, ZDS
Contact Number:	(062) 225-1464, 09178496991, 09060985822
Email Address:	molave@1stvalleybank.com

Branch:	Oroquieta
Address:	AE Bldg. Sen Jose Ozamiz St. Capitol Drive Pob. 1 Oroquieta City
Contact Number:	(088) 531-0383, 0977 805 0748, 0908 894 5194
Email Address:	oroquieta@1stvalleybank.com

Branch:	Ozamiz 1
Address:	Don Anselmo Bernad Avenue, Ozamiz City, Misamis Occidental
Contact Number:	(088) 521-3785, (088) 521-0112,
Email Address:	ozamiz@1stvalleybank.com

Branch:	Ozamiz 2
Address:	Rizal Ave. Cor. Burgos Street, Ozamiz City, Misamis Occidental
Contact Number:	(088) 521-4122, 0910-7380-511, 0995-275-5347
Email Address:	ozamiz2@1stvalleybank.com

Branch:	Pagadian
Address:	Ariosa Street Santiago District Pagadian City
Contact Number:	(062)214-4937, 0998-549-3822
Email Address:	pagadian@1stvalleybank.com

DIRECTORY

Branch:	San Francisco
Address:	Quezon St, Brgy. 02, Poblacion, San Francisco, Agusan del Sur
Contact Number:	(085) 343-8070, 0948 402 0088
Email Address:	sanfrancisco@1stvalleybank.com

Branch:	San Miguel Branch Lite
Address:	Purok Lapu-lapu, Poblacion, San Miguel, Zamboanga del Sur
Contact Number:	(0909-239-4307
Email Address:	sanmiguel@1stvalleybank.com

Branch:	Sindangan
Address:	Rasonable Bldg., Ramon Magsaysay, Sindangan, Zamboanga del Norte
Contact Number:	(065) 224-2433, 0917-849-8316
Email Address:	sindangan@1stvalleybank.com

Branch:	Tagum
Address:	CI-TGM-GARCIA, Bldg, Garcia St., Cor Bonifacio, St., Tagum City, Davao
Contact Number:	(084) 216-7812, 0917-819-6058, 0912-894-4809
Email Address:	tagum@1stvalleybank.com

Branch:	Talakag
Address:	Noble St., Brgy. 04, Talakag Bukidnon
Contact Number:	09178482547
Email Address:	talakag@1stvalleybank.com

Branch:	Zamboanga Canelar
Address:	Mayor Jaldon Street, Brgy. Canelar, Zamboanga City
Contact Number:	(062)991-2388 , (062)993-2168
Email Address:	zamboanga@1stvalleybank.com

Report of Independent Auditors

The Board of Directors
1st Valley Bank, Inc., A Development Bank
Vamenta Blvd. Corner Lirio Street, Carmen
Cagayan de Oro City

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of 1st Valley Bank, Inc., A Development Bank (the Bank), which comprise the statements of financial position as at December 31, 2018 and 2017, and the statements of comprehensive income, statements of changes in capital funds and statements of cash flows for the years then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards (PFRS).

Basis for Opinion

We conducted our audits in accordance with Philippine Standards on Auditing (PSA). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the Code of Ethics for Professional Accountants in the Philippines (Code of Ethics) together with the ethical requirements that are relevant to our audits of the financial statements in the Philippines, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

As disclosed in Note 1 to the financial statements, on January 13, 2018, the Bank's Board of Directors approved the plan of merger of the Bank with Sugbuanon Rural Bank, Inc. and D'Asian Hills Bank, Inc., with the Bank as the surviving entity. As of December 31, 2018, the Bank's application of merger was already submitted to the Banko Sentral ng Pilipinas and the Securities and Exchange Commission, but still pending approval. The accompanying financial statements have been prepared assuming the Bank will continue as a going concern

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

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

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with PSA will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with PSA, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

PUNONGBAYAN & ARAULLO

By: Ramilito L. Nañola
Partner

CPA Reg. No. 0090741
TIN 109-228-427
PTR No. 7333698, January 3, 2019, Makati City
SEC Group A Accreditation
Partner - No. 0395-AR-3 (until May 19, 2019)
Firm - No. 0002-FR-5 (until Mar. 26, 2021)
BIR AN 08-002511-19-2018 (until Jan. 25, 2021)
Firm's BOA/PRC Cert. of Reg. No. 0002 (until Jul. 24, 2021)

March 20, 2019

1st VALLEY BANK, INC., A DEVELOPMENT BANK
STATEMENTS OF FINANCIAL POSITION
DECEMBER 31, 2018 AND 2017
(Amounts in Philippine Pesos)

	Notes	2018	2017
RESOURCES			
CASH AND OTHER CASH ITEMS	6	**P 74,911,233**	P 133,420,224
DUE FROM BANGKO SENTRAL NG PILIPINAS	6	**370,499,440**	388,796,188
DUE FROM OTHER BANKS	6	**588,053,970**	424,916,385
INVESTMENT SECURITIES AT AMORTIZED COST - Net	7	**529,700,546**	-
HELD-TO-MATURITY INVESTMENTS - Net	7	-	334,655,592
LOANS AND DISCOUNTS - Net	8	**6,863,642,051**	5,399,009,088
BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT - Net	9	**110,193,591**	110,249,673
INVESTMENT PROPERTIES	10	**217,548,139**	225,935,434
OTHER RESOURCES - Net	11	**383,916,738**	183,374,319
TOTAL RESOURCES		**P 9,138,465,708**	P 7,200,356,903
LIABILITIES AND CAPITAL FUNDS			
DEPOSIT LIABILITIES	12	**P 4,158,344,512**	P 4,269,860,953
BILLS PAYABLE	13	**2,461,508,766**	808,892,308
ACCRUED EXPENSES AND OTHER LIABILITIES	14	**508,167,986**	397,369,623
Total Liabilities		**7,128,021,264**	5,476,122,884
CAPITAL FUNDS	15	**2,010,444,444**	1,724,234,019
TOTAL LIABILITIES AND CAPITAL FUNDS		**P 9,138,465,708**	P 7,200,356,903

See Notes to Financial Statements.

1st VALLEY BANK, INC., A DEVELOPMENT BANK
STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017
(Amounts in Philippine Pesos)

	Notes	2018	2017
INTEREST INCOME ON:			
Loans and receivables	8	P 930,066,834	P 779,380,313
Investment securities at amortized cost	7	17,327,346	-
Due from other banks	6	896,050	2,012,640
Held-to-maturity investments	7	-	3,119,374
		948,290,230	784,512,327
INTEREST EXPENSE ON:			
Deposit liabilities	12	134,340,364	137,048,030
Bills payable	13	96,832,415	28,624,740
Others	17	1,404,552	1,312,966
		232,577,331	166,985,736
NET INTEREST INCOME		715,712,899	617,526,591
IMPAIRMENT LOSSES	8, 11	137,830,191	150,479,428
NET INTEREST INCOME AFTER IMPAIRMENT LOSSES		577,882,708	467,047,163
OTHER INCOME	16	432,672,048	330,163,690
OTHER EXPENSES	16	643,374,244	552,852,719
NET INCOME BEFORE TAX		367,180,512	244,358,134
TAX EXPENSE	18	99,193,823	71,153,724
NET INCOME		267,986,689	173,204,410
OTHER COMPREHENSIVE INCOME (LOSS)			
Items that will not be reclassified subsequent to profit or loss:			
Actuarial losses on remeasurements of defined benefit plan	17	(6,584,444)	(4,662,212)
Share in other comprehensive income of associate	11	585,996	-
Tax income	18	2,151,132	1,398,664
		(4,609,111)	(3,263,548)
TOTAL COMPREHENSIVE INCOME		P 263,377,578	P 169,940,862

See Notes to Financial Statements.

1st VALLEY BANK, INC., A DEVELOPMENT BANK
STATEMENTS OF CHANGES IN CAPITAL FUNDS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017
(Amounts in Philippine Pesos)

	Capital Stock (see Note 15)	Stock Dividends Distributable (see Note 15)	Other Reserves (see Note 2)	Remeasurements of Defined Benefit Plan (see Note 17)	Surplus (see Note 2)	Total
Balance at January 1, 2018						
As previously reported	P 638,720,900	P 127,744,180	P 317,239,922	(P 7,153,365)	P 647,682,382	**P 1,724,234,019**
Effect of adoption of PFRS 9, net of tax	-	-	-	-	22,422,649	**22,422,649**
As restated	638,720,900	127,744,180	317,239,922	(7,153,365)	670,105,031	1,746,656,668
Total comprehensive income (loss) for the year	-	-	-	(4,609,111)	267,986,689	263,377,578
Distribution of stock dividends	127,744,180	(127,744,180)	-	-	-	-
Share in other comprehensive income of associate	-	-	-	-	410,198	410,198
Balance at December 31, 2018	**P 766,465,080**	**P -**	**P 317,239,922**	**(P 11,762,476)**	**P 938,501,918**	**P 2,010,444,444**
Balance at January 1, 2017	P 638,720,900	P -	P 317,239,922	(P 3,889,817)	P 602,222,152	P 1,554,293,157
Total comprehensive income (loss) for the year				(3,263,548)	173,204,410	169,940,862
Stock dividends declared	-	127,744,180	-	-	(127,744,180)	-
Balance at December 31, 2017	P 638,720,900	P 127,744,180	P 317,239,922	(P 7,153,365)	P 647,682,382	P 1,724,234,019

See Notes to Financial Statements.

1st VALLEY BANK, INC., A DEVELOPMENT BANK
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017
(Amounts in Philippine Pesos)

	Notes	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income before tax		P 367,180,512	P 244,358,134
Adjustments for:			
Interest income	6, 7, 8	(948,290,230)	(784,512,327)
Impairment losses	8, 11	137,830,191	150,479,428
Interest expense	12, 13, 17	232,577,331	166,985,736
Depreciation and amortization	9, 11	37,539,118	45,519,557
Fair value gain on investment properties	10	(16,903,515)	(18,712,582)
Gain on disposal of non-financial assets	9, 10, 11	3,575,015	(9,850,045)
Equity share in net income of an associate	11	410,198	(9,178,255)
Loss on disposal of bank premises, furniture, fixtures and equipment	9	-	17,090
Operating loss before working capital changes		(186,081,380)	(214,893,264)
Decrease (increase) in loans and discounts		(1,520,904,000)	66,904,059
Increase in investment properties		21,715,795	(1,830,213)
Increase in other resources		(126,631,891)	(36,552,035)
Increase (decrease) in deposit liabilities		(115,143,313)	182,829,485
Increase in accrued expenses and other liabilities		61,752,840	21,947,361
Cash from (used in) operations		(1,865,291,949)	18,405,393
Interest received		889,153,725	753,655,893
Interest paid		(203,705,891)	(187,954,329)
Cash paid for income taxes		(115,938,182)	(83,570,337)
Net Cash From (Used in) Operating Activities		(1,295,782,297)	500,536,620
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to HTM investments	7	(504,984,078)	(539,969,708)
Proceeds from maturity of amortized cost securities	7	309,939,124	-
Advance payment made for investment in DAHBI	11, 21	(40,300,000)	
Acquisition of bank premises, furniture, fixtures and equipment	9	(35,186,167)	(39,557,311)
Proceeds from disposal of bank premises, furniture, fixtures and equipment	9	28,806	2,242,532
Proceeds from maturity of HTM investments	7	-	216,864,000
Acquisition of software	11	-	(9,353,272)
Acquisition of investments in a subsidiary and an associate	11	-	(4,379,086)
Net Cash Used in Investing Activities		(270,502,315)	(374,152,845)
CASH FLOWS FROM FINANCING ACTIVITIES			
Additions to bills payables	13	2,413,916,530	255,467,443
Settlements of bills payables	13	(761,300,072)	(760,031,876)
Net Cash From (Used in) Financing Activities		1,652,616,458	(504,564,433)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		86,331,846	(378,180,658)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD			
Cash and other cash items		133,420,224	89,342,431
Due from Bangko Sentral ng Pilipinas (BSP)		388,796,188	426,678,917
Due from other banks		424,916,385	809,292,107
		947,132,797	1,325,313,455
CASH AND CASH EQUIVALENTS AT END OF PERIOD			
Cash and other cash items		74,911,233	133,420,224
Due from BSP		370,499,440	388,796,188
Due from other banks		588,053,970	424,916,385
		P 1,033,464,643	P 947,132,797

See Notes to Financial Statements.

1ST VALLEY BANK, INC., A DEVELOPMENT BANK
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(Amounts in Philippine Pesos)

1. CORPORATE INFORMATION

1st Valley Bank, Inc., A Development Bank (the Bank) is a development bank which was registered with the Philippine Securities and Exchange Commission (SEC) on April 19, 2013 and started commercial operations on August 1, 2013. The Bank was organized for the purpose of the consolidation of two rural banks namely: 1st Valley Bank, Inc., A Rural Bank (1VBRB) and Community Rural Bank of Clarin (Misamis Occidental), Inc. (Clarin). Consequently, the Bank acquired all the assets and assumed all the liabilities of 1VBRB and Clarin in exchange for the Bank's shares of stock.

The Bank is currently engaged in accepting deposits from the public and in the extension of the rural credit to small farmers and tenants and to deserving rural industries or enterprises.

As a banking institution, the Bank's operations are regulated and supervised by the Bangko Sentral ng Pilipinas (BSP). As such, the Bank is required to comply with banking rules and regulations such as those relating to maintenance of reserve requirements on deposit liabilities and deposit substitutes and those relating to the adoption and use of safe and sound banking practices, among others, as promulgated by the BSP. The Bank's activities are subject to the provisions of Republic Act (R.A.) No. 8791, *General Banking Law of 2000* and other related banking laws.

In 2017, the Bank acquired 20% ownership interest in Sugbuanon Rural Bank, Inc. (SRBI), whose business is similar to the Bank's business in accepting deposits from the public and in the extension of rural credit to small farmers and tenants to deserving rural industries or enterprises. SRBI's registered office, which is also its principal place of business, is located at G/F Dr. Ramon Arcenas Building, Osmeña Boulevard, Kamagayan, Cebu City, Philippines and it has six branches located in Mandaue City and in the Municipalities of Minglanilla, Bantayan, Bogo, Balamban and Pinamungajan, all in the Province of Cebu. Accordingly, the Bank accounted for its investment in SRBI as an associate (see Notes 3 and 11).

On July 18, 2018, the Bank entered into a Share Purchase Agreement (SPA) for the acquisition and subscription of shares of stock in D' Asian Hills Bank, Inc. (DAHBI). The acquisition involves 124,526,200 shares representing 100% ownership interest in DAHBI for an aggregate purchase price of P35,000,000.

The Bank's registered office, which is also its principal place of business, is located at Vamenta Blvd. Corner Lirio Street, Carmen, Cagayan de Oro City.

As of December 31, 2018, the Bank has 43 branches in over eight provinces in Mindanao namely: Lanao del Norte, Misamis Oriental, Misamis Occidental, Zamboanga del Norte, Zamboanga del Sur, Zamboanga Sibugay, Bukidnon and in Davao City; and 4 branches in Visayas namely: Bayawan City and Dumaguete City in Negros Oriental, and La Carlota City and Kabankalan City in Negros Occidental.

As of January 13, 2018, the Bank's Board of Directors (BOD) approved the plan of merger of the Bank with SRBI and DAHBI, with the Bank as the surviving entity. As of December 31, 2018, the Bank has not yet received an approval from the BSP for the plan of merger.

The financial statements of the Bank as of and for the year ended December 31, 2018 (including the comparative financial statements as of and for the year ended December 31, 2018 and the corresponding figures as of January 1, 2017) were authorized for issue by the Bank's Board of Directors (BOD) on March 20, 2019.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies that have been used in the preparation of these financial statements are summarized below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of Preparation of Financial Statements

(a) Statement of Compliance with Philippine Financial Reporting Standards

The financial statements of the Bank have been prepared in accordance with Philippine Financial Reporting Standards (PFRS). PFRS are adopted by the Financial Reporting Standards Council (FRSC) from the pronouncements issued by the International Accounting Standards Board, and approved by the Philippine Board of Accountancy.

The financial statements have been prepared using the measurement bases specified by PFRS for each type of asset, liability, income and expense. The measurement bases are more fully described in the accounting policies that follow.

(b) Presentation of Financial Statements

The financial statements are presented in accordance with Philippine Accounting Standard (PAS) 1, *Presentation of Financial Statements*. The Bank presents all items of income and expenses in a single statement of comprehensive income.

The Bank presents a third statement of financial position as at the beginning of the preceding period when it applies an accounting policy retrospectively, or makes a retrospective restatement or reclassification of items that has a material effect on the information in the statement of financial position at the beginning of the preceding period. The related notes to the third statement of financial position are not required to be disclosed, except for the disclosures required under PAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

In 2018, the Bank adopted PFRS 9, *Financial Instruments*, which was applied using the transitional relief allowed by the standard. This allows the Bank not to restate its prior periods' financial statements. Differences arising from the adoption of PFRS 9 in relation to classification and measurement and impairment of financial assets are recognized in the opening balance of Surplus (or other component of equity, as appropriate) in the current year [see Note 2.2(a)(ii)].

Further, the Bank adopted PFRS 15, *Revenue from Contracts with Customers*, which was applied using the modified retrospective approach under which there were no changes on the accounts in the statement of financial position as at January 1, 2018.

The table below shows the impact of the adoption of PFRS 9 to the Bank's total equity as of January 1, 2018.

		Effects on		
		Surplus		Total Equity
Balance at January 1, 2018	P	647,682,382	P	1,724,234,019
Impact of PFRS 9 [see Note 2.2(a)(ii)]:				
Decrease in allowance for credit losses -				
Loans and discounts		32,032,356		32,032,356
Total impact from remeasurement		679,714,738		1,756,266,375
Increase in deferred tax liability arising from -				
Decrease in credit loss allowance		(9,609,707)		(9,609,707)
	P	670,105,031	P	1,746,656,668

(c) *Functional and Presentation Currency*

These financial statements are presented in Philippine pesos, the Bank's functional and presentation currency, and all values represent absolute amounts except when otherwise indicated.

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

2.2 Adoption of New and Amended PFRS

(a) *Effective in 2018 that are Relevant to the Bank*

The Bank adopted for the first time the following amendment, new PFRS, interpretation and improvements, which are mandatorily effective for annual periods beginning on or after January 1, 2018:

PAS 40 (Amendments)	:	Investment Property – Reclassification to and from Investment Property
PFRS 9	:	Financial Instruments
PFRS 15	:	Revenue from Contracts with Customers; Clarifications to PFRS 15
International Financial Reporting Interpretations Committee (IFRIC) 22	:	Foreign Currency Transactions and Advance Consideration
Annual Improvements to PFRS (2014-2016 Cycle)		
PAS 28 (Amendments)	:	Investment in Associates – Clarification on Fair Value Through Profit or Loss Classification
PFRS 1 (Amendments)	:	First-time Adoption of Philippine Financial Reporting Standards – Deletion of Short-term Exemptions.

Discussed below and in the succeeding page are the relevant information about these standards, interpretation and improvements.

(i) PAS 40 (Amendments), *Investment Property – Reclassification to and from Investment Property*. The amendment states that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use. The amendment provided a non-exhaustive list of examples constituting change in use. The application of this amendment has no impact on the Bank's financial statements.

