CARD Bank, Inc.
(A Microfinance-Oriented Rural Bank)

Financial Statements
December 31, 2018 and 2017

and

Independent Auditor's Report

SGV
Building a better working world

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BOA/PRC Reg. No. 0001,
October 4, 2018, valid until August 24, 2021
SEC Accreditation No. 0012-FR-5 (Group A),
November 6, 2018, valid until November 5, 2021

INDEPENDENT AUDITOR'S REPORT

The Stockholders and the Board of Directors
CARD Bank, Inc. (A Microfinance-Oriented Rural Bank)
20 M. L. Quezon St., City Subdivision,
San Pablo City, Laguna

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of CARD Bank, Inc. (A Microfinance-Oriented Rural Bank) (the Bank), which comprise the statements of financial position as at December 31, 2018 and 2017, and the statements of income, statements of comprehensive income, statements of changes in equity 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 (PFRSs).

Basis for Opinion

We conducted our audits in accordance with Philippine Standards on Auditing (PSAs). Our responsibilities under those standards are further described in the *Auditor's 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 audit 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.

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 PFRSs, 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.

Auditor's 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 auditor's 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 PSAs 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 PSAs, 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 auditor's 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 auditor's 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.

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Report on the Supplementary Information Required Under Revenue Regulations No. 15-2010

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information required under Revenue Regulations 15-2010 in Note 25 to the financial statements is presented for purposes of filing with the Bureau of Internal Revenue and is not a required part of the basic financial statements. Such information is the responsibility of the management of CARD Bank, Inc. (A Microfinance-Oriented Rural Bank). The information has been subjected to the auditing procedures applied in our audit of the basic financial statements. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

SYCIP GORRES VELAYO & CO.

Ray Francis C. Balagtas

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PTR No. 7332523, January 3, 2019, Makati City

April 9, 2019

CARD BANK, INC.
(A MICROFINANCE-ORIENTED RURAL BANK)
STATEMENTS OF FINANCIAL POSITION

	December 31	
	2018	2017
ASSETS		
Cash and other cash items	**₱135,437,786**	₱143,046,805
Due from Bangko Sentral ng Pilipinas (Notes 6 and 13)	**323,613,641**	256,064,797
Due from other banks (Note 6)	**1,500,449,173**	1,948,860,842
Financial assets at fair value through other comprehensive income (Note 7)	**851,523,493**	–
Available-for-sale investments (Note 7)	–	376,124,647
Investment securities at amortized cost (Note 8)	**704,052,548**	–
Held-to-maturity investments (Note 8)	–	246,475,260
Loans and receivables (Note 9)	**10,407,292,246**	7,990,274,840
Investments in associates (Note 10)	**323,874,988**	246,812,578
Property and equipment (Note 11)	**481,717,442**	518,757,284
Retirement asset (Note 19)	**248,783,407**	252,154,652
Deferred tax assets (Note 21)	**1,840,203**	18,552,951
Other assets (Note 12)	**155,640,295**	151,572,020
	₱15,134,225,222	₱12,148,696,676

LIABILITIES AND EQUITY

Liabilities		
Deposit liabilities (Notes 13 and 22)		
Demand	**₱223,492,822**	₱185,941,415
Savings	**10,014,106,324**	7,836,619,226
	10,237,599,146	8,022,560,641
Bills payable (Note 14)	**529,496,198**	910,974,768
Income tax payable	**230,640,743**	100,043,581
Other liabilities (Note 15)	**443,290,933**	352,640,029
	11,441,027,020	9,386,219,019
Equity		
Capital stock (Note 17)		
Preferred stock	**1,000,000,000**	681,763,800
Common stock	**1,000,000,000