(ii) PFRS 9, *Financial Instruments*. This new standard on financial instruments has replaced PAS 39, *Financial Instruments: Recognition and Measurement,* and PFRS 9 issued in 2009, 2010 and 2013. This standard contains, among others, the following:

- three principal classification categories for financial assets based on the business model on how an entity is managing its financial instruments on how the entity is managing its financial instruments, i.e., financial assets at amortized costs, fair value through profit and loss (FVTPL) and fair value through other comprehensive income (FVOCI);

- an expected credit loss (ECL) model in determining impairment of all financial assets that are not measured at FVTPL which generally depends on whether there has been a significant increase in credit risk since initial recognition of such financial assets; and,

- a new model on hedge accounting that provides significant improvements principally by aligning hedge accounting more closely with the risk management activities undertaken by entities when hedging their financial and non-financial risk exposures.

The Bank's new accounting policies relative to the full adoption of PFRS 9 are fully disclosed in Note 2.3.

The application of the ECL methodology based on the stages of impairment assessment for loans and receivables resulted in the additional allowance for credit losses amounting to P32,032,356 as of January 1, 2018. Such amount, together with the related deferred tax liability amounting to P9,609,707, were adjusted to the opening balance of the Surplus account.

The reconciliation of the prior year's closing allowance for impairment measured in accordance with PAS 39 incurred loss model to the new impairment allowance measured in accordance with the PFRS 9 ECL model is presented in Note 8.

(iii) PFRS 15, *Revenue from Contract with Customers,* together with the *Clarifications to PFRS 15* (herein referred to as PFRS 15). This standard will replace PAS 18, *Revenue*, and PAS 11, *Construction Contracts*, the related Interpretations on revenue recognition: IFRIC 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreement for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers*, and Standing Interpretations Committee 31, *Revenue – Barter Transactions Involving Advertising Services.* This new standard establishes a comprehensive framework for determining when to recognize revenue and how much revenue to recognize. The core principle in the said framework is for an entity to recognize revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying this new standard, the Bank is required to account for revenue arising from contracts with customers following the five-step model as follows:

(a) identify the contract with a customer;
(b) identify the performance obligations;
(c) determine the transaction price;
(d) allocate the transaction price to the performance obligations; and,
(e) recognize revenue when (or as) performance obligations are satisfied.

Based on an assessment of the Bank's revenue streams as at January 1, 2018, management determined that the current revenue recognition of the Bank's revenues from its lending and deposit-taking activities, which include certain fees income, service charges and penalties, as well as gains arising from sale of non-financial assets, are within the scope of PFRS 15 (see Note 2.13). For those revenues under the scope of PFRS 15, recognition and measurement did not vary significantly from PAS 18. Substantial portion of the Bank's revenues arises from financial instruments (e.g., interest income), which are outside the scope of PFRS 15.

(iv) IFRIC 22, *Foreign Currency Transactions and Advance Consideration – Interpretation on Foreign Currency Transactions and Advance Consideration.* The interpretation provides more detailed guidance on how to account for transactions that include the receipt or payment of advance consideration in a foreign currency. The interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary asset (arising from advance payment) or liability (arising from advance receipt). If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. The application of this amendment has no impact on the Bank's financial statements.

(v) Annual Improvements to PFRS 2014-2016 Cycle. Among the improvements, the following amendments are relevant to the Bank but had no material impact on the Bank's financial statements as these amendments merely clarify existing requirements:

- PAS 28 (Amendments), *Investment in Associates – Clarification on Fair Value Through Profit or Loss Classification.* The amendments clarify that the option for venture capital organization, mutual funds and other similar entities to elect the fair value through profit or loss classification in measuring investments in associates and joint ventures shall be made at initial recognition, separately for each associate or joint venture.

- PFRS 1 (Amendments), *First-time Adoption of Philippine Financial Reporting Standards – Deletion pf Short-term Exemptions.* The amendments removed short-term exemptions in PFRS 1 covering PFRS 7, *Financial Instruments: Disclosures*, PAS 19, *Employee Benefits*, and PFRS 10, *Consolidated Financial Statements*, because the reporting period to which the exemptions applied have already transpired.

(b) Effective in 2018 but not Relevant to the Bank.

The following amendments to existing standards are mandatorily effective for annual periods beginning on or after January 1, 2018 but are not relevant to the Bank's financial statements:

PFRS 2 (Amendments)	:	Share-based Payment – Classification and Measurement of Share-based Payment Transactions
PFRS 3 (Amendments)*	:	Business Combinations – Definition of a Business
PFRS 4 (Amendments)	:	Insurance Contracts – Applying PFRS 9 with PFRS 4

* *As of December 31, 2018, these amendments to existing standards are still subject to BOA's approval.*

(c) Effective Subsequent to 2018 but not Adopted Early

There are new PFRS, interpretations, improvements and amendments to existing standards effective for annual periods subsequent to 2018, which are adopted by the FRSC. Management will adopt the following relevant pronouncements in accordance with their transitional provisions; and, unless otherwise stated, none of these are expected to have significant impact on the Bank's financial statements:

(i) PAS 19 (Amendments), *Employee Benefits – Plan Amendment, Curtailment or Settlement* (effective January 1, 2019). The amendments require the use of updated actuarial assumptions to determine current service cost and net interest for the remainder of the annual reporting period after the plan amendment, curtailment or settlement when the entity remeasures its net defined benefit liability (asset).

(ii) PAS 28 (Amendments), *Investment in Associates – Long-term Interest in Associates and Joint Venture* (effective from January 1, 2019). The amendments clarify that the scope exclusion in PFRS 9 applies only to ownership interests accounted for using the equity method. Thus, the amendments further clarify that long-term interests in an associate or joint venture – to which the equity method is not applied – must be accounted for under PFRS 9, which shall also include long-term interests that, in substance, form part of the entity's net investment in an associate or joint venture.

(iii) PFRS 9 (Amendments), *Financial Instruments – Prepayment Features with Negative Compensation* (effective from January 1, 2019). The amendments clarify that prepayment features with negative compensation attached to financial instruments may still qualify under the "solely payments of principal and interests" (SPPI) test. As such, the financial assets containing prepayment features with negative compensation may still be classified at amortized cost or at FVOCI.

(iv) PFRS 16, *Leases* (effective from January 1, 2019). The new standard will eventually replace PAS 17, *Leases*, and its related interpretation IFRIC 4, *Determining Whether an Arrangement Contains a Lease*. For lessees, it requires to account for leases "on-balance sheet" by recognizing a "right-of-use" asset and a lease liability. The lease liability is initially measured as the present value of future lease payments. For this purpose, lease payments include fixed, non-cancellable payments for lease elements, amounts due under residual value guarantees, certain types of contingent payments and amounts due during optional periods to the extent that extension is reasonably certain. In subsequent periods, the "right-of-use" asset is accounted for similar to a purchased asset subject to depreciation or amortization. The lease liability is accounted for similar to a financial liability which is amortized using the effective interest method. However, the new standard provides important reliefs or exemptions for short-term leases and leases of low value assets. If these exemptions are used, the accounting is similar to operating lease accounting under PAS 17 where lease payments are recognized as expenses on a straight-line basis over the lease term or another systematic basis (if more representative of the pattern of the lessee's benefit).

For lessors, lease accounting is similar to PAS 17's. In particular, the distinction between finance and operating leases is retained. The definitions of each type of lease, and the supporting indicators of a finance lease, are substantially the same as PAS 17's. The basic accounting mechanics are also similar, but with some different or more explicit guidance in few areas. These include variable payments, sub-leases, lease modifications, the treatment of initial direct costs and lessor disclosures.

The management plans to adopt the modified retrospective application of PFRS 16 where the cumulative effect of initially applying the standard will be recognized as an adjustment to the opening balance of Retained Earnings account at the date of initial application. The Bank will elect to apply the standard to contracts that were previously identified as leases applying PAS 17 and IFRIC 4 at the date of initial application. Management is currently assessing the financial impact of this new standard on the Bank's financial statements.

(v) IFRIC 23, *Uncertainty over Income Tax Treatments* (effective from January 1, 2019). The interpretation provides clarification on the determination of taxable profit, tax bases, unused tax losses, unused tax credits, and tax rates when there is uncertainty over income tax treatments. The core principle of the interpretation requires the Bank to consider the probability of the tax treatment being accepted by the taxation authority. When it is probable that the tax treatment will be accepted, the determination of the taxable profit, tax bases, unused tax losses, unused tax credits, and tax rates shall be on the basis of the accepted tax treatment. Otherwise, the Bank has to use the most likely amount or the expected value, depending on the surrounding circumstances, in determining the tax accounts identified immediately above.

(vi) PFRS 10 (Amendments), *Consolidated Financial Statements*, and PAS 28 (Amendments), *Investments in Associates and Joint Ventures – Sale or Contribution of Assets Between an Investor and its Associates or Joint Venture* (effective date deferred indefinitely). The amendments to PFRS 10 require full recognition in the investor's financial statements of gains or losses arising on the sale or contribution of assets that constitute a business as defined in PFRS 3, *Business Combinations*, between an investor and its associate or joint venture. Accordingly, the partial recognition of gains or losses (i.e., to the extent of the unrelated investor's interests in an associate or joint venture) only applies to those sale of contribution of assets that do not constitute a business. Corresponding amendments have been made to PAS 28 to reflect these changes. In addition, PAS 28 has been amended to clarify that when determining whether assets that are sold or contributed constitute a business, an entity shall consider whether the sale or contribution of those assets is part of multiple arrangements that should be accounted for as a single transaction.

(vii) Annual Improvements to PFRS 2015-2017 Cycle (effective from January 1, 2019). Among the improvements, the following amendments are relevant to the Bank but had no material impact on the Bank's financial statements as these amendments merely clarify existing requirements:

- PAS 12 (Amendments), *Income Taxes – Tax Consequences of Dividends*. The amendments clarify that all income tax consequence of dividend payments should be recognized in profit or loss.

- PAS 23 (Amendments), *Borrowing Costs – Eligibility for Capitalization*. The amendments clarify that any specific borrowing which remains outstanding after the related qualifying asset is ready for its intended purpose, such borrowing will then form part of the entity's general borrowings when calculating the capitalization rate for capitalization purposes.

2.3 Financial Assets

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

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. Deposits, amounts due to banks and customers, and loans are recognized when cash is received by the Bank or advanced to the borrowers.

At initial recognition, the Bank measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at FVTPL, transaction costs such as fees and commissions that are incremental or directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs of financial assets and financial liabilities carried at FVTPL are immediately expensed in profit or loss.

(a) *Classification, Measurement and Reclassification of Financial Assets in Accordance with PFRS 9*

Under PFRS 9, the classification and measurement of financial assets is driven by the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. The classification and measurement of financial assets are described below and in the succeeding pages.

(i) *Financial Assets at Amortized Cost*

Financial assets are measured at amortized cost if both of the following conditions are met:

- the financial asset is held within the Bank's business model whose objective is to hold financial assets in order to collect contractual cash flows ("hold-to-collect"); and,

- the contractual terms of the instrument give rise, on specified dates, to cash flows that are SPPI on the principal amount outstanding.

Financial assets meeting these criteria are measured initially at fair value plus transaction costs. They are subsequently measured at amortized cost using the effective interest method, less any allowance.

The Bank's financial assets at amortized cost are presented in the statement of financial position as Cash and Other Cash Items, Due from BSP, Due from Other Banks, Loans and Discounts, and Investment Securities at Amortized Cost accounts.

For purposes of cash flows reporting and presentation, cash and cash equivalents comprise accounts with original maturities of three months or less, including cash and other cash items and unrestricted balances due from BSP and due from other banks, interbank call loans, and loans and receivables arising from reverse repurchase agreement. These generally include cash on hand, demand deposits and short-term, highly liquid investments readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value.

The Bank may irrevocably elect at initial recognition to classify a financial asset that meets the amortized cost criteria above as at FVTPL if that designation eliminates or significantly reduces an accounting mismatch had the financial asset been measured at amortized cost. In 2018 and 2017, the Bank has not made such designation.

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

The Bank accounts for financial assets at FVOCI if the assets meet the following conditions:

- they are held under a business model whose objective is to hold to collect the associated cash flows and sell ("hold-to-collect and sell"); and,

- the contractual terms of the financial assets give rise to cash flows that are SPPI on the principal amount outstanding.

At initial recognition, the Bank can make an irrevocable election (on an instrument-per-instrument basis) to designate equity investments as at FVOCI; however, such designation is not permitted if the equity investment is held by the Bank for trading. Currently, the Bank has not designated financial assets as at FVOCI on initial application of PFRS 9 (2014).

Financial assets at FVOCI are initially measured at fair value plus transaction costs. Subsequently, they are measured at fair value, with no deduction for any disposal costs. Gains and losses arising from changes in fair value, including the foreign exchange component, are recognized in other comprehensive income, net of any effects arising from income taxes, and are reported as part of Revaluation Reserves account in equity. When the asset is disposed of, the cumulative gain or loss previously recognized in the Revaluation Reserves account is not reclassified to profit or loss, but is reclassified directly to Retained Earnings account.

Any dividends earned on holding these equity instruments are recognized in profit or loss, when the Bank's right to receive dividends is established in accordance with PFRS 15, unless the dividends clearly represent recovery of a part of the cost of the investment.

(iii) Financial Assets at Fair Value Through Profit or Loss

Debt securities that do not meet the amortized cost criteria, or that meet the criteria but the Bank has chosen to designate as at FVTPL at initial recognition, are measured at FVTPL. Equity investments are classified as financial assets at FVTPL, unless the Bank designates an equity investment that is not held for trading as at fair value through FVOCI at initial recognition. Currently, the Bank does not hold financial assets at FVTPL.

A financial asset is considered as held for trading if:

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

(b) Recognition of Interest Income Using Effective Interest Rate Method

Interest income on financial assets at amortized cost and all interest-bearing debt financial assets at FVTPL, or at at FVOCI (beginning January 1, 2018), is calculated by applying the effective interest rate to the gross carrying amount of the financial assets except for those that are subsequently identified as credit-impaired and those that are purchased or originated credit-impaired assets.

The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

The effective interest rate is calculated by taking into account any discount or premium on acquisition, fees and costs that are an integral part of effective interest rate. The Bank recognizes interest income using a rate of return that represents the best estimate of a constant rate of return over the expected life of the instrument; hence, it recognizes the effect of potentially different interest rates charged at various stages, and other characteristics of the product life cycle (including prepayments, penalty interest and charges).

If expectations regarding the cash flows on the financial asset are revised for reasons other than credit risk, the adjustment is booked as a positive or negative adjustment to the carrying amount of the asset with an increase or reduction in interest income.

The Bank calculates interest income by applying the effective interest rate to the gross carrying amount of the financial assets, except for those that are subsequently identified as credit-impaired and or are purchased or originated credit-impaired assets.

For financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the net carrying amount of the financial assets (after deduction of the loss allowance). If the asset is no longer credit-impaired, the calculation of interest income reverts to gross basis. For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying a credit-adjusted effective interest rate to the amortized cost of the asset. The calculation of interest income does not revert to a gross basis even if the credit risk of the asset subsequently improves.

The interest earned is recognized as part of Interest Income account in the statement of profit or loss.

(c) Classification, Measurement and Reclassification of Financial Assets in Accordance with PAS 39

Financial assets other than those designated and effective as hedging instruments are classified into the following categories: financial assets at FVTPL, loans and receivables, held-to-maturity (HTM) investments and available-for-sale (AFS) financial assets. Financial assets are assigned to the different categories by management on initial recognition, depending on the purpose for which the investments were acquired.

Regular purchases and sales of financial assets are recognized on their trade date. All financial assets that are not classified as at FVTPL are initially recognized at fair value plus any directly attributable transaction costs. Financial assets carried at FVTPL are initially recorded at fair value and the related transaction costs are recognized in profit or loss. A more detailed description of the categories of financial assets currently relevant to the Bank is shown below and in the succeeding page.

(i) Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money, goods or services directly to a debtor with no intention of trading the receivables.

The Bank's financial assets categorized as loans and receivables are presented as Cash and Other Cash Items, Due from BSP, Due from Other Banks, Loans and Discounts, and Other investments, Advances to an associate and Accounts receivable (under Other Resources account) in the statement of financial position. Cash and cash equivalents comprise of cash and non-restricted balances with the BSP and amounts due from other banks, which are subject to insignificant risk of changes in value.

Loans and discounts are subsequently measured at amortized cost using the effective interest method, less impairment losses, if any. Impairment loss is provided when there is objective evidence that the Bank will not be able to collect all amounts due to it in accordance with the original terms of the receivables. The amount of the impairment loss is determined as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred), discounted at the financial asset's original effective interest rate or current effective interest rate determined under the contract if the loan has a variable interest rate.

The carrying amount of the asset shall be reduced either directly or through the use of an allowance account. The amount of the loss shall be recognized in profit or loss.

(ii) HTM Investments

This category includes non-derivative financial assets with fixed or determinable payments and a fixed date of maturity that the Bank has the positive intention and ability to hold to maturity. Investments intended to be held for an undefined period are not included in this classification. If the Bank were to sell other than an insignificant amount of HTM investments, the whole category would be tainted and reclassified to AFS financial assets. The Bank currently holds government bonds designated into this category.

Subsequent to initial recognition, HTM investments are measured at amortized cost using the effective interest method, less impairment losses, if any.

(d) Impairment of Financial Assets Under PFRS 9

From January 1, 2018, the Bank recognizes allowances for ECL on a forward-looking basis associated with its financial assets at amortized cost. No impairment loss is recognized on equity investments that are either measured at FVTPL or designated at FVOCI.

Recognition of credit losses is no longer dependent on the Bank's identification of a credit loss event. The measurement of the ECL reflects: (i) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes; (ii) the time value of money; and, (iii) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

The amount of allowance for ECL is updated at the end of each reporting period to reflect the changes in credit risk of the financial asset since initial recognition. The Bank recognizes lifetime ECL when there has been a significant increase in credit risk (SICR) since initial recognition. However, if the credit risk on the financial instrument has not increased significantly since initial recognition, the Bank measures the loss allowance for that financial instrument at an amount equal to 12-month ECL. Lifetime ECL represents the expected credit losses that will result from all possible default events over the expected life of a financial instrument. In contrast, 12-month ECL represents the portion of lifetime ECL that is expected to result from default events on a financial instrument that are possible within 12 months after the end of the reporting period.

The Bank's ECL model follows a three-stage impairment approach, which guide in the determination of the loss allowance to be recognized in the financial statements. The staging of financial assets, definition of default for purposes of determining ECL, and credit risk assessment are further discussed in Note 4.1.

ECL is a function of the probability of default (PD), loss-given default (LGD), and exposure-at-default (EAD), with the timing of the loss also considered, and is estimated by incorporating forward-looking economic information and through the use of experienced credit judgement. These elements are discussed more fully in Note 4.1.

The Bank calculates ECL either on an individual or a collective basis. For modelling ECL parameters which were carried out on a collective basis, the financial instruments are grouped on the basis of shared credit risk characteristics, such as but not limited to instrument type, credit risk rating, collateral type, product type, historical net charge-offs, industry type, and geographical locations of the borrowers or counterparties.

Also, the Bank applies a simplified ECL approach for its accounts receivables wherein the Bank uses a provisioning matrix that considers historical changes in the behavior of the portfolio of credit exposures based on internally collected data to predict conditions over the span of a given observation period. These receivables include claims from various counterparties, which are not originated through the Bank's lending activities. For these instruments, the Bank measures the loss allowance of an amount equal to lifetime ECL.

The Bank recognizes an impairment loss in profit or loss for all financial instruments subjected to ECL impairment assessment with a corresponding adjustment to their carrying amount through a loss allowance account. With respect to investments in debt securities that are measured at FVOCI, the related loss allowance account is recognized in other comprehensive income and accumulated in the Revaluation Reserve account, and does not reduce the carrying amount of the financial asset in the statement of financial position.

(e) Impairment of Financial Assets Under PAS 39 Prior to January 1, 2018

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

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Bank about the following loss events:

(i) significant financial difficulty of the issuer or obligor;

(ii) a breach of contract, such as a default or delinquency in interest or principal payments;

(iii) the Bank granting the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;

(iv) it becoming probable that the borrower will enter bankruptcy or other financial reorganization;

(v) the disappearance of an active market for that financial asset because of financial difficulties; or,

(vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including: adverse changes in the payment status of borrowers in the group, or national or local economic conditions that correlate with defaults on the assets in the group.

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

If there is objective evidence that an impairment for individually assessed financial assets has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in profit or loss. If a financial asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Bank may measure impairment on the basis of an instrument's fair value using an observable market price.

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

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

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

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

When possible, the Bank seeks to restructure loans rather than to take possession of the collateral. This may involve extending the payment arrangement and agreement for new loan conditions. Management continuously reviews restructured loans to ensure that all criteria evidencing the good quality of the loan are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate. The difference between the recorded sale of the original loan and the present value of the restructured cash flows, discounted at the original effective interest rate, is recognized as part of Impairment Losses account in profit or loss.

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

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in statement of profit or loss.

(f) Derecognition of Financial Assets

(i) Modification of Loans

When the Bank derecognizes a financial asset through renegotiation or modification of contractual cash flows of loans to customers, the Bank assesses whether or not the new terms are substantially different to the original terms. The Bank considers, among others:

- If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay;
- Whether any substantial new terms are introduced that will affect the risk profile of the loan;
- Significant extension of the loan term when the borrower is not in financial difficulty;
- Significant change in the interest rate;
- Change in the currency the loan is denominated in; and/or,
- Insertion of collateral, other security or credit enhancements that will significantly affect the credit risk associated with the loan.

If the terms are substantially different, the Bank derecognizes the financial asset and recognizes a "new" asset at fair value and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Bank also assesses whether the new financial asset recognized is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are as gain or loss on derecognition of financial assets in profit or loss. As to the impact on ECL measurement, the expected fair value of the "new" asset is treated as the final cash flow from the existing financial asset at the date of derecognition; such amount is included in the calculation of cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Bank recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognizes a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows of the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets). As to the impact on ECL measurement, the derecognition of the existing financial asset will result in the expected cash flows arising from the modified financial asset to be included in the calculation of cash shortfalls from the existing financial asset.

(ii) *Derecognition other than Modification of Loans*

A financial asset (or where applicable, a part of a financial asset or part of a group of financial assets) is derecognized when the contractual rights to receive cash flows from the financial instruments expire, or when the financial assets and all substantial risks and rewards of ownership have been transferred to another party. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

(g) *Financial Liabilities at Amortized Cost*

Financial liabilities which include deposit liabilities, manager's check payable, accrued interest and other expenses (except for tax-related payables), and other liabilities (except for post-employment defined benefit obligation), are recognized when the Bank becomes a party to the contractual terms of the instrument.

Financial liabilities are recognized initially at their fair value and subsequently measured at amortized cost using the effective interest method, for maturities beyond one year less settlement payments. All interest-related charges on financial liabilities are recognized as an expense in the statement of profit or loss under the caption Interest Expense. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are charged to profit or loss on an accrual basis and are added to the carrying amount of the instrument to the extent that they are not settled in the period when they arise.

(h) *Derecognition of Financial Liabilities*

Financial liabilities are derecognized from the statement of financial position only when the obligations are extinguished either through discharge, cancellation or expiration. The difference between the carrying amount of the financial liability derecognized and the consideration paid or payable is recognized in profit or loss.

2.4 Bank Premises, Furniture, Fixtures and Equipment

Land is stated at cost less accumulated impairment losses, if any. All other items of bank premises, furniture, fixtures and equipment are stated at cost less accumulated depreciation, amortization and any impairment in value.

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

Depreciation is computed on a straight-line basis over the estimated useful lives of the assets as follows:

Building	20 years
Furniture, fixtures and equipment	3-5 years
Transportation equipment	5 years

Leasehold improvements are amortized over the term of the lease or useful lives of the improvements of ten years, whichever is shorter.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see Note 2.16).

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

Fully depreciated and amortized assets are retained in the accounts until these are no longer in use and no further charge for depreciation is made in respect of those assets.

An item of bank premises, furniture, fixtures and equipment, including the related accumulated depreciation, amortization and impairment loss, if any, is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in profit or loss in the year the item is derecognized.

2.5 Investment Properties

Investment properties represent land and buildings acquired by the Bank in settlement of loans from defaulting borrowers through foreclosure or dacion in payment. These properties are neither held by the Bank for sale in the next 12 months nor used in the rendering of services or for administrative purposes.

At initial recognition, investment properties shall be measured at fair value, which comprises its purchases price and directly attributable costs incurred such as legal fees, transfer taxes and other transaction costs. Subsequent to initial recognition, investment properties are accounted for under the fair value model with changes in the fair value immediately recognized in profit or loss as Fair value gain (loss) on revaluation of investment properties presented as part of Other Income account in the statements of comprehensive income.

Investment properties are measured at the fair value at the end of the reporting period. Fair values are supported by market value evidence and is determined by independent appraisers with sufficient experience with respect to both the location and the nature of the investment properties.

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

Investment properties are derecognized upon disposal or when permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gain or loss on the retirement or disposal of investment properties is recognized in profit or loss under Other Income account in the year of retirement or disposal.

2.6 Other Resources

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

Other resources include the Bank's investment in an associate. An associate is an entity over which the Bank is able to exert significant influence but which are neither subsidiaries nor interests in joint venture. The investment in an associate is initially recognized at cost and subsequently accounted for in the financial statements using the equity method from the date on which the investee becomes an associate. On acquisition of the investment in an associate, any excess of the cost of the investment over the Bank's share in the fair value of the net assets of the investee is recognized as goodwill, included as part of the investment cost. Any excess of the share in the fair value of the net assets of the investee over the cost is recognized in profit or loss as part of Equity share in net profit or loss of an associate under Other Income account in the statement of comprehensive income.

Under the equity method, the investment cost is adjusted for the Bank's share in net profit or loss of the associate. Dividend distributions from the associate are accounted for as a reduction of the carrying value of the investment. Furthermore, the Bank's share in the components of other comprehensive income is recognized as part of investment cost. When the Bank's share in net losses of an associate exceeds the Bank's cost, the Bank discontinues recognizing its share of losses, to the extent that it has no legal or constructive obligation on behalf of the associate.

When the Bank reduces its ownership interests in an associate but continues to use the equity method, the Bank reclassifies to profit or loss its share of the gain or loss that had previously been recognized in other comprehensive income relating to the reduction in ownership interest, if, and only if, that gain or loss is allowed to be recycled in accordance with existing standards.

Amounts reported in the financial statements of the associate have been adjusted where necessary to ensure consistency with the accounting policies of the Bank.

At the end of the reporting period, the Bank makes an assessment whether there is any indication of impairment in its investment in an associate. If any indication exists, the recoverable amount is estimated and any impairment loss is recognized in the statement of income (see Note 2.16).

2.7 Intangible Assets

Intangible assets, presented under Other Resources in the statements of financial position, include acquired licenses and software which are accounted for under the cost model. The cost of the asset is the amount of cash or cash equivalents paid or the fair value of the other considerations given up to acquire an asset at the time of its acquisition or production.

Capitalized costs are amortized on a straight-line basis over the estimated useful lives as the lives of these intangible assets are considered finite. In addition, intangible assets are subject to impairment testing as described in Note 2.16.

Software are capitalized on the basis of the costs incurred to acquire and install the specific software. Costs associated with maintaining computer software and those costs associated with research activities are recognized as expense in profit or loss as incurred. The capitalized cost is amortized over five years.

The cost of license with clearing services is recognized as intangible asset and is amortized over five years.

When an intangible asset is disposed of, the gain or loss on disposal is determined as the difference between the proceeds and the carrying amount of the asset and is recognized in profit or loss.

2.8 Assets Classified as Held for Sale

Assets classified as held for sale include repossessed jewelry and motor vehicle that the Bank intends to sell within one year from the date of classification as held for sale and are included as part of Other Resources in the statements of financial position.

The Bank classifies an asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. In the event that the sale of the asset is extended beyond one year, the extension of the period required to complete the sale does not preclude an asset from being classified as held for sale if the delay is caused by events or circumstances beyond the Bank's control and there is sufficient evidence that the Bank remains committed to its plan to sell the asset.

Assets held for sale are measured at the lower of their carrying amounts, immediately prior to their classification as held for sale, and their fair value less costs to sell. The Bank shall recognize an impairment loss for any initial or subsequent write-down of the asset at fair value less cost to sell. Gain for any subsequent increase in fair value less cost to sell of an asset is recognized to the extent of the cumulative impairment loss previously recognized. Assets classified as held for sale are not subject to depreciation.

If the Bank has classified an asset as held for sale, but the criteria for it to be recognized as held for sale are no longer satisfied, the Bank shall cease to classify the asset as held for sale.

The gain or loss arising from the sale or remeasurement of held for sale assets is recognized in profit or loss and included as part of Other Income in the statement of comprehensive income.

2.9 Financial Liabilities

Financial liabilities, which include deposit liabilities, bills payable, and accrued expenses and other liabilities (except for post-employment benefit obligation and tax-related liabilities) are recognized when the Bank becomes a party to the contractual terms of the instrument. All interest-related charges are recognized as an expense under the caption Interest Expense in the statement of comprehensive income.

Deposit liabilities are recorded or stated at amounts in which they are to be paid, which approximate their fair values.

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

Accrued expenses and other liabilities are recognized initially at their fair values and subsequently measured at amortized cost using effective interest method for maturities beyond one year, less settlement payments.

Dividend distributions to shareholders are recognized as financial liabilities upon declaration by the Bank.

Financial liabilities are derecognized from the statement of financial position only when the obligations are extinguished either through discharge, cancellation or expiration. The difference between the carrying amount of the financial liability derecognized and the consideration paid or payable is recognized in profit or loss.

2.10 Offsetting of Financial Instruments

Financial assets and financial liabilities are offset and the resulting net amount, considered as a single financial asset or financial liability, is reported in the statement of financial position when the Bank currently has legally enforceable right to set-off the recognized amounts and there is intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. The right of set-off must be available at the end of the reporting period, that is, it is not contingent on a future event. It must also be enforceable in the normal course of business, in the event of default, and in the event of insolvency or bankruptcy; and, must be legally enforceable for both entity and all counterparties to the financial instruments.

2.11 Provisions and Contingencies

Provisions are recognized when present obligations will probably lead to an outflow of economic resources and they can be estimated reliably even if the timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive obligation that has resulted from past events.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the end of the reporting period, including the risks and uncertainties associated with the present obligation. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. When time value of money is material, long-term provisions are discounted to their present values using a pretax rate that reflects market assessments and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense. Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate.

In those cases where the possible outflow of economic resource as a result of present obligations is considered improbable or remote, or the amount to be provided for cannot be measured reliably, no liability is recognized in the financial statements. Similarly, possible inflows of economic benefits to the Bank that do not yet meet the recognition criteria of an asset are considered contingent assets, hence, are not recognized in the financial statements. On the other hand, any reimbursement that the Bank can be virtually certain to collect from a third party with respect to the obligation is recognized as a separate asset not exceeding the amount of the related provision.

2.12 Capital Funds

Capital stock represents the nominal value of shares that have been issued.

Other reserves include any premium received on the initial issuance of capital stock representing the difference between the net assets received from 1VBRB and Clarin, and the amount of the shares issued arising from a business combination accounted for under the pooling-of-interest method. Any transaction costs associated with the issuance of shares are deducted from the other reserves, net of any related income tax benefits.

Remeasurements of defined benefit plan comprise of net accumulated actuarial gains or losses arising from experience adjustments and other changes in actuarial assumptions, and actual return on plan assets (excluding amounts pertaining to net interest).

Surplus includes all current and prior period results of operations as reported in the profit or loss section of the statement of comprehensive income, reduced by the amount of any dividends declared.

2.13 Revenue and Expense Recognition

Prior to January 1, 2018, revenue is recognized to the extent that the revenue can be reliably measured; it is probable that future economic benefits will flow to the Bank; and the expenses and costs incurred and to be incurred can be measured reliably.

In 2018, revenue is recognized only when (or as) the Bank satisfies a performance obligation by transferring control of the promised services to the customer. A contract with a customer that results in a recognized financial instrument in the Bank's financial statements may partially be within the scope of PFRS 9 and partially within the scope of PFRS 15. In such case, the Bank first applies PFRS 9 to separate and measure the part of the contract that is in-scope of PFRS 9, and then applies PFRS 15 to the residual part of the contract. Expenses and costs, if any, are recognized in profit or loss upon utilization of the assets or services or at the date these are incurred. All finance costs are reported in profit or loss on accrual basis, except capitalized borrowing costs which are included as part of the cost of the related qualifying asset, if any (see Note 2.18).

The Bank also earns service fees and commissions on various banking services, and gains on sale of properties, which are supported by contracts approved by the parties involved. These revenues are accounted for by the Bank in accordance with PFRS 15. For revenues arising from various banking services, which are to be accounted for under PFRS 15, the following provides information about the nature and timing of satisfaction of performance obligations in contracts with customers, including significant payment terms, and the related revenue recognition policies:

(a) *Service fees and charges*

(i) *Commission and fees* – these income arising from loans, deposits, and other banking transactions are recognized as income based on agreed terms and conditions with customers which are generally when the services has been performed.

(ii) *Late payment fees* – these are billed on late payments of loans and are recognized as income upon occurrence of the late payment event.

(b) *Penalties* – these are charges from deposit accounts that fall under dormancy or maintaining balance. These fees are recognized at the time of dormancy.

(c) *Gains on Assets Sold*

Gains on assets sold under Other Income account, arise from the disposals of bank premises, furniture, fixtures and equipment, investment properties and other non-financial assets. The Bank recognizes the gain on sale at the time the control of the assets is transferred to the buyer, when the Bank does not retain either continuing managerial involvement to the degree usually associated with ownership, or effective control over the assets sold, and when the collectability of the entire sales price is reasonably assured. Gains on sale and redemption of assets is presented under Other Operating Income account in the statement of comprehensive income.

2.14 Leases – Bank as Lessee

Leases which do not transfer to the Bank substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments (net of any incentives received from the lessor) are recognized as expense in statement of comprehensive income on a straight-line basis over the lease term. Associated costs, such as repairs, maintenance and insurance, are expensed as incurred.

The Bank determines whether an arrangement is, or contains, a lease based on the substance of the arrangement. It makes an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

A reassessment is made after inception of the lease only if one of the following applies:

(a) there is a change in contractual terms, other than a renewal or extension of the arrangement;

(b) a renewal option is exercised or extension granted, unless that term of the renewal or extension was initially included in the lease term;

(c) there is a change in the determination of whether fulfillment is dependent on a specified asset; or,

(d) there is a substantial change to the asset.

2.15 Foreign Currency Transactions and Translation

The accounting records of the Bank are maintained in Philippine pesos. Foreign currency transactions during the year are translated into the functional currency at exchange rates which approximate those prevailing on transaction dates. Resources and liabilities denominated in foreign currencies are translated to Philippine pesos at the prevailing exchange rates at the end of the reporting period.

Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit or loss.

2.16 Impairment of Non-financial Assets

Bank premises, furniture, fixtures and equipment, intangible assets, and other non-financial assets are subject to impairment testing whenever events or changes in circumstances indicate that their carrying amount may not be recoverable.

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

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

All assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist. An impairment loss is reversed if the asset's or cash generating unit's carrying amount recoverable amount exceeds its carrying amount.

2.17 Employee Benefits

The Bank provides post-employment benefits to employees through a defined benefit plan, as well as a defined contribution plan and other employee benefits, which are recognized and measured as follows:

(a) Post-Employment Defined Benefit Plan

A defined benefit plan is a post-employment plan that defines an amount of post-employment benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and salary. The legal obligation for any benefits from this kind of post-employment plan remains with the Bank, even if plan assets for funding the defined benefit plan have been acquired. Plan assets may include assets specifically designated to a long-term benefit fund, as well as qualifying insurance policies. The Bank's defined benefit post-employment plan covers all regular full-time employees. The pension plan is tax-qualified, non-contributory and administered by a trustee.

The liability recognized in the statement of financial position for a defined benefit plan is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows for expected benefit payments using a discount rate derived from the interest rates of a zero coupon government bonds [using the reference rates published by Bloomberg using its valuation technology, Bloomberg Valuation (BVAL), and by Philippine Dealing and Exchange Corp. (PDEX) in 2017 and prior years], that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related post-employment liability. BVAL provides evaluated prices that are based on market observations from contributed sources.

Remeasurements, comprising of actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions and the return on plan assets (excluding amount included in net interest) are reflected immediately in the statement of financial position with a charge or credit recognized in other comprehensive income in the period in which they arise. Net interest is calculated by applying the discount rate at the beginning of the period, taking account of any changes in the net defined benefit liability or asset during the period as a result of contributions and benefit payments. Net interest is reported as part of Interest Expense or Interest Income account in the statement of comprehensive income.

Past service costs are recognized immediately in profit or loss in the period of a plan amendment or curtailment.

(b) Post-Employment Defined Contribution Plan

A defined contribution plan is a post-employment plan under which the Bank pays fixed contributions into an independent entity. The Bank has no legal or constructive obligations to pay further contributions after payment of the fixed contribution. The contributions recognized in respect of defined contribution plans are expensed as they fall due. Liabilities and assets may be recognized if underpayment or prepayment has occurred.

(c) Termination Benefits

Termination benefits are payable when employment is terminated by the Bank before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Bank recognizes termination benefits at the earlier of when it can no longer withdraw the offer of such benefits and when it recognizes costs for a restructuring that is within the scope of PAS 37, *Provisions, Contingent Liabilities and Contingent Assets,* and involves the payment of termination benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the reporting period are discounted to their present value.

(d) Compensated Absences and Other Employee Benefits

Compensated absences are recognized for the number of paid leave days (including holiday entitlement) remaining at the end of the reporting period. In addition, the Bank recognizes a liability and an expense for other employee benefits based on a formula that is fixed, regardless of the Bank's income after certain adjustments, and does not take into consideration the profit attributable to the Bank's shareholders.

The Bank recognizes a provision where it is contractually obliged to pay the benefits, or where there is a past practice that has created a constructive obligation. They are presented as Post-employment benefit obligation under the Accrued Expenses and Other Liabilities account in the statement of financial position at the undiscounted amount that the Bank expects to pay as a result of the unused entitlement.

2.18 Borrowing Costs

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

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

2.19 Income Taxes

Tax expense recognized in profit or loss comprises the sum of current tax and deferred tax not recognized in other comprehensive income or directly in equity, if any.

Current tax assets or liabilities comprise those claims from, or obligations to, fiscal authorities relating to the current or prior reporting period, that are uncollected or unpaid at the reporting period. They are calculated using the tax rates and tax laws applicable to the fiscal periods to which they relate, based on the taxable profit for the year. All changes to current tax assets or liabilities are recognized as a component of tax expense in profit or loss.

Deferred tax is provided using the liability method on temporary differences at the end of the reporting period between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes. Under the liability method, with certain exceptions, deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets are recognized for all deductible temporary differences and the carry forward of unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the deferred tax asset can be utilized. Unrecognized deferred tax assets are reassessed at the end of each reporting period and are recognized to the extent that it has become probable that future taxable profit will be available to allow such deferred tax assets to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realized or the liability is settled provided such tax rates have been enacted or substantively enacted at the end of the reporting period.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized.

The measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the Bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. For purposes of measuring deferred tax assets and deferred tax liabilities for investment properties that are measured using the fair value model, the carrying amounts of such properties are presumed to be recovered entirely through sale, unless the presumption is rebutted, that is, when the investment property is depreciable and is held within the business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale.

Most changes in deferred tax assets or liabilities are recognized as a component of tax expense in profit or loss, except to the extent that it relates to items recognized in other comprehensive income or capital funds. In this case, the tax is also recognized in other comprehensive income or directly in capital funds, respectively.

Deferred tax assets and deferred tax liabilities are offset if the Bank has a legally enforceable right to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxation authority.

2.20 Related Party Transactions and Relationships

Related party transactions are transfers of resources, services or obligations between the Bank and its related parties, regardless whether a price is charged.

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. These parties include: (a) individuals owning, directly or indirectly through one or more intermediaries, control or are controlled by, or under common control with the Bank; (b) associates; (c) individuals owning, directly or indirectly, an interest in the voting power of the Bank that gives them significant influence over the Bank and close members of the family of any such individual; and, (d) the Bank's funded retirement plan.

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

2.21 Events After the End of the Reporting Period

Any post-year-end event that provides additional information about the Bank's financial position at the end of the reporting period (adjusting event) is reflected in the financial statements. Post-year-end events that are not adjusting events, if any, are disclosed when material to the financial statements.

3. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The preparation of the Bank's financial statements in accordance with PFRS requires management to make judgments and estimates that affect the amounts reported in the financial statements and related notes. Judgments and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may ultimately differ from these estimates.

3.1 Critical Management Judgments in Applying Accounting Policies

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

(a) Evaluation of Business Model Applied in Classifying Financial Instruments

The Bank manages its financial assets based on business models that maintain adequate level of financial assets to match its expected cash outflows, largely its core deposit funding arising from customers' withdrawals and continuing loan disbursements to borrowers, while maintaining a strategic portfolio of financial assets for trading activities consistent with its risk appetite.

The Bank's business models reflect how it manages its portfolio of financial instruments. The Bank's business models need not be assessed at entity level or as a whole but shall be applied at the level of a portfolio of financial instruments (i.e., group of financial instruments that are managed together by the Bank) and not on an instrument-by-instrument basis (i.e., not based on intention or specific characteristics of individual financial instrument), except for designation of equity instruments at FVOCI.

In determining the classification of a financial instrument, the Bank evaluates in which business model a financial instrument or a portfolio of financial instruments belong to taking into consideration the objectives of each business model established by the Bank (e.g., held-for-trading, generating accrual income, direct matching to a specific liability) as those related to the Bank's investment, trading and lending strategies.

In addition, PFRS 9 emphasizes that if more than an infrequent sale is made out of a portfolio of financial assets carried at amortized cost, an entity should assess whether and how such sales are consistent with the objective of collecting contractual cash flows. In making this judgment, the Bank considers certain circumstances documented in its business model manual to assess that an increase in the frequency or value of sales of financial instruments in a particular period is not necessary inconsistent with a held-to-collect business model if the Bank can explain the reasons for those sales and why those sales do not reflect a change in the Bank's objective for the business model.

(b) *Testing the Cash Flow Characteristics of Financial Assets*

In determining the classification of financial assets, the Bank assesses whether the contractual terms of the financial assets give rise on specified dates to cash flows that are SPPI on the principal outstanding, with interest representing time value of money and credit risk associated with the principal amount outstanding. The assessment as to whether the cash flows meet the SPPI test is made in the currency in which the financial asset is denominated. Any other contractual term that changes the timing or amount of cash flows (unless it is a variable interest rate that represents time value of money and credit risk) does not meet the amortized cost criteria. In cases where the relationship between the passage of time and the interest rate of the financial instrument may be imperfect, known as modified time value of money, the Bank assesses the modified time value of money feature to determine whether the financial instrument still meets the SPPI criterion. The objective of the assessment is to determine how different the undiscounted contractual cash flows could be from the undiscounted cash flows that would arise if the time value of money element was not modified (the benchmark cash flows). If the resulting difference is significant, the SPPI criterion is not met. In view of this, the Bank considers the effect of the modified time value of money element in each reporting period and cumulatively over the life of the financial instrument.

(c) *Distinction Between Investment Properties, Assets Held-for-Sale and Owner-occupied Properties*

The Bank determines whether a property qualifies as an investment property, assets held-for-sale or owner-occupied properties. In making its judgment, the Bank considers whether the property generates cash flows largely independent of the other assets held by an entity. Owner-occupied properties generate cash flows that are attributable not only to the property but also to other assets used in its banking operations.

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

The Bank considers each property separately in making its judgment.

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

The Bank classifies its acquired properties as Bank Premises, Furniture, Fixtures and Equipment if used in operations, as Assets Held-for-Sale if the Bank expects that the properties will be recovered through sale rather than use, as Investment Properties if held for currently undetermined future use and is regarded as held for capital appreciation, or as financial assets in accordance with PFRS 9. At initial recognition, the Bank determines the fair value of acquired properties through internally and externally generated appraisal. The appraised value is determined based on the current economic and market conditions, as well as the physical condition of the property. The Bank's methodology in determining the fair value of acquired properties are further discussed in Note 5.3.2.

(e) Distinction Between Operating and Finance Leases

The Bank has entered into various lease agreements as a lessee. Judgment was exercised by management to distinguish each lease agreement as either an operating or finance lease by looking at the transfer or retention of significant risk and rewards of ownership of the properties covered by the agreements. Failure to make the right judgment will result in either overstatement or understatement of assets and liabilities. Management has assessed that all its existing lease arrangements qualify under operating lease.

(f) Recognition of Provisions and Contingencies

Judgment is exercised by management to distinguish between provisions and contingencies. Policies on recognition of provisions and contingencies are discussed in Note 2.11 and relevant disclosures are presented in Note 21.

In dealing with the Bank's various legal proceedings, its estimate of the probable costs that may arise from claims and contingencies has been developed in consultation and coordination with the Bank's internal and outside counsels acting in defense for the Bank's legal cases and are based upon the analysis of probable results.

Although the Bank does not believe that its on-going proceedings will have material adverse effect on the Bank's financial position, it is possible that future results of operations could be materially affected by changes in the estimates or in the effectiveness of the strategies conducted relating to those proceedings.

3.2 Key Sources of Estimation of Uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of each reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of resources and liabilities within the next reporting period:

(a) Estimation of Allowance for ECL on Financial Assets (2018)

When measuring allowance for ECL for relevant categories of financial assets, management applies judgment in defining the criteria in assessing whether a financial asset has experienced SICR since initial recognition, and in the estimation of the contractual cash flows due from counterparty and those that the Bank would expect to receive, taking into account the cash flows from the realization of collateral and integral credit enhancements. The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions about future economic conditions and credit behaviour of counterparties (e.g., the likelihood of counterparties defaulting and the resulting losses). The computation of the ECL also consider the use of reasonable and supportable forward-looking information, which is based on assumptions for the future movement of different economic drivers and how these drivers will affect each other that may result in different levels of loss allowance.

Significant factors affecting the estimates on the ECL model include:

- internal risk rating matrix which determines the PD to be assigned to a financial asset;
- criteria for assessing if there has been an SICR and when a financial asset will be transferred between the three stages;
- the Bank's definition of default for different segments of credit exposures that considers the regulatory requirements;

- establishing groups of similar financial assets (i.e., segmentation) for the purposes of measuring ECL on a collective basis;
- establishment of LGD parameters based on historical recovery rates of claims against defaulted counterparties across different group of financial instruments; and,
- establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL.

Explanation of the inputs, assumptions and estimation used in measuring ECL, and the analysis of the allowance for ECL on various groups of financial instruments is further detailed in Note 4.2.

(b) Estimation of Impairment of Loans and Receivables and Investment Securities at Amortized Cost (2017)

The Bank reviews its loans and receivables portfolio to assess impairment at least on a semi-annual basis. In determining whether an impairment loss should be recorded in profit or loss, the Bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from the portfolio before the decrease can be identified with an individual item in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers or issuers in a group, or national or local economic conditions that correlate with defaults on assets in the group.

Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

The carrying value of loans and receivables and the analysis of allowance for impairment on such financial assets are shown in Note 9, while the information related to investment securities at amortized cost are presented in Note 7.1.

(c) Estimation of Useful Lives of Bank Premises, Furniture, Fixtures and Equipment and Intangible Assets

The Bank estimates the useful lives of bank premises, furniture, fixtures and equipment and intangible assets based on the period over which the assets are expected to be available for use. The estimated useful lives of these assets are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets.

The carrying amount of bank premises, furniture, fixtures and equipment, and intangible assets (presented under Other Resources) are disclosed in Notes 9 and 11, respectively. Based on management's assessment as at December 31, 2018 and 2017, there is no change in the estimated useful lives of these assets during those years. Actual results, however, may vary due to changes in estimates brought about by changes in factors mentioned above.

(d) *Fair Value Measurement of Investment Properties*

The Bank's investment properties are carried at fair value at the end of the reporting period. The fair values of the investment properties as disclosed in Note 5.3.2 are determined on the basis of the appraisals conducted by qualified internal and independent professional appraisers applying the relevant valuation methodologies as discussed therein.

For land and buildings with appraisal conducted prior to the end of the current reporting period, management determines whether there are significant circumstances during the intervening period that may require adjustments or changes in the disclosure of fair value of those properties. As of December 31, 2018 and 2017, there were no circumstances that management has determined possible adjustments in the fair value of these properties.

(e) *Estimation of Fair Value Disclosures for Assets Held for Sale*

The Bank's assets held for sale is measured using the cost model. The estimated fair values of assets held for sale as disclosed in Note 5.3.2, are determined on the basis of the appraisals conducted by qualified internal and independent professional appraisers applying the relevant valuation methodologies as discussed therein.

For assets held for sale with appraisal conducted prior to the end of the current reporting period, management determines whether there are significant circumstances during the intervening period that may require adjustments or changes in the disclosure of fair value of those properties. As of December 31, 2018 and 2017, there were no circumstances that management has determined possible adjustments in the fair value of the assets held for sale.

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

In assessing impairment, management estimates the recoverable amount of each asset or a cash-generating unit based on expected future cash flows and uses an interest rate to calculate the present value of those cash flows. Estimation uncertainty relates to assumptions about future operating results and the determination of a suitable discount rate (see Note 2.16). Though management believes that the assumptions used in the estimation of fair values reflected in the financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable values and any resulting impairment loss could have a material adverse effect on the results of operations.

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

The Bank reviews its deferred tax assets at the end of each reporting period and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Management assessed that the carrying amount of deferred tax assets recognized in the statements of financial position as disclosed in Note 18 can be utilized in the coming years.

(b) *Valuation of Post-employment Defined Benefit*

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

The amounts of post-employment benefit obligation and expense and an analysis of the movements in the estimated present value of post-employment benefit, as well as the significant assumptions used in estimating such obligation are presented in Note 17.2.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES

The Bank is exposed to a variety of financial risks in relation to its financial instruments. The Bank's financial assets and financial liabilities by category are summarized in Note 5. The main types of risks are credit risk, liquidity risk, market risk (foreign currency and interest rate risks), and operational risk and anti-money laundering controls.

The Bank's risk management, which is closely coordinated with the BOD, Management Committee and the Risk Management Committee (RMC) of the Bank, focuses on actively securing the Bank's short to medium-term cash flows by minimizing the exposure to financial markets. Long-term financial investments are managed to generate reasonable returns.

The Bank does not actively engage in the trading of financial assets for speculative purposes nor does it write options. The most significant financial risks to which the Bank is exposed to are described as follows:

4.1 Credit Risk

Credit risk is the risk that a customer or counterparty may fail to fulfill its contractual obligations to the Bank. This includes risk of non-payment by borrowers and issuers, failed settlement of transactions and default on outstanding contracts.

The Bank performs aging analysis, in accordance with its loan loss methodology, for computation of required reserves.

The Bank's loans and receivables are actively monitored to avoid significant concentrations and possible deterioration of credit risk.

The Bank's activities are governed by its Credit Risk Policy Manual which defines guiding principles and parameters for credit activities as well as roles and responsibilities of every party to the over-all credit process. Credit policies and standards are periodically reviewed to ensure effectiveness and relevance.

The Management Committee undertakes portfolio management by reviewing the Bank's loan portfolio, including the portfolio risks associated with particular industry sectors, loan size and maturity, and development of a strategy for the Bank to achieve its desired portfolio mix and risk profile.

The Management Committee reviews the Bank's loan portfolio in line with the Bank's policy of not having significant unwarranted concentrations of exposure to individual counterparties, in accordance with the BSP's prohibitions on maintaining a financial exposure to any single person or group of connected persons in excess of 25% of its net worth.

For investment securities at amortized cost, credit risk is addressed by setting limits as to the maximum amount of investment that can be made on certain type of security with consideration of the credit quality of the counterparty.

4.1.1 Exposure to Credit Risk

The Bank's exposure to credit risk is limited to the carrying amount of financial assets recognized at the end of reporting period as shown in the statements of financial position. The following table shows the exposure to credit risk as of December 31, 2018 and 2017 for each risk grouping and the related allowance for impairment:

	2018				
	Due from BSP and Other Banks	**Loans and Discounts (Net)**	**Investment securities at amortized cost**	**Other Resources (Net)**	**Total**
Carrying amount	P 958,553,410	P6,863,642,051	P 529,700,546	P 210,187,776	P 8,562,083,783
Neither past due nor impaired	P 958,553,410	P6,545,582,219	P 529,700,546	P 208,090,757	P 8,241,925,932
Collectively and individually impaired	-	566,914,057	-	9,798,343	576,712,400
Allowance for impairment	-	(248,854,225)	-	(7,701,324)	(256,555,549)
	-	318,059,832	-	2,097,019	320,156,851
Total carrying amount	**P 958,553,410**	**P6,863,642,051**	**P 529,700,546**	**P 210,187,776**	**P 8,562,083,783**

	2017				
	Due from BSP and Other Banks	Loans and Discounts (Net)	HTM Investments	Other Resources (Net)	Total
Carrying amount	P 813,712,573	P5,399,009,088	P 334,655,592	P 95,236,802	P 6,642,614,055
Neither past due nor impaired	P 813,712,573	P5,110,367,518	P 334,655,592	P 84,528,912	P 6,343,264,595
Collectively and individually impaired	-	548,022,798	-	15,569,754	563,592,552
Allowance for impairment	-	(259,381,228)	-	(4,861,864)	(264,243,092)
	-	288,641,570	-	10,707,890	299,349,460
Total carrying amount	**P 813,712,573**	**P5,399,009,088**	**P 334,655,592**	**P 95,236,802**	**P 6,642,614,055**

The Due from BSP account represents the aggregate balance of noninterest-bearing deposit accounts in local currency maintained by the Bank with the BSP primarily to meet reserve requirements and to serve as a clearing account for any interbank claims. Hence, no significant credit risk is anticipated for this account.

The Bank is able to manage the credit risk arising from due from other banks by ensuring that the banks where these financial assets are invested are of high reputation and good credit standing. Portion of due from other banks are secured by the lower of the aggregate maximum insurance coverage of P0.5 million and the balance of the deposit account, as provided for under R.A. No. 9576, *Amendment to Charter of Philippine Depository Insurance Corporation (PDIC).*

The Bank's Investment securities in amortized cost are government securities with minimal credit risks.
The carrying amount of financial assets recorded in the financial statements represents the Bank's maximum exposure to credit risk without taking into account the value of any collateral obtained.

4.1.2 Concentration of Credit Risk

The concentrations of credit risk by sector of the Bank's financial assets as of December 31, 2018 and 2017 are presented below.

	2018				
	Due from BSP and Other Banks	**Loans and Discounts (Net)**	**Investment securities at amortized cost**	**Other Resources (Net)**	**Total**
Financial intermediaries	P 958,553,410	P -	P -	P -	P 958,553,409
Government	-	-	529,700,546	-	529,700,546
Agriculture, fishing, hunting and forestry	-	1,568,897,260	-	-	1,568,897,260
Wholesale and retail trade, repair of motor vehicles/motorcycles, personal and household goods	-	1,382,185,361	-	-	1,382,185,362
Others	-	4,013,436,563	-	217,989,100	4,231,425,663
	P 958,553,410	**P 6,964,519,184**	**P 529,700,546**	**P 217,989,100**	**P 8,670,762,240**

	2017				
	Due from BSP and Other Banks	Loans and Discounts (Net)	HTM Investments	Other Resources (Net)	Total
Financial intermediaries	P 813,712,573	P -	P -	P -	P 813,712,573
Government	-	-	334,655,592	-	334,655,592
Agriculture, fishing, hunting and forestry	-	2,741,565,784	-	-	2,741,565,784
Wholesale and retail trade, repair of motor vehicles/motorcycles, personal and household goods	-	797,769,963	-	-	797,769,963
Others	-	2,043,941,244	-	100,098,666	2,144,039,910
	P 813,712,573	P 5,583,276,991	P 334,655,592	P 100,098,666	P 6,831,743,822

4.1.3 Collateral Held as Security and Other Credit Enhancements

The Bank holds collateral against loans to borrower in the form of mortgage interests over properties, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. The Bank's collateral portfolio is presented in Note 8.

Collateral is not usually held against investment securities, and no such collateral was held at December 31, 2018 and 2017.

4.1.4 Expected Credit Loss Measurement

(a) Assessment of Significant Increase in Credit Risk (SICR)

In assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, the Bank assesses the change in the risk of a default occurring over the remaining life of the financial instrument. In making this assessment, the Bank assesses on a periodic basis both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information as appropriate. These may include macroeconomic conditions, economic sector and geographical region relevant to the counterparty or borrower and other factors that are counterparty-specific. As the Bank holds various arrays of financial instruments, the extent of assessment may depend on the materiality of the financial instrument or the complexity of the portfolio being assessed.

The Bank's ECL model follows a three-stage impairment approach in determining the loss allowance to be recognized in the financial statements:

(i) Stage 1 – comprises of all credit exposures that are considered 'performing' and with no observed SICR since initial recognition. These include those financial instruments with low credit risk. For these financial instruments, the loss allowance is determined based on a 12-month ECL.

(ii) Stage 2 – comprises of all financial instruments assessed to have SICR since initial recognition based on the Bank's quantitative and qualitative criteria, though not yet deemed to be credit-impaired. With reference to the Bank's credit risk assessment, Stage 2 includes credit exposures that are considered 'under-performing' in which risk ratings were downgraded by at least three notches and/or downgraded to CCC+ or to Especially Mentioned. Stage 2 financial instruments may also include those financial instruments where the credit risk has improved and have been reclassified from Stage 3 subject to the Bank's observation period on the creditworthiness of the counterparty. A lifetime ECL is recognized for these financial instruments.

(iii) Stage 3 – comprises credit exposures which are assessed as 'credit-impaired', thus considered by the Bank as 'non-performing', which is assessed consistently with the Bank's definition of default for each loan portfolio. Generally, this includes accounts that are classified as Substandard, Doubtful and Loss. The Bank recognizes a lifetime ECL for all credit-impaired financial assets.

The Bank considers low credit risk for listed debt security when its credit risk rating is equivalent to a globally understood definition of 'investment grade' (which should be from at least one major rating agency); other debt securities are considered to be low credit risk when they have a low risk of default and the issuer has a strong capacity to meet its contractual cash flow obligations in the near term.

Financial assets that are credit-impaired on initial recognition are classified as purchased or originated credit-impaired assets. ECL is only recognized or released to the extent that there is a subsequent change in the ECLs.

The criteria for determining whether credit risk has increased significantly vary by portfolio and include quantitative changes in probabilities of default and qualitative factors, including a backstop based on delinquency. The credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, based on the Bank's internal credit assessment, the borrower or counterparty is determined to have well-defined credit weaknesses. Under the Bank's ICRRS, these are exposures rated at least Substandard. For exposures with no internal credit risk rating performed, if contractual payments are more than a specified days past due threshold, the credit risk is deemed to have increased significantly since initial recognition. Depending on the number of days past due which differ across the various retail products of the Bank, a credit exposure may be transferred to Stage 2 or Stage 3. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. In subsequent reporting periods, if the credit risk of the financial instrument improves such that there is no longer a SICR since initial recognition, the Bank shall revert to recognizing a 12-month ECL. As a general rule, an upgrade or transfer of credit exposure from Stage 3 to Stage 1 is allowed when there is sufficient evidence to support that full collection of principal and interest is probable, consistent with the Bank's definition of curing period.

For portfolios in respect of which the Bank has limited historical data, external benchmark information (e.g., Basel LGD) is used to supplement the internally available data. The portfolios for which external benchmark information represents a significant input into measurement of ECL include exposures to low default borrower segments.

(b) Definition of Default

Loans and Receivables

The Bank defines a financial asset as in default, which is aligned with the definition of credit-impaired asset, when it meets one or more of the following criteria:

- *Quantitative* – in this criterion, the Bank defines a loan instrument as in default, which is aligned with the definition of credit-impaired, when the borrower is more than 90 days past due on its contractual payments (applicable to corporate or SME loans), more than 180 days past due for unsecured retail loans, and more than 365 days past due for secured retail loans.

- *Qualitative* – this includes instances where the borrower is unlikely to pay its obligations and is deemed to be in significant financial difficulty, which include cases of: (i) loan restructuring for economic or legal reasons relating to the borrower's financial difficulty on terms that the Bank would not consider otherwise; (ii) borrower's death; (iii) breach of financial covenant/s; or, (iv) the borrower entering bankruptcy or financial reorganization.

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment.

An instrument is considered to be no longer in default or have cured when the borrower is able to repay the installments in arrears and the account no longer meets any of the default criteria for a consecutive period of 180 days within which the borrower shall make consecutive payments.

These criteria have been applied to all financial instruments held by the Bank and are consistent with the definition of default used for internal credit risk management purposes. Such definition has been consistently applied in determining PD, EAD, and LGD throughout the ECL calculations of the Bank.

Investments in Debt Securities

Investments in debt securities is assessed as credit-impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of an event that occurred after the initial recognition of the security (a "loss event") and that loss event has impact on the estimated future cash flows of the securities. Losses expected as a result of future events, shall also be considered in estimating the ECL. Objective evidence that the security is impaired includes observable data that comes to the attention of the holder of the security about the following loss events:

- significant financial difficulty of the issuer or obligor;
- breach of contract, such as a default or delinquency in interest or principal payments;
- the financial institution, for economic or legal reasons relating to the issuer's financial difficulty, granting to the issuer a concession that the financial institution would not otherwise consider;
- it becoming probable that the issuer will enter bankruptcy or other financial reorganization;
- the disappearance of an active market for that security because of financial difficulties; or,
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of securities since the initial recognition of those assets, although the decrease cannot yet be identified with the individual securities in the portfolio, including adverse change in the payment status of issuers in the portfolio; or national or local economic conditions that correlate with defaults on the securities in the portfolio.

The disappearance of an active market because a financial institution's held securities are no longer publicly traded is not an evidence of impairment. A downgrade of an issuer's credit rating is not, by itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a security below its cost or amortized cost is not necessarily evidence of impairment (for example, a decline in fair value of an investment in debt security that results from an increase in the risk-free interest rate).

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Bank considers the following factors:

- the market's assessment of creditworthiness as reflected in the bond yields;
- the rating agencies' assessment of creditworthiness;
- the country's ability to access the capital markets for new debt issuance;
- the probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness; or,
- the internal support mechanism in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfill the required criteria.

(c) Key Inputs, Assumptions and Estimation Techniques Used in Measurement of ECL

The ECL is determined by projecting the PD, LGD and EAD for each future month and for each individual exposure or collective segment.

- *Probability of Default (PD)*

  This represents an estimate of likelihood of a borrower defaulting on its financial obligation over a given time horizon, either over the next 12 months (12-month PD) or over the remaining lifetime (lifetime PD) of the obligation. PD is calculated based on statistical rating models, and assessed using rating tools tailored to the various categories of counterparties and exposures, which consider both quantitative and qualitative factors. In determining PD, the Bank performs segmentation of its credit exposures based on homogenous characteristics and developed a systematic PD methodology for each portfolio. Generally, if a counterparty or exposure migrates between rating classes, this will lead to a change in the estimate of the associated PD.

- *Loss Given Default (LGD)*

  This pertains to pertains to estimate of loss related to the amount that may not be recovered after the borrower defaults. The Bank estimates LGD parameters based on historical recovery rates of claims against defaulted counterparties, which takes into consideration the realization of any collateral that is integral to the financial asset. For secured credit exposure, the determination of LGD is dependent on the Bank's collateral data which are available at the origination of the instrument which takes into account the amount and timing of the cash inflows (actual recovery) and outflows (actual expenses) and on the time value of money. Recoveries are calculated on a discounted cash flows basis using the effective interest rate as the discounting factor.

- *Exposure at Default (EAD)*

  This represents the gross carrying amount of the exposure in the event of default which include the amortized cost amount of an instrument and any accrued interest receivable.

These three components are multiplied together and adjusted for the likelihood of survival (i.e., the exposure has not been prepaid or defaulted in an earlier month). This effectively calculates an ECL for each future month, which is then discounted back to and summed at the end of the reporting period. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

The lifetime PD is developed by applying a maturity profile to the current 12-month PD. The maturity profile looks at how defaults develop on a portfolio from the point of initial recognition throughout the life of the instrument. The maturity profile is based on historical observed data and is assumed to be the same across all assets within a portfolio and credit grade band. Such profile is supported by a historical analysis (i.e., an observation period of five years) which uses, among others the number of rated accounts and ratings of bad accounts at the time of default. Bad accounts are defaulted accounts classified into three classes such as the non-performing loans, accounts classified as Substandard, Doubtful or Loss, and real past due accounts.

In a risk rating model applied by the Bank, a better rating or score denotes less probability of default than those of a worse rating. Identifying the counterparty default is done through a computation of the portfolio's observed default frequency (ODF). In cases when ODF method and the data to be used is limited, the Bank may also employ the implied probability of default frequency and the application of overlay factors in the PD. Using the historical defaults under the Bank's ICRRS based on an external credit rating agency's scale, ODF is calculated per rating class using the cumulative five-year data as the basis for grouping. This represents the actual numbers of bad borrower cases that have occurred during the five-year timeframe. On the other hand, unrated accounts are distributed to existing credit rating classifications using normal distribution assumption.

For loans with periodic amortization and one-time full payment at end of the term, EAD is based on the contractual repayments owed by the borrower over a 12-month or lifetime basis. This will also be adjusted for any expected overpayments made by a borrower. Early repayment or refinancing assumptions are also incorporated into the calculation.

The 12-month and lifetime LGDs are determined based on the factors which impact the recoveries made post default, and may vary by product type. For secured products, this is primarily based on collateral type and projected collateral values, historical discounts to market or book values due to forced sales, time to repossession and recovery costs observed. For unsecured products, LGD is typically set at product level due to the limited differentiation in recoveries achieved across different borrowers. The LGD is influenced by collection strategies.

The determination of the 12-month and lifetime PD, LGD, and EAD includes the overlay of forward-looking economic information.

Further, the assumptions underlying the calculation of the ECL – such as how the maturity profile of the PDs and how collateral values change – are monitored and reviewed by the Bank on a periodic basis.

There have been no significant changes in the estimation techniques or significant assumptions made by the Bank in 2018.

(d) Overlay of Forward-looking Information (FLI) in the Measurement of ECL

The Bank incorporates FLI in its assessment of SICR and calculation of ECL. The Bank has performed historical analysis and has identified the key macroeconomic variables (MEVs) affecting credit risk associated with its borrowers and/or counterparties and the ECL for each portfolio of debt instruments.

The Bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between MEVs, credit risk, and credit losses.

The significance of the selected MEVs as predictors of default may change over time as historical information is added. As such, the generated macro-economic models are updated at least on an annual basis.

The MEVs and their associated impact on the PD, EAD and LGD vary by financial instrument. To project the MEVs for the full remaining life of each financial instrument, a mean reversion approach has been used, which means that MEVs tend to either a long run average rate (e.g., for unemployment) or a long run average growth rate (e.g., GDP) over a period of two to five years. The impact of these economic variables on the PD, EAD and LGD has been determined by performing statistical regression analysis to understand the impact changes in these variables have had historically on default rates and on the components of LGD and EAD.

The MEVs considered by the Bank includes economic data and forecasts published by government bodies (e.g., BSP and Philippine Statistics Authority), international organizations (e.g., International Monetary Fund), and certain reputable private and academic organizations involved in forecasting. Accordingly, the Bank has identified key drivers for credit risk for its corporate loans portfolio, which include gross domestic product, unemployment rates, and interest rates. For exposures to specific industries and/or geographical regions, the key drivers also include commodity and/or real estate price indices. On the other hand, the key drivers for the Bank's retail loans portfolio include foreign exchange rates, unemployment rates and interest rates.

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty, and therefore, the actual outcomes may be significantly different to those projections. The Bank considers these forecasts to represent its best estimate of the possible outcomes and has analyzed the non-linearities and asymmetries within the Bank's different product types to establish that the chosen scenarios are appropriately representative of the range of possible scenarios.

Management has also considered other FLIs such as any regulatory, legislative, or political changes, but are not deemed to have a significant impact on the calculation of ECL. Management reviews and monitors the appropriateness of FLIs at least annually.

4.2 Liquidity Risk

The Bank's policy is to maintain adequate liquidity at all times. This policy aims to honor all cash requirements on an ongoing basis and to avoid raising funds above market rates or through the forced sale of assets.

Liquidity risk is the risk that sufficient funds may not be available to adequately meet the credit demands of the Bank's customers and repay deposits on maturity. The Bank's objective in liquidity management is to ensure that the Bank has sufficient liquid financial assets at all times to meet obligations when they fall due, under both normal and stressed conditions, without incurring unacceptable losses that would be detrimental to the Bank's operations.

The Bank manages liquidity risk by maintaining a portfolio of highly liquid financial assets of appropriate quality to ensure short-term funding requirements are met regularly and in the event of unforeseen interruption of cash flows. Specifically, the Bank's liquidity risk management is focused on the matching of the maturities of its liquid financial assets and short-term liabilities. In addition, the Bank also seeks to maintain sufficient liquidity to take advantage of interest rate opportunities when this arises.

The settlement groupings of the Bank's financial assets and financial liabilities as of December 31, 2018 and 2017 are as follows:

	2018			
	Within One Year	**Beyond One Year But Less Than Five Years**	**Beyond Five Years**	**Total**
Resources:				
Cash and other cash items	P 74,911,233	P -	P -	P 74,911,233
Due from BSP and other banks	958,553,410	-	-	958,553,410
Loans and discounts - net	1,461,459,023	4,982,256,520	419,926,508	6,863,642,051
Investment securities at amortized cost	445,025,033	75,000,000	9,675,513	529,700,546
Other resources - net	189,216,213	20,971,563	-	210,187,776
	3,129,164,912	5,078,228,083	429,602,021	8,636,995,016
Liabilities:				
Deposit liabilities	3,619,435,550	422,522,539	116,386,423	4,158,344,512
Bills payable	1,386,162,319	1,075,346,447	-	2,461,508,766
Accrued expenses and other liabilities	433,351,556			433,351,556
	5,438,949,425	1,497,868,986	116,386,423	7,053,204,834
Net Periodic Gap	(2,309,784,513)	3,580,359,097	313,215,598	P1,583,790,182
Cumulative Total Gap	**(P2,309,784,513)**	**P 1,270,574,584**	**P1,583,790,182**	**P -**

	2017			
	Within One Year	Beyond One Year But Less Than Five Years	Beyond Five Years	Total
Resources:				
Cash and other cash items	P 133,420,224	P -	P -	P 133,420,224
Due from BSP and other banks	813,712,573	-	-	813,712,573
Loans and discounts – net	1,426,936,519	3,134,959,961	837,112,608	5,399,009,088
HTM investments	259,996,772	65,000,000	9,658,820	334,655,592
Other resources – net	95,236,802	-	-	95,236,802
	2,729,302,890	3,199,959,961	846,771,428	6,776,034,279
Liabilities:				
Deposit liabilities	3,331,662,199	406,191,609	532,007,145	4,269,860,953
Bills payable	500,656,809	308,235,499	-	808,892,308
Accrued expenses and other liabilities	353,373,631	-	-	353,373,631
	4,185,692,639	714,427,108	532,007,145	5,423,026,892
Net Periodic Gap	(1,456,389,749)	2,485,532,853	314,764,283	1,343,907,387
Cumulative Total Gap	(P1,456,389,749)	P 1,029,143,104	P1,343,907,387	P -

The Bank continually assesses business opportunities and strategies where it can effectively and sufficiently match its short-term funding requirements with adequate liquid assets through taking customers' deposits with longer maturities and discounting loans to other financial institutions with repayments terms enough to cover credit demands of customers.

4.3 Foreign Currency Risk

The Bank has no significant exposure to foreign currency risks as most transactions are denominated in Philippine pesos, its functional currency.

4.4 Interest Rate Risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair value of financial instruments. The Bank's cash flow interest rate risk relates primarily to the possible changes in the prevailing interest rates on amounts due from other banks and deposit liabilities that are subject to variable interest rates (see Notes 6 and 12). The volatility in the interest rates of these financial instruments will result to an increase or decrease of the Bank's interest spread, and consequently will affect its financial performance. All other financial assets and financial liabilities either have fixed rates or non-interest bearing; hence, were not considered in the cash flow interest rate risk sensitivity.

The table in the succeeding page illustrates the sensitivity of the Bank's profit before tax and equity to a reasonably possible change in interest rates of +/- 20 basis points (bps) and +/- 32 bps for Philippine peso in 2018 and 2017, respectively. These changes are considered to be reasonably possible based on observation of current market conditions. The calculations are based on a change in the average market interest rate for each period, and the financial instruments held at the end of each reporting period that are sensitive to changes in interest rates. All other variables are held constant.

	2018		2017	
	+20 bps	**-20 bps**	+32 bps	-32 bps
Profit before tax	**(P3,832,588)**	**P3,832,588**	(P 1,994,866)	P 1,994,866
Equity	**(2,682,812)**	**2,862,812**	(1,396,406)	1,396,406

To mitigate this risk, the Bank follows a prudent policy in managing assets and liabilities in order to ensure that exposure to interest rate risk are kept within acceptable levels.

4.5 Operational Risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, or may lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is able to manage this risk. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff training and assessment processes, including the maintenance of internal audit.

4.6 Anti-Money Laundering Controls

The Anti-Money Laundering Act (AMLA) or RA No. 9160 was passed in September 2001 and was amended by RA No. 9194, RA No. 10167, and RA No. 10365 in March 2003, June 2012 and February 2013, respectively. Under the AMLA, as amended, the Bank is required to submit "Covered Transaction Reports" to the Anti-Money Laundering Council (AMLC) involving single transactions in cash or other equivalent monetary instruments in excess of P0.50 million within one banking day. The Bank is also required to submit "Suspicious Transaction Reports" to the AMLC in the event that circumstances exist and there are reasonable grounds to believe that the transaction is suspicious. Furthermore, terrorist financing was criminalized in RA No. 10168.

In addition, the AMLA requires that the Bank safe keeps, as long as the account exists, all the Know Your Customer (KYC) documents involving its clients, including documents that establish and record the true and full identity of its clients. Likewise, transactional documents must be maintained and stored for five years from the date of the transaction. In cases involving closed accounts, the KYC documents must be kept for five years after their closure. Meanwhile, all records of accounts with court cases must be safe kept until there is a final resolution.

On January 27, 2011, BSP Circular No. 706 (the Circular) was implemented superseding all policies on AMLA. The Circular requires the Bank to adopt a comprehensive and risk-based Money Laundering and Terrorist Financing Prevention Program (MLPP) designed according to the covered institution's corporate structure and risk profile.

The Compliance Unit of the Bank, headed by the Chief Compliance Officer (CCO), monitors the Bank's compliance on the implementation and management of MLPP. The Branch Operations Head is the compliance officer at the branch level, that oversees the daily activities of the branch. The CCO regularly reports to the Audit Committee and to the BOD the results of their monitoring of AMLA compliance.

In an effort to further prevent money laundering activities, the Bank strengthens its KYC policies and guidelines. New individual customers shall establish their true and full identity, and shall maintain an account only in the true and full name of the account owner. Likewise, the Bank is required to risk profile its clients to Low, Normal or High with its corresponding due diligence of Reduced, Average or Enhanced, in compliance with the risk-based approach mandated by the Circular. Politically Exposed Persons are automatically profiled as high risk and subject to enhanced due diligence. Any suspicious transaction is reported to the Bank's AML Committee, who investigates and deliberates whether the transaction has a valid ground to be reported as Suspicious Transaction Report.

5. CATEGORIES, FAIR VALUES AND OFFSETTING OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

5.1 Carrying Amounts and Fair Values by Category

The carrying amounts and fair values of the categories of financial assets and financial liabilities presented in the statements of financial position are shown below and in the succeeding page.

	2018		2017	
	Carrying Amounts	**Fair Values**	Carrying Amounts	Fair Values
Financial Assets				
At amortized cost:				
Cash and other cash items	**P 74,911,233**	**P 74,911,233**	P 133,420,224	P 133,420,224
Due from BSP	**370,499,440**	**370,499,440**	388,796,188	388,796,188
Due from other banks	**588,053,970**	**588,053,970**	424,916,385	424,916,385
Loans and discounts – net	**6,863,632,051**	**6,863,632,051**	5,399,009,088	5,399,009,088
Other resources – net	**210,187,776**	**210,187,776**	95,236,802	95,236,802
Investments securities at Amortized cost	**529,700,546**	**529,700,546**	-	-
HTM Investments	**-**	**-**	334,655,592	337,421,360
	P 8,636,985,016	**P 8,636,985,016**	P 6,776,034,279	P 6,778,800,047

	2018		2017	
	Carrying Amounts	**Fair Values**	Carrying Amounts	Fair Values
Financial Liabilities				
At amortized cost:				
Deposit liabilities	**P 4,158,344,512**	**P 4,158,344,512**	P 4,269,860,953	P 4,269,860,953
Bills payable	**2,461,508,766**	**2,461,508,766**	808,892,308	808,892,308
Accrued expenses and other liabilities	**433,351,556**	**433,351,556**	353,373,631	353,373,631
	P7,053,204,834	**P7,053,204,834**	P 5,432,126,892	P 5,432,126,892

See Notes 2.3 and 2.9 for a description of the accounting policies for each category of financial instruments including the determination of fair values. A description of the Bank's risk management objectives and policies for financial instruments is provided in Note 4.

5.2 Offsetting Financial Assets and Financial Liabilities

The Bank's loans and discounts secured through hold-out on deposits, and bills payable secured through loans are the only financial instruments subject to offsetting, enforceable master netting arrangements and similar agreements. However, the Bank does not present such loans and discounts net of the deposit liabilities or bills payable net of the loans and discounts used as collateral in the statements of financial position. The table below show the gross amounts presented in the financial statements:

	Gross amounts recognized in the statements of financial position	Related amounts not set off in the statements of financial position – Financial Instruments	Collateral received	Net amount
2018:				
Financial assets –				
Loans and discounts	**P 6,964,519,184**	**(P 1,885,405,335)**	**P -**	**P 5,079,113,849**
Financial liabilities:				
Deposits	**4,158,344,512**	**(5,450,363)**	**-**	**4,152,894,149**
Bills payable	**2,461,508,766**	**(1,879,954,972)**	**-**	**581,553,794**
2017:				
Financial assets –				
Loans and discounts	P 5,583,276,991	(P 593,528,444)	P -	P 4,989,748,547
Financial liabilities:				
Deposits	4,269,860,953	(10,306,157)	-	4,259,554,796
Bills payable	808,892,308	(583,222,287)	-	225,670,021

For financial assets subject to enforceable master netting arrangements or similar arrangements between the Bank and counterparties, it allows for net settlement of the relevant financial assets and financial liabilities when both elect to settle on a net basis. In the absence of such election, financial assets and financial liabilities will be settled on a gross basis; however, each party to the master netting agreement or similar agreement will have the option to settle all such amounts on a net basis in the event of default of the other party.

For purposes of presenting the information in the preceding page, the related amounts not set-off in the statements of financial position pertains to: (a) deposit hold-out which serves as the Bank's collateral enhancement for certain loans and receivables; and, (b) certain loans and receivables assigned by the Bank as collateral for its bills payable. The financial instruments that can be set-off are only disclosed to the extent of the amounts of the Bank's counterparties.

5.3 Fair Value Hierarchy

In accordance with PFRS 13, *Fair Value Measurement*, the fair value of financial assets and liabilities and non-financial assets which are measured at fair value on a recurring or non-recurring basis and those assets and liabilities not measured at fair value but for which fair value is disclosed in accordance with other relevant PFRS, are categorized into three levels based on the significance of inputs used to measure the fair value. The fair value hierarchy has the following levels:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that an entity can access at the measurement date;

- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and,

- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The level within which the asset or liability is classified is determined based on the lowest level of significant input to the fair value measurement.

For purposes of determining the market value at Level 1, a market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

For investments which do not have quoted market price, the fair value is determined by using generally acceptable pricing models and valuation techniques or by reference to the current market of another instrument which is substantially the same after taking into account the related credit risk of counterparties, or is calculated based on the expected cash flows of the underlying net asset base of the instrument.

When the Bank uses valuation technique, it maximizes the use of observable market data where it is available and relies as little as possible on entity specific estimates. If all significant inputs required to determine the fair value of an instrument are observable, the instrument is included in Level 2. Otherwise, it is included in Level 3.

5.3.1 Financial Instruments Measured at Amortized Cost for which Fair Value is Disclosed

The table below and in the succeeding page summarizes the fair value hierarchy of the Bank's financial assets and financial liabilities which are not measured at fair value in the statements of financial position but for which fair value is disclosed.

		2018			
	Notes	Level 1	Level 2	Level 3	Total
Financial assets					
At amortized cost:					
Cash and other cash items	6	P 74,911,233	P -	P -	P 74,911,233
Due from BSP	6	370,499,440	-	-	370,399,440
Due from other banks	6	588,053,970	-	-	588,053,970
Loans and discounts	8	-	-	6,863,642,051	6,863,642,051
Other resources - net	11	-	-	433,351,556	433,351,556
Investment securities at					
Government securities	7	529,700,546	-	-	529,700,546
		P 1,563,165,189	**P -**	**P7,296,993,607**	**P 8,860,158,796**
Financial liabilities					
At amortized cost:					
Deposit liabilities	12	P -	P -	P 4,158,344,512	P 4,158,344,512
Bills payable	13	-	-	2,461,508,766	2,461,508,766
Accrued expenses					
and other liabilities	14	-	-	433,351,556	433,351,556
		P -	**P -**	**P7,053,204,834**	**P 7,053,204,834**

		2017			
	Notes	Level 1	Level 2	Level 3	Total
Financial assets					
At amortized cost:					
Cash and other cash items	6	P 133,420,224	P -	P -	P 133,420,224
Due from BSP	6	388,796,188	-	-	388,796,188
Due from other banks	6	424,916,385	-	-	424,916,385
Loans and discounts	8	-	-	5,399,009,088	5,399,009,088
Other resources - net	11	-	-	95,236,802	95,236,802
Investment securities at					
Government securities	7	334,655,592	-	-	334,655,592
		P 1,281,788,389	P -	P 5,494,245,890	P 6,776,034,279
Financial liabilities					
At amortized cost:					
Deposit liabilities	12	P -	P -	P 4,269,860,953	P 4,269,860,953
Bills payable	13	-	-	808,892,308	808,892,308
Accrued expenses					
and other liabilities	14	-	-	353,373,631	353,373,631
		P -	P -	P 5,432,126,892	P 5,432,126,892

The Bank has certain financial assets and financial liabilities measured at amortized cost as of the end of the reporting period whose related fair value are disclosed. For financial assets and financial liabilities whose fair values are included in Level 1, management considers that the carrying amounts of those short-term financial instruments approximate their fair values.

The fair values of the financial assets and financial liabilities included in Level 2 and 3 above which are not traded in an active market is determined by using generally acceptable pricing models and valuation techniques or by reference to the current market value of another instrument which is substantially the same after taking into account the related credit risk of counterparties, or is calculated based on the expected cash flows of the underlying net asset base of the instrument.

5.3.2 Fair Value Disclosures for Non-Financial Assets

The total estimated fair values of the Bank's assets held for sale amounted to P5.8 million and P4.6 million as of December 31, 2018 and 2017, respectively (see Note 11.6). The fair values of the Bank's assets held for sale classified under Other Resources account are determined on the basis of the appraisals performed by the external and internal appraisers with appropriate qualifications and recent experience in the valuation of similar properties in the relevant locations. In estimating the fair value of these properties, management takes into account the market participant's ability to generate economic benefits by using the assets in their highest and best use. The fair value hierarchy of those properties as of December 31, 2018 and 2017 is categorized as Level 3 [see Note 3.2(d)].

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

The fair values of the Bank's land and buildings classified under investment properties were determined based on the following approaches:

(a) Fair Value Measurement for Land

The Level 3 fair value of land was derived using the observable recent prices of the reference properties and were adjusted for differences in key attributes such as property size, zoning, and accessibility. The most significant input into this valuation approach is the price per square meter; hence, the higher the price per square meter, the higher the fair value of the properties.

(b) Fair Value Measurement for Buildings

The Level 3 fair value of the buildings was determined using the cost approach that reflects the cost to a market participant to construct an asset of comparable usage, construction standards, design and layout, adjusted for obsolescence. The most significant inputs used in the valuation include direct and indirect costs of construction such as but not limited to, labor and contractor's profit, materials and equipment, surveying and permit costs, electricity and utility costs, architectural and engineering fees, insurance and legal fees. These inputs were derived from various suppliers and contractor's quotes, price catalogues, and construction price indices. Under this approach, higher estimated costs used in the valuation will result in higher fair value of the properties.

(c) Fair Value Measurement for Motor Vehicles and Jewelries

The Level 3 fair value of the motor vehicles and jewelries was determined based on the appraisal report of internal appraisers. Fair value was determined based on the replacement cost of an asset with an equally satisfactorily substitute asset which is normally derived from the current acquisition cost of a similar asset, new or used, or of an equivalent productive capacity or service potential.

There has been no change to the valuation techniques used by the Bank during the year for its non-financial assets. Also, there were no transfers into or out of Level 3 fair value hierarchy in 2018 and 2017.

6. CASH AND CASH EQUIVALENTS

The components of cash and cash equivalents are as follows:

	Note	2018	2017
Cash and other cash items	6.1	**P 74,911,233**	P 133,420,224
Due from BSP	6.2	**370,499,440**	388,796,188
Due from other banks	6.3	**588,053,970**	424,916,385
		P1,033,464,643	P 947,132,797

6.1 Cash and Other Cash Items

These represent the total amount of cash in the Bank's vault in the form of Philippine currency and checks and other cash items received after the cut-off time until the close of the regular banking hours.

6.2 Due from BSP

Due from BSP represents the deposit balance maintained with the BSP to meet reserve requirements. Based on BSP Circular No. 832, *Increase in Reserve Requirements*, dated May 8, 2014, the required reserves against deposit and deposit substitute liabilities shall be eight percent (8.00%) for demand, savings and time deposits (see Note 12). The composition of the required reserves shall be demand deposits with the BSP. Deposits maintained by banks with the BSP in compliance with the reserve requirement are noninterest-bearing.

6.3 Due from Other Banks

Due from other banks maintained under savings, demand, and time accounts are as follows:

	2018	2017
Commercial banks:		
Savings	**P 296,641,943**	P 207,935,943
Demand	**28,668,245**	4,169,314
Time	**-**	-
	325,310,188	278,182,122
Government banks:		
Savings	**60,011,387**	31,133,059
Demand	**165,070,945**	114,162,349
Time	**37,661,450**	67,515,720
	262,743,782	212,811,128
	P 588,053,970	P 424,916,385

Interest rates on these deposits range from 0.25% to 1.50% per annum both in 2018 and 2017.

7. INVESTMENT SECURITIES AT AMORTIZED COST (2018) AND HELD-TO-MATURITY INVESTMENTS (2017)

7.1 Investment Securities at Amortized Cost

The account consists of five-year peso-denominated treasury bonds which bear fixed interest rates ranging from 1.89% to 4.96% in 2018 per annum, and will mature within 1 to 20 years.

Interest income earned from investment securities at amortized cost in 2018 amounting to P17.3 million is shown as Interest Income on Investment Securities at Amortized Cost in the 2018 statement of comprehensive income.

A reconciliation of the Bank's investment securities at amortized cost at the beginning and end of 2018 (nil in 2017), which includes the change in the carrying amounts arising from a change in measurement and classification on transition to PFRS 9 (2014) is shown below.

		2018
Balance at beginning of period	P	-
Reclassification from HTM investments to Investment securities at amortized cost		334,655,592
Additions		504,984,078
Periodic maturities collected	(	314,995,793)
Discount amortization		5,056,669
Balance at end of period	**P**	**529,700,546**

The maturity profile of the investment securities at amortized cost are as follows:

		2018
Within one year	P	445,025,033
Beyond one year but less than five years		75,000,000
Beyond five years		9,675,513
	P	**529,700,546**

7.2 Held-to-Maturity Investments

The account consists of five-year peso-denominated treasury bonds, which bear fixed interest rates ranging from 2.45% to 4.30% in 2017 per annum, and will mature within 1 to 20 years.

Interest income earned from HTM investments amounting to P3.1 million in 2017 is shown as Interest Income on HTM investments in the 2017 statement of comprehensive income.

In 2018, in line with the adoption of PFRS 9 (2014), the HTM investment classification was now removed and now presented as investment securities at amortized cost (see Note 7.1). Changes in this account are summarized as follows.

	2018	2017
Balance at beginning of year	**P 334,655,592**	P 9,642,766
Reclassification from HTM investments to Investment securities at amortized cost	**(334,655,592)**	-
Additions	**-**	539,969,708
Periodic maturities collected	**-**	(216,864,000)
Discount amortization	**-**	1,907,118
Balance at end of year	**P -**	P 334,655,592

The maturity profile of the HTM investments follows:

	2018	2017
Within one year	**P -**	P 259,996,772
Beyond one year but less than five years	**-**	65,000,000
Beyond five years	**-**	9,658,820
	P -	P 334,655,592

8. LOANS AND DISCOUNTS

This account is comprised of:

	2018	2017
Loans and discounts	**P6,964,519,184**	P 5,583,276,991
Allowance for impairment	**(248,854,225)**	(259,381,228)
Unearned interests and discounts	**(24,166,553)**	(37,893,815)
Accrued interest receivable	**172,143,645**	113,007,140
	P6,863,642,051	P 5,399,009,088

The balance of loans and discounts include non-accruing loans amounting to P544.9 million and P548.0 million as of December 31, 2018 and 2017, respectively.

Interest rates on receivables from customers range from 6.00% to 30.00% per annum in 2018 and 2017.

Interest income earned from loans and discounts amounting to P930.1 million and P779.4 million in 2018 and 2017, respectively, is shown as Interest Income on Loans and receivables account in the statements of comprehensive income.

Loans and discounts amounting to P2.9 billion and P583.2 million as of December 31, 2018 and 2017, respectively, are assigned to bills payable for rediscounting availments. The related liabilities are not set-off in the financial statements but are subject to offsetting arrangements (see Notes 5.2 and 13).

Loans and discounts portfolio (at gross amounts) is analyzed as follows:

	2018	2017
Current:		
Individuals for other purposes	**P4,023,251,374**	P2,088,656,804
Agrarian and other agriculture credits	**1,278,208,313**	2,432,572,008
Small and medium enterprises	**1,096,145,440**	514,025,381
	6,397,605,127	5,035,254,193
Past due items:		
Individuals for other purposes	**245,902,106**	215,744,88
Agrarian and other agriculture credits	**290,688,947**	308,993,776
Small and medium enterprises	**30,323,004**	23,284,142
	566,914,057	548,022,798
	P 6,964,519,184	P5,583,276,991

The Bank's concentration of gross loans and discounts as to industry follows:

	2018	2017
Agriculture, fishing, hunting and forestry	**P1,568,897,260**	P2,741,565,784
Wholesale and retail trade, repair of motor vehicles/motorcycles, personal and household goods	**1,382,185,362**	797,769,963
Others	**4,013,436,562**	2,043,941,244
	P6,964,519,184	P5,583,276,991

The breakdown of total gross loans and discounts as to secured and unsecured follows:

	2018	2017
Secured:		
Real estate	**P1,610,039,758**	P1,117,034,166
Chattel	**427,620,654**	186,161,470
Hold out deposits	**5,450,363**	10,306,157
	2,043,110,775	1,313,501,793
Unsecured	**4,921,408,409**	4,269,775,198
	P6,964,519,184	P5,583,276,991

The maturity profile of the total gross loans and discounts follows:

	2018	2017
Within one year	**P1,603,190,100**	P1,611,204,422
Beyond one year but less than five years	**4,896,575,876**	3,134,959,961
Beyond five years	**464,753,208**	837,112,608
	P6,964,519,184	P5,583,276,991

All of the Bank's loans and discounts have been reviewed for indications of impairment. Certain loans and discounts were found to be impaired and provisions have been recorded accordingly. A reconciliation of allowance for impairment at the beginning and end of the reporting period is shown below.

	Note	**2018**	2017
Balance at beginning of year			
As previously stated		**P 259,381,228**	P 191,949,568
ECL adjustment for 2017		**(32,032,356)**	-
As restated		**227,348,872**	191,949,568
Impairment losses		**137,830,191**	148,565,155
Reclassification	11.6	**(3,348,413)**	788,354
Write-offs		**(112,976,425)**	(81,921,849)
Balance at end of year		**P 248,854,225**	P 259,381,228

Impairment losses, net of reversal of allowance, are presented as part of Impairment Losses in the statements of comprehensive income.

9. BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT

The gross carrying amounts and accumulated depreciation and amortization of bank premises, furniture, fixtures and equipment at the beginning and end of the reporting period are shown below.

	Land	**Building**	**Transportation Equipment**	**Furniture, Fixtures and Equipment**	**Leasehold Improvements**	**Total**
December 31, 2018						
Cost	P 17,963,677	P 79,370,518	P 89,492,371	P 144,518,300	P 70,434,674	P 401,779,540
Accumulated depreciation and amortization	-	(48,614,206)	(65,997,464)	(129,554,849)	(47,419,429)	(291,585,949)
Net carrying amount	**P 17,963,677**	**P 30,756,311**	**P 23,494,907**	**P 14,963,451**	**P 23,015,245**	**P 110,193,591**
December 31, 2017						
Cost	P 17,963,677	P 44,936,456	P 56,895,585	P 80,190,911	P 47,518,475	P 247,505,104
Accumulated depreciation and amortization	-	(13,204,539)	(36,173,689)	(63,949,054)	(23,928,149)	(137,255,431)
Net carrying amount	P 17,963,677	P 31,731,917	P 20,721,896	P 16,241,857	P 23,590,326	P 110,249,673
January 1, 2017						
Cost	P 17,963,677	P 32,707,625	P 47,954,640	P 64,848,568	P 37,658,637	P 201,133,147
Accumulated depreciation and amortization	-	(1,012,845)	(25,211,039)	(48,611,389)	(17,408,168)	(92,243,441)
Net carrying amount	P 17,963,677	P 31,694,780	P 22,743,601	P 16,237,179	P 20,250,469	P 108,889,706

A reconciliation of the carrying amounts of bank premises, furniture, fixtures and equipment at the beginning and end of the reporting period is shown below.

	Land	Building	Transportation Equipment	Furniture, Fixtures and Equipment	Leasehold Improvements	Total
Balance at January 1, 2018, net of accumulated depreciation and amortization	P 17,963,677	P 31,731,917	P 20,721,896	P 16,241,857	P 23,590,326	P 110,249,673
Additions	-	8,231,167	14,108,669	12,468,014	378,316	35,186,166
Disposals	-	-	(28,805)	-	(-)	(28,805)
Reclassifications	-	(5,766,306)	(406,988)	(12,229)	6,260,365	74,842
Depreciation amortization charges for the year	-	(3,440,467)	(10,899,865)	(13,734,191)	(7,213,762)	(35,288,285)
Balance at December 31, 2018, net of accumulated depreciation and amortization	**P 17,963,677**	**P 30,756,311**	**P 23,494,907**	**P 14,963,451**	**P 23,015,245**	**P 110,193,591**
Balance at January 1, 2017, net of accumulated depreciation and amortization	P 17,963,677	P 31,694,780	P 22,743,601	P 16,237,179	P 20,250,469	P 108,889,706
Additions	-	21,575,291	5,604,300	8,839,404	3,538,316	39,557,311
Disposals	-	-	(2,234,119)	(25,503)	-	(2,259,622)
Reclassifications	-	(18,462,073)	5,570,764	6,528,443	6,321,522	(41,344)
Depreciation amortization charges for the year	-	(3,076,081)	(10,962,650)	(15,337,666)	(6,519,981)	(35,896,378)
Balance at December 31, 2017, net of accumulated depreciation and amortization	P 17,963,677	P 31,731,917	P 20,721,896	P 16,241,857	P 23,590,326	P 110,249,673

Certain fully depreciated assets costing P206.3 million and P161.7 million as of December 31, 2018 and 2017, are still being used in operations.

In 2017, the Bank sold certain transportation equipment and fixtures and equipment with a total carrying amount of P2.3 million for P2.2 million. In 2018, the Bank disposed fully depreciated furniture and fixture, and transportation equipment with a carrying amount of P28,805. The loss on sale in 2017 amounting to P17,090 is presented as part of Loss on sale of non-financial assets as part of Operating expenses account in the 2017 statement of comprehensive income (see Note 16.1). No gain or loss on sale was recognized in 2018.

The BSP requires that investments in fixed assets do not exceed 50% of the Bank's unimpaired capital. As of December 31, 2018 and 2017, the Bank has satisfactorily complied with this BSP requirement.

10. INVESTMENT PROPERTIES

The Bank's investment properties include parcels of land and buildings acquired principally through foreclosures.

The gross carrying amounts and cumulative fair value adjustments of investment properties presented in the statements of financial position as at December 31, 2018 and 2017 are shown below.

	Land	Buildings	Total
December 31, 2018			
Cost	P 79,792,422	P 13,450,303	P 93,242,725
Cumulative fair value adjustment	105,016,074	19,289,340	124,305,414
	P 184,808,496	**P 32,739,643**	**P217,548,139**
December 31, 2017			
Cost	P 99,010,035	P 19,523,500	P118,533,535
Cumulative fair value adjustment	87,873,319	19,528,580	107,401,899
	P 186,883,354	P 39,052,080	P225,935,434

A reconciliation of the carrying amounts of investment properties at the beginning and end of 2018 and 2017 is shown below.

	Land	Buildings	Total
Balance at January 1, 2018	P 186,883,354	P 39,052,080	P225,935,434
Additions	25,740,506	-	25,740,506
Disposals	(44,958,119)	(6,073,197)	(51,031,316)
Fair value gain (loss)	17,142,755	(239,240)	16,903,515
Balance at December 31, 2018	**P 184,808,496**	**P 32,739,643**	**P217,548,139**
Balance at January 1, 2017	P 195,870,576	P 4,143,324	P200,013,900
Additions	17,218,944	2,200,427	19,419,371
Disposals	(11,953,462)	(256,957)	(12,210,419)
Fair value gain (loss)	(14,252,704)	32,965,286	18,712,582
Balance at December 31, 2017	P 186,883,354	P 39,052,080	P225,935,434

The Bank sold certain investment properties with total gross carrying amount of P51.0 million for P58.4 million and P18.6 million for P26.3 million in 2018 and 2017, respectively. As a result, the Bank recognized a loss on sale amounting to P3.4 million in 2018 and gain on sale amounting to P7.7 million in 2017, which is presented as part of Gain on sale of non-financial assets under Other Income account in the statements of comprehensive income (see Note 16.1).

11. OTHER RESOURCES

This account consists of:

	Notes	2018	2017
Advances to an associate and others	11.3,19,21.2	**P 186,958,884**	P 40,000,000
Deferred tax assets	18	**88,217,240**	59,915,411
Sales contract receivable	11.2	**27,650,919**	14,315,804
Accounts receivable	11.1	**23,679,297**	25,782,862
Other investment	11.4	**20,000,000**	20,000,000
Equity investment in an associate	11.5	**18,408,870**	13,557,341
Intangible assets - net	11.3	**5,250,128**	8,172,986
Assets held-for-sale	11.6	**5,338,900**	4,264,628
Others		**16,113,824**	2,227,151
		391,618,062	188,236,183
Allowance for impairment		**(7,701,324)**	(4,861,864)
		P 383,916,738	P 183,374,319

11.1 Accounts Receivables

The Accounts receivable is mainly composed of receivables from remittance companies arising from money remittance operations.

11.2 Sales Contract Receivable

Sales contract receivables represent the balance of the selling price of assets owned or acquired under an agreement wherein the title to the said assets shall only be transferred to the buyer upon full payment.

11.3 Intangible Assets

The Bank's intangible assets consist of the following:

(a) Software

Software mainly consists of payments for the right to use FinnOne, the comprehensive banking solution software used by the Bank. The movements in the carrying value of this account are shown below.

	2018	2017
Balance at beginning of year	**P 3,841,442**	P 1,945,577
Additions	**22,405,382**	9,353,272
Amortization during the year	**(23,162,468)**	(7,457,407)
Balance at end of year	**P 3,084,356**	P 3,841,442

The amortization on software is presented as part of Depreciation and amortization under Other Expenses account in the statements of comprehensive income (see Note 16.2).

(b) License

In December 2014, the Bank made a one-time, non-refundable membership fee to Philippine Clearing House Corporation (PCHC), which entitled the Bank to participate directly in the clearing operations of PCHC and BSP. The fee paid by the Bank amounts to P10.8 million and was amortized over five years beginning January 1, 2015. The movements in the carrying value of this account are shown below.

	2018	2017
Balance at beginning of year	**P 4,331,544**	P 6,497,316
Amortization during the year	**(2,165,772)**	(2,165,772)
Balance at end of year	**P 2,165,772**	P 4,331,544

The Bank's amortization is presented as part of Depreciation and amortization under Other Expenses account in the statements of comprehensive income (see Note 16.2).

11.4 Other Investment

Other investment pertains to the Bank's investment in escrow fund with a certain bank to acquire certain non-listed equity shares. On June 6, 2017, the BSP approved the Bank's application for the acquisition of the non-listed equity shares. The escrow fund is yet to be released and the proceeds for the acquisition was from the Bank's unrestricted cash.

Upon approval of the BSP on June 6, 2017 of the Bank's application for the acquisition of the 20% ownership interest in SRBI, the Bank recognized such as an investment in an associate accounted for under the equity method.

11.5 Investment in an Associate

The carrying value of investment in SRBI accounted for under the equity method is as follows:

	2018	2017
Acquisition cost	**P 4,379,086**	P 4,379,086
Excess of share of fair value of net assets over cost	**8,990,366**	8,990,366
Accumulated share in profit	**4,629,221**	187,889
Accumulated share in OCI	**410,197**	-
Balance at end of year	**P 18,408,870**	P 13,557,341

As of the date of acquisition, the Bank's share in net assets of SRBI amounted to P13.4 million resulting in an excess of share in fair value of net assets over cost amounting to P9.0 million included as part of Share in net profit of an associate under Other Income account in the 2017 statement of comprehensive income.

	Note	2018	2017
Balance at beginning of year		**P 13,557,341**	P -
Acquisition cost		**-**	4,379,086
Excess of share of fair value of net assets over cost		**-**	8,990,366
Share in profit of associate		**4,441,332**	187,889
Share in OCI	16.1	**410,197**	-
Balance at end of year		**P 18,408,870**	P 13,557,341

Summarized information with respect to the Bank's associate from the date of acquisition of ownership in associate is presented below.

	2018	2017
Total resources	**P 861,870,233**	P 525,515,269
Total liabilities	**(758,773,614)**	(458,135,596)
Net assets as of December 31, 2018	**P 103,096,619**	P 67,379,673
Total income	**P 107,850,875**	P 73,561,512
Total expenses	**(85,644,213)**	(63,547,227)
Net profit for the period	**22,206,662**	10,014,285
Other comprehensive income	**2,050,986**	-
Pre-acquisition income	**-**	(9,074,841)
	24,257,648	939,444
Ownership interest	**20%**	20%
Share in total comprehensive income for the period	**P 4,851,530**	P 187,889

In addition, the Bank granted advances to SRBI totaling P51.4 million, which remains outstanding as of December 31, 2018. These advances are payable on demand, non-interest bearing and unsecured. A reconciliation of other investment balance is presented below.

	2018	2017
Beginning balance	**P 40,000,000**	P -
Advances during the year	**86,017,152**	40,000,000
Repayment during the year	**(74,653,886)**	-
Ending balance	**P 51,363,266**	P 40,000,000

11.6 Assets Held for Sale

The Bank's assets held for sale is composed of the following:

		2018		2017
Jewelry	**P**	**5,203,890**	P	4,042,952
Motor vehicle		**135,000**		221,676
	P	**5,338,890**	P	4,264,628

The changes in the carrying amount of the assets held-for-sale are summarized as follows:

		2018		2017
Balance at beginning of year	**P**	**4,264,628**	P	11,460,915
Repossessions		**6,243,585**		17,205,715
Sale and redemption	**(**	**5,169,323)**	(	24,402,002)
Balance at end of year	**P**	**5,338,890**	P	4,264,628

The fair values of the Bank's assets held-for-sale were based on the latest appraised values, as determined by both external and internal professional appraisers (see Note 5.3.2).

Net gain on sale of assets held-for-sale amounted to P5.5 million and P4.5 million in 2018 and 2017, respectively and is included as part of Gain on sale of non-financial assets under the Other Income account in the statements of comprehensive income (see Note 16.1).

All of the Bank's other resources have been reviewed for indications of impairment. Certain accounts receivables were found to be impaired and provisions have been recorded accordingly. A reconciliation of allowance for impairment at the beginning and end of the reporting period is shown below.

	Note		2018		2017
Balance at beginning of year		**P**	**4,861,864**	P	3,735,945
Impairment loss during the year			**4,865,703**		1,914,273
Reclassification	8	**(**	**2,026,243)**	(	788,354)
Balance at end of year		**P**	**7,701,324**	P	4,861,864

Impairment losses recognized in 2018 and 2017 are presented as part of Impairment Losses account in the statements of comprehensive income.

12. DEPOSIT LIABILITIES

Deposit liabilities are in the form of savings, demand and time deposits with annual interest rates ranging from 1.00% to 16.67% per annum both in 2018 and 2017.

The breakdown of deposit liabilities are as follows:

	2018	2017
Demand	**P 386,270,967**	P 274,873,931
Savings	**1,591,677,346**	1,486,343,480
Time	**2,180,396,199**	2,508,643,542
	P 4,158,344,512	P 4,269,860,953

Under existing BSP regulations, deposit liabilities are subject to regular and liquidity reserve of 8.00% both in 2018 and 2017. The Bank has reserves from its balance in Due from BSP account amounting to P370.5 million and P388.8 million as of December 31, 2018 and 2017, respectively (see Note 6.2). The Bank is in compliance with these BSP regulations as of the end of reporting periods.

The maturity profile of deposit liabilities is disclosed in Note 4.2.

13. BILLS PAYABLE

This account consists of borrowings from:

	2018	2017
Land Bank of the Philippines	**P2,336,424,902**	P 798,805,319
Development Bank of the Philippines	**124,996,875**	10,000,000
Quedan Corporation	**86,989**	86,989
	P2,461,508,766	P 808,892,308

Bills payable are subject to annual fixed interest rates ranging from 4.00% to 7.80% and from 2.35% to 5.50% in 2018 and 2017, respectively, and have maturities ranging from one to four years.

Bills payable are collateralized by the assignment of certain loans amounting to P1.9 billion and P583.2 million as of December 31, 2018 and 2017, respectively (see Note 8).

The maturity profile of bills payable is presented below.

	2018	2017
Within one year	**P1,386,075,329**	P 500,656,809
Beyond one year	**1,075,433,437**	308,235,499
	P2,461,508,766	P 808,892,308

The movements in this account are presented below:

	2018	2017
Balance at beginning of year	**P 808,892,308**	P1,313,456,741
Additions	**2,413,916,530**	255,467,443
Settlements	**(761,300,072)**	(760,031,876)
Balance at end of year	**P2,461,508,766**	P 808,892,308

14. ACCRUED EXPENSES AND OTHER LIABILITIES

The composition of this account follows:

	Note	2018	2017
Accrued interest		**P 206,340,210**	P 177,468,770
Accounts payable		**185,641,925**	152,440,121
Post-employment benefit obligation	17.2	**36,169,861**	24,641,267
Accrued expenses		**41,369,421**	23,364,740
Income tax payable		**38,646,569**	19,454,725
		P 508,167,986	P 397,369,623

Accounts payable consists mainly of deposits from borrowers for the payment of registration of mortgage documents and redemption of property or assets acquired, and of loan payments made by borrowers prior to due date.

Accrued expenses consist of leave credits of employees, salary differentials, utilities expense and rent.

15. CAPITAL FUNDS AND CAPITAL MANAGEMENT

15.1 Capital Stock

As of December 31, 2018 and 2017, the Bank has 160,000,000 authorized common shares, 2,000,000 preferred shares A and 38,000,000 preferred shares B. All of these types of shares are with par value of P10 per share. There are no outstanding preferred shares as of December 31, 2018 and 2017.

The capital stock of the Bank consists of 76,646,508 issued and outstanding common stocks with par value of P10 per share. As of December 31, 2018 and 2017, the Bank has 33 stockholders owning 100 or more common shares each of the Bank's capital stock.

15.2 Capital Management

(a) Regulatory Capital

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

In implementing current capital requirements, BSP requires the Bank to maintain a prescribed ratio of 10% of qualifying regulatory capital to total risk-weighted assets including market risk and operational risk.

Under the relevant provisions of the current BSP regulations, the regulatory capital is analyzed into two tiers.

Tier 1 Capital and Tier 2 Capital are defined as follows:

(i) Tier 1 Capital includes the following:
  a. paid-up common stock;
  b. surplus and surplus reserves; and,
  c. undivided profits (for domestic banks only),

  Subject to deductions for:
  a. treasury shares (if any);
  b. unrealized losses on underwritten listed equity securities purchased;
  c. unbooked valuation reserves, and other capital adjustments based on the latest BSP report of examination;
  d. outstanding unsecured credit accommodations, both direct and indirect, to Directors, Officers, Stockholders and Related Interests (DOSRI);
  e. goodwill; and,
  f. deferred tax asset.

(ii) Tier 2 Capital includes:
  a. dividends distributable (if any);
  b. appraisal increment reserve – bank premises if any, as authorized by the Monetary Board of the BSP;
  c. deposit for stock subscription on common stock; and,
  d. general loan loss provision, limited to a maximum of 1.0% of credit risk-weighted assets.

The Bank's regulatory capital position as of December 31, 2018 and 2017 (as reported to the BSP) are presented as follows (in thousands of Philippine Pesos):

	2018	2017
Tier 1 Capital	**P 1,684,577**	P 1,591,378
Tier 2 Capital	**33,753**	51,634
Total regulatory qualifying capital	**P 1,718,330**	P 1,643,012
Total risk weighted assets	**P 7,658,921**	P 6,066,469
Capital ratios:		
Total regulatory capital expressed as percentage of total risk-weighted assets	**22.44%**	27.08%
Total Tier 1 expressed as percentage of total risk-weighted assets	**21.99%**	26.23%

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

(b) Capital Allocation

The allocation of capital between specific operations and activities is, to a large extent driven by optimization of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but in some cases the regulatory requirements do not reflect fully the varying degrees of risk associated with different activities. In such cases the capital requirements may be flexed to reflect differing risk profiles subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes. The process of allocation of capital to specific operations and activities is undertaken independently of those responsible for the operation, and is subject to review by the Bank's RMC.

Although maximization of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Bank to particular operations or activities, it is not the sole basis used for decision making. Account profitability is also taken, and synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Bank's longer term strategic objectives. The Bank's policies in respect of capital management and allocation are reviewed regularly by the BOD.

(c) *Minimum Capital Requirement*

In 2014, the BSP issued Circular No. 854 increasing the minimum capitalization of banks. For thrift banks with head office outside national capital region with 11 to 50 branches, the minimum capitalization is P400 million.

The Bank has complied with the above minimum capital requirement as of December 31, 2018 and 2017.

15.3 Stock Dividend Distributable

On August 19, 2017, the Bank's BOD approved the declaration of 20% common stock dividend amounting to P127,744,180, which is equivalent to 12,774,418 common shares and was distributed to the stockholders on January 30, 2018. No similar transaction occurred in 2018.

16. OTHER INCOME AND OPERATING EXPENSES

16.1 Other Income

Presented below are the details of this account:

	Notes	2018	2017
Service fees and charges		**P 303,805,810**	P 211,490,257
Recovery on charged-off assets		**46,626,746**	48,226,147
Fair value gain (loss) on revaluation of investment properties	10	**16,903,515**	(18,712,582)
Gain (loss) on sale of non-financial assets	9, 10, 11	**(3,375,015)**	9,850,045
Gain (loss) on sale of bank premises, furniture, fixtures and equipment	9	**-**	(17,090)
Share in net profit of an associate	11	**4,441,332**	9,178,255
Miscellaneous		**64,469,549**	32,723,494
		P 432,672,048	P 330,163,690

Miscellaneous includes penalties charged to borrowers for late payments.

16.2 Other Expenses

Presented below are the details of these accounts:

	Notes	2018	2017
Salaries and employee benefits	17.1	**P 218,103,392**	P 186,624,085
Taxes and licenses	22.1(e)	**121,426,982**	92,612,676
Security, clerical, messengerial and janitorial services		**38,450,680**	34,395,055
Depreciation and amortization	9, 11.3	**37,623,368**	45,519,557
Insurance expense		**31,126,306**	35,633,262
Information technology services		**21,547,429**	1,332,469
Rent	21.1	**20,206,849**	17,882,633
Power, light and water		**18,108,449**	16,304,697
Postage, telephone, cables and telegrams		**16,430,935**	15,638,925
Incentive fees		**14,872,033**	13,152,738
Supplies		**12,759,189**	12,035,496
Repairs and maintenance		**12,634,303**	13,182,655
Fuel and lubricants		**12,258,650**	8,800,126
Transportation and travel		**10,107,388**	9,694,492
Litigation expenses		**10,099,608**	8,672,384
Management and professional fees	19.1	**6,634,229**	4,773,513
Banking fees		**4,155,288**	2,670,018
Representation and entertainment		**2,228,191**	2,284,508
Donations and charitable contributions		**2,005,841**	2,050,893
Advertising and publicity		**1,888,521**	1,294,460
Miscellaneous		**30,706,613**	28,298,077
		P 643,374,244	P 552,852,719

17. EMPLOYEE BENEFITS

17.1 Salaries and Employee Benefits Expense

Expenses recognized for employee benefits are analyzed below.

	Note	2018	2017
Short-term employee benefits		**P 210,773,239**	P 179,710,214
Post-employment benefits	17.2	**7,330,153**	6,913,871
		P 218,103,392	P 186,624,085

17.2 Post-employment Benefits

(a) Characteristics of the Defined Benefit Plan

The Bank maintains a funded, tax-qualified, non-contributory post-employment benefit plan that is being administered by a trustee bank that is legally separated from the Bank. The trustee bank managed the fund in coordination with the Bank's Retirement Plan Committee who acts in the best interest of the plan assets and is responsible for setting the investment policies. The post-employment plan covers all regular full-time employees.

The normal retirement age is 60 with a minimum of five years of credited service. The plan also provides for an early retirement at age 50 with a minimum of five years of credited service and late retirement after age 60, both subject to the approval of the Bank's BOD. Normal retirement benefit is an amount equivalent to 150% of the final monthly covered compensation (average monthly basic salary during the last 12 months of credited service) for every year of credited service.

(b) Explanation of Amounts Presented in the Financial Statements

Actuarial valuations are made annually to update the retirement benefit costs and the amount of contributions. All amounts presented below are based on the actuarial valuation report obtained from an independent actuary in 2018 and 2017.

The amount of post-employment benefit obligation recognized in the financial statements is determined as follows (see Note 14):

	2018	2017
Present value of obligation	**P 73,309,206**	P 62,018,139
Fair value of plan assets	**(37,139,345)**	(37,376,872)
	P 36,169,861	P 24,641,267

The movements in present value of the retirement benefit obligation recognized in the books are as follows:

	2018	2017
Balance at beginning of year	**P 62,018,139**	P 52,023,321
Current service cost	**7,330,153**	6,913,871
Interest expense	**3,535,034**	2,798,855
Actuarial losses (gains) arising from:		
Changes in financial assumptions	**13,086,478**	4,141,771
Experience adjustment	**(8,870,043)**	(1,207,329)
Benefits paid directly from book reserves	**(3,790,555)**	(2,652,350)
Balance at end of year	**P 73,309,206**	P 62,018,139

The movements in the fair value of plan assets are presented below.

	2018	2017
Balance at beginning of year	**P 37,376,872**	P 17,618,753
Actual contributions	**-**	20,000,000
Return on plan assets (excluding amounts included in net interest)	**(2,368,009)**	(1,727,770)
Interest income	**2,130,482**	1,485,889
Balance at end of year	**P 37,139,345**	P 37,376,872

Actual return on plan assets resulted to a loss amounted to P237,527 in 2018 and a gain amounted to P241,881 in 2017.

The composition of the fair value of plan assets at the end of the reporting period by category and risk characteristics is shown below.

	2018	2017
Government and corporate bonds	**P 35,427,124**	P 12,837,630
Cash and cash equivalents	**2,045,994**	4,797,945
Liabilities	**(96,246)**	(16,822)
	37,376,872	17,618,753
Actual contributions	**-**	20,000,000
Actual returns on plan assets	**(237,527)**	(241,881)
	(237,527)	19,758,119
	P 37,139,345	P 37,376,872

Plan assets do not comprise any of the Bank's own financial instruments or any of its assets occupied and/or used in its operations.

The components of amounts recognized in profit or loss and in other comprehensive income in respect of the defined benefit obligation are presented below.

	2018	2017
Recognized in profit or loss:		
Current service cost	**P 7,330,153**	P 6,913,871
Net interest expense	**1,404,552**	1,312,966
	P 8,734,705	P 8,226,837
Recognized in other comprehensive income (loss):		
Actuarial losses (gains) arising from changes in:		
financial assumptions	**P 13,086,478**	P 4,141,771
experience adjustments	**(8,870,043)**	(1,207,329)
Return on plan assets (excluding amounts included in net interest expense)	**2,368,009**	1,727,770
	P 6,584,444	P 4,662,212

Current service cost is presented as part of Salaries and employee benefits under the Other Expenses account (see Note 16.2) while net interest expense is included as part of the Other interest expenses under Interest Expense account in the statements of comprehensive income.

Amounts recognized in other comprehensive income were included within the item that will not be reclassified subsequently to profit or loss.

In determining the amounts of post-employment benefit obligation, the following significant actuarial assumptions were used:

	2018	2017
Discount rates	**7.48%**	5.70%
Expected rate of salary increases	**7.00%**	7.00%

Assumptions regarding future mortality experience are based on published statistics and mortality tables. The average remaining working lives of an individual retiring at the age of 60 is 28 years. These assumptions were developed by management with the assistance of an independent actuary. Discount factors are determined close to the end of each reporting period by reference to the interest rates of zero coupon government bonds with terms of maturity approximating to the terms of the retirement obligation. Other assumptions are based on current actuarial benchmarks and management's historical experience.

(c) *Risks Associated with the Retirement Plan*

The plan exposes the Bank to actuarial risks such as investment risk, interest rate risk, longevity risk and salary risk.

(i) *Investment and Interest Risks*

The present value of the defined benefit obligation is calculated using a discount rate determined by reference to market yields of government bonds. Generally, a decrease in the interest rate of reference government bonds will increase the plan obligation. However, this will be partially offset by an increase in the return on the plan's investments in debt securities and if the return on plan asset falls below this rate, it will create a deficit in the plan. Currently, the plan has cash and cash equivalents and debt securities. Due to the long-term nature of the plan obligation, a level of continuing debt securities is an appropriate element of the Bank's long-term strategy to manage the plan efficiently.

(ii) *Longevity and Salary Risks*

The present value of the defined benefit obligation is calculated by reference to the best estimate of the mortality of the plan participants both during and after their employment and to their future salaries. Consequently, increases in the life expectancy and salary of the plan participants will result in an increase in the plan obligation.

(d) Other Information

The information on the sensitivity analysis for certain significant actuarial assumptions, asset-liability matching strategy, and the timing and uncertainty of future cash flows related to the retirement plan are described below and in the succeeding page.

(i) Sensitivity Analysis

Each sensitivity analysis on the significant actuarial assumptions was prepared by remeasuring the defined benefit obligation at the actuarial valuation report date after first adjusting one of the current assumptions according to the applicable sensitivity increment or decrement, based on changes in the relevant assumption that were reasonably possible at the valuation date, while all other assumptions remained unchanged. The sensitivities were expressed as the corresponding change in the defined benefit obligation.

The following table summarizes the effects of changes in the significant actuarial assumptions used in the determination of the defined benefit obligation as of December 31:

	Impact on Post-Employment Benefit Obligation		
	Change in Assumption	Increase in Assumption	Decrease in Assumption
2018:			
Discount rate	**+/- 1.00%**	**(P 4,749,995)**	**P 4,226,752**
Salary growth rate	**+/- 1.00%**	**4,749,995**	**(4,282,414)**
2017:			
Discount rate	+/- 1.00%	(P 3,486,368)	P 3,935,602
Salary growth rate	+/- 1.00%	3,368,086	(3,058,589)

The sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions, the same method (present value of the defined benefit obligation calculated with the projected unit credit method at end of the reporting period) has been applied as when calculating the pension liability recognized within the statements of financial position.

(ii) Funding Arrangements and Expected Contributions

The schedule of expected future benefit payments as of December 31 for the next ten years is as follows:

	2018	2017
Within one year	**P 25,849,871**	P 6,899,773
Beyond one year but less than five years	**19,626,568**	18,115,297
Beyond five years	**56,078,431**	33,307,122
	P 101,554,870	P 58,322,192

The weighted average duration of the defined benefit obligation at the end of the reporting period is 6.1 years. The Bank expects to contribute P15.0 million to the plan in 2019.

18. TAXES

The components of tax expense as reported in the statements of comprehensive income for the years ended December 31, 2018 and 2017 are as follows:

	2018	2017
Recognized in profit or loss		
Current tax expense:		
Regular corporate income tax at 30% (RCIT)	**P 131,485,347**	P 83,963,516
Final tax at 20%	**3,644,679**	1,026,403
	135,130,026	84,989,919
Deferred tax income relating to origination and reversal of temporary differences	**(35,936,203)**	(13,836,195)
	P 99,193,823	P 71,153,724
Recognized in other comprehensive income		
Deferred tax expense relating to origination and relating to temporary differences	**P 2,151,132**	P 1,398,664

The reconciliation of tax on pretax profit computed at the applicable statutory rates to tax expense related in profit or loss section is shown below.

	2018	2017
Tax on pretax profit at 30%	**P 110,154,154**	P 73,307,440
Adjustment for income subjected to lower income tax rates	**(1,822,340)**	(513,201)
Tax effects of non-deductible expenses and non-taxable income	**471,716**	1,112,962
Adjustment for income tax as an effect of PFRS 9	**(9,609,707)**	(2,753,477)
	P 99,193,823	P 71,153,724

The deferred tax assets (presented under Other Resources account in the statements of financial position – see Note 11) as of December 31 relate to the following:

	Statements of Financial Position		Statements of Comprehensive Income: Profit or Loss		Statements of Comprehensive Income: Other Comprehensive Income	
	2018	2017	**2018**	2017	**2018**	2017
Allowance for impairment:						
Loans and discount	**P 74,656,268**	P 77,814,368	**(P 6,451,606)**	(P 20,229,497)	**P -**	P -
Other resources	**2,310,397**	1,458,560	**(851,837)**	(337,776)	**-**	-
Fair value gain (loss) on revaluation of investment properties	**(5,071,056)**	(32,220,570)	**(27,149,515)**	5,613,775	**-**	-
Post-employment benefit obligation	**10,850,958**	7,392,380	**(1,438,245)**	4,327,655	**2,151,133**	1,398,664
Unamortized past service cost	**5,470,673**	5,470,673	**-**	(3,210,352)	**-**	-
Deferred tax assets – net	**P 88,217,240**	P 59,915,411				
Deferred tax income (expense) – net			**(P 35,936,203)**	(P 13,386,195)	**P 2,151,133**	P 1,398,664

The Bank is subject to minimum corporate income tax (MCIT), which is computed at 2% of the Bank's gross income as defined under the tax regulations or to RCIT, whichever is higher. No MCIT was reported in 2018 and 2017 as the RCIT was higher than MCIT in those years.

In 2018 and 2017, the Bank opted to claim itemized deductions in computing of its income tax due.

19. RELATED PARTY TRANSACTIONS

The Bank's related parties include its DOSRI, related parties under common ownership, the Bank's key management personnel and others as described below.

The summary of the Bank's significant transactions and outstanding balance with its related parties as of and for the years ended December 31, 2018 and 2017 are as follows:

		2018		2017	
Related Party Category	Notes	**Amount of Transaction**	**Outstanding Balance**	Amount of Transaction	Outstanding Balance
DOSRI					
Deposit	19.1(a)	**P 123,378,409**	**P 36,832,978**	P 469,156,036	P 81,374,053
Loan receivables	19.1(a)	**1,851,018**	**5,040,437**	310,581	3,189,419
Management fees	19.1(b)	**1,217,216**	**-**	510,720	-
Associate					
Advances	11	**106,658,884**	**146,658,884**	40,000,000	40,000,000
Key management personnel					
Compensation	19.2	**26,293,752**	**-**	21,336,229	-

None of the Bank's outstanding balances with related parties has indications of impairment; hence, no impairment losses were recognized in both years.

19.1 DOSRI

(a) Loans and Deposits

In the ordinary course of business, the Bank has loan and deposit transactions with certain DOSRI. Under existing policies of the Bank, these loans are made on substantially the same terms as loans granted to other individuals and businesses of comparable risks. The amount of individual loans to DOSRI, of which 70% must be secured, should not exceed the amount of the deposit and book value of their investment in the Bank. In the aggregate, loans to DOSRI generally should not exceed the total equity or 15% of the total loan portfolio of the Bank, whichever is lower.

Certain DOSRI have outstanding loans with the Bank as of December 31, 2018 and 2017 and deposits with the Bank as of December 31, 2018 and 2017. The outstanding loans with DOSRI are all current. The following table shows information relating to the loans classified as DOSRI accounts under BSP Circular No. 423 and as of December 31, 2018:

Total outstanding DOSRI loans	P	6,663,487
Unsecured DOSRI loans		3,195,487
Percent of DOSRI loans to total loans		0.10%
Percent of unsecured DOSRI loans to total DOSRI loans		47.96%

(b) *Management Services*

In 2014, the Bank entered into a management service contract with the regional operating headquarters (ROHQ) of Bridge, where Bridge is a stockholder of the Bank. The service contract to be rendered by Bridge ROHQ covers the following projects:

- Implementation of action plan from corporate governance review;
- Design of incentive system based linking reward to performance;
- Dissemination of current best practice sales approaches techniques;
- Identification of behavioral indicators of future loan repayment and re-design renewal credit assessment;
- Reduction of collection frequency and elimination of unproductive account officer activities;
- Design and automation of collection process; and,
- Review of market, segment, client needs, competition, and alternative additional products.

The Bank recognized management fees expense amounting to P1.2 million and P0.5 million in 2018 and 2017, respectively, for the services billed by Bridge ROHQ reported as part of Management and professional fees under Other Expenses account in the statements of comprehensive income. There is no outstanding liability arising from this transaction as of December 31, 2018 and 2017.

19.2 Key Management Compensation

The compensation of key management personnel is broken down as follows:

	2018	2017
Short-term employee benefits	**P 19,184,029**	P 15,567,000
Post-employment defined benefit	**7,109,723**	5,769,229
	P 26,293,752	P 21,336,229

19.3 Retirement Plan

The Bank's retirement fund is a multi-employer retirement plan, which is administered by a trustee bank. The retirement fund includes investments in government bonds and cash and cash equivalents with fair value totalling P37.1 million and P37.4 million as of December 31, 2018 and 2017, respectively. The retirement fund has no outstanding deposits or investment in the Bank as of December 31, 2018 and 2017.

The details of the contributions of the Bank and benefits paid out by the plan to employees are presented in Note 17.2(b).

20. SELECTED FINANCIAL PERFORMANCE INDICATORS

The following are some measures of the Bank's financial performance indicators:

	2018	2017
Return on average equity	**11.95%**	10.14%
Return on average resources	**2.62%**	2.31%
Net interest margin	**9.48%**	9.05%
Net profit margin	**23.20%**	21.51%
Interest coverage ratio	**2.45 : 1.00**	2.44 : 1.00
Debt-to-equity ratio	**3.68 : 1.00**	3.11 : 1.00
Capital adequacy ratio	**19.34%**	27.08%

21. COMMITMENTS AND CONTINGENCIES

The following are the significant commitments and contingencies involving the Bank:

21.1 Operating Lease Commitments – Bank as a Lessee

The Bank entered into non-cancellable lease agreements for the lease of its office spaces and the premises where some of its branches and extension offices are situated for a period of three to eight years, renewable upon mutual agreement between the parties. These leases are accounted for as operating leases which either require fixed rental rate over the term of the lease or with stipulated annual escalation rate of 5.00% to 10.00%.

The future minimum rentals payable under these operating leases as of December 31 are as follows:

	2018	2017
Within one year	**P 17,103,282**	P 17,103,282
Beyond one year but less than five years	**16,391,656**	16,391,656
Beyond five years	**11,443,747**	11,443,747
	P 44,938,685	P 44,938,685

Total rent expense related to these operating leases amounted to P20.2 million and P17.9 million in 2018 and 2017, respectively, and is presented as Rent under Other Expenses account in the statements of comprehensive income (see Note 16.2).

21.2 Acquisition of DAHBI

On July 18, 2018, the Bank entered into a Share Purchase Agreement (SPA) for the acquisition and subscription of shares of stock in DAHBI. The acquisition involves 124,526,200 shares representing 100% ownership interest in DAHBI for an aggregate purchase price of P35,000,000.

DAHBI's registered office, which is also its principal place of business, is located at Fortich St, Malaybalay City, 8700 Bukidnon, Philippines and it has sixteen branches located in Bukidnon, Misamis Oriental, Cebu, Davao del Sur, and North Cotabato.

As of December 31, 2018, the acquisition of shares is still subject to approval of the BSP. The down payment of P29.8 million is recorded under Other Resources account in the 2018 statement of financial position (see Note 11).

As of and for the period ended December 31, 2018, DAHBI's total assets, total liabilities, revenues and net loss amounted to P517,791,627, P498,048,799, P99,443,616, and P33,324,668, respectively.

The Bank granted advances to DAHBI totaling P95.3 million, which remains outstanding as of December 31, 2018. These advances are payable on demand, non-interest bearing and unsecured.

21.3 Others

The Bank is a plaintiff in various cases pending in courts for alleged claims against the Bank, the outcome of which are not fully determinable as of date. Also, in the normal course of the Bank's operations, there are various outstanding commitments and contingent liabilities such as guarantees, commitments to extend credit, etc., which are not reflected in the financial statements. The Bank recognizes in its books any losses and liabilities incurred in the course of its operations as soon as these become determinable and quantifiable. Management believes that, as of December 31, 2018 and 2017, no additional material losses or liabilities are required to be recognized in the financial statements as a result of these commitments and transactions.

22. EVENTS AFTER THE END OF THE REPORTING PERIOD

On February 20, 2019, RA No. 11232, *An Act Providing for the Revised Corporation Code of the Philippines*, was enacted and signed into law. The RA amended certain provisions of the Corporation code of the Philippines effective February 23, 2019. Among the provisions, only the change in corporate term of stock corporations from 50 years, unless otherwise provided in the Bank's Articles of Incorporation, to perpetual existence is relevant to the Bank.

23. SUPPLEMENTAL INFORMATION REQUIRED BY THE BUREAU OF INTERNAL REVENUE

Presented below and in the succeeding pages is the supplementary information which is required by the Bureau of Internal Revenue (BIR) under its existing revenue regulations (RR) to be disclosed as part of the notes to the financial statements. This supplementary information is not a required disclosure under PFRS. All information are presented in their absolute amounts.

23.1 Requirements Under RR No. 15-2010

The information on taxes, duties and license fees paid or accrued during the taxable year required under RR No. 15-2010 are as follows:

(a) Gross Receipts Tax

In lieu of value-added taxes, the Bank is subject to the gross receipts tax (GRT) imposed on all banks and non-bank financial intermediaries performing quasi-banking transactions pursuant to Section 121 of the Tax Code, as amended.

In 2018, the Bank reported total GRT amounting to P77,223,579, which is shown as part of Taxes and licenses under Operating Expenses account in the 2018 statement of comprehensive income [see Notes 16.2 and 22.1(e)].

(b) Documentary Stamp Tax

In general, the Bank's documentary stamp tax (DST) transactions arise from the execution of debt instruments, security documents, certificates of deposits and bills of exchange.

For the year ended December 31, 2018, DST affixed amounted to P34,378,124 representing documentary stamps imposed mainly on debt instruments documents issued during the period [see Note 23.1(e)].

(c) Taxes on Importations

The Bank has not paid or accrued any taxes on importations as it has no importations for the year ended December 31, 2018.

(d) Excise Tax

The Bank did not have any transactions in 2018, which are subject to excise tax.

(e) Taxes and Licenses

The details of Taxes and licenses presented under Other Expenses account in the 2018 statement of comprehensive income follow:

	Notes	
GRT	22.1(a)	P 77,223,579
DST	22.1(b)	34,378,124
Business permits and registration		9,792,954
Others		32,325
	16.2	P 121,426,982

(f) *Withholding Taxes*

The details of total withholding taxes for the year ended December 31, 2018 are shown below.

Final	P 21,310,397
Compensation and employee benefits	4,943,289
Expanded	3,191,609
	P 29,445,295

(g) *Deficiency Tax Assessments and Tax Cases*

As of December 31, 2018, the Bank does not have any final deficiency tax assessments from the BIR nor does it have tax cases outstanding or pending in courts or bodies outside of the BIR in any of the open taxable years.

23.2 Requirements Under RR No. 19-2011

RR 19-2011 requires schedules of taxable revenues and other non-operating income, costs of services, itemized deductions and other significant tax information to be disclosed in the notes to financial statements.

The amounts of taxable revenues and income, and deductible costs and expenses presented below are based on relevant tax regulations issued by the BIR, hence, may not be the same as the amounts reflected in the profit or loss section of the statement of comprehensive income.

(a) *Taxable Revenues*

The Bank's taxable revenues subject to regular tax rate for the year ended December 31, 2018 amounted to P930,066,834.

(b) *Deductible Costs of Services*

Deductible costs of services for the year ended December 31, 2018 is broken down as follows:

Interest expense	P 226,563,610
Salaries and employee benefits	87,269,407
Insurance - PDIC	11,000,000
Supervision fees - BSP	4,155,288
	P 328,988,305

(c) *Taxable Non-operating and Other Income*

The details of taxable non-operating and other income in 2018, which are subject to regular tax rate are shown below.

Service fees and charges	P 303,805,921
Gain on revaluation of non-financial assets	107,401,899
Recovery on charged-off assets	46,626,746
Others	64,469,549
	P 522,304,115

(d) *Itemized Deductions*

The amounts of itemized deductions for the year ended December 31, 2018 subject to regular tax rate are as follow:

Bad debts	P 145,517,738
Salaries and allowances	125,889,836
Taxes and licenses	121,426,982
Security services	38,450,680
Depreciation and amortization	37,623,368
Information technology services	21,547,429
Rent	20,206,849
Insurance	20,126,306
Communication, light and water	18,108,449
Postage, telephone, cables, and telegram	16,430,935
Incentive fee	14,872,033
Office supplies	12,759,189
Repairs and maintenance	12,634,303
Fuel and oil	12,258,650
Transportation and travel	10,107,388
Professional fees	6,634,229
Loss on sale of bank premises	3,575,015
Representation and entertainment	2,228,191
Donations and charitable contributions	2,005,841
Advertising and publicity	1,888,521
Miscellaneous	40,806,221
	P 685,098,153

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Let's build your future together

1st Valley Bank
A Development Bank

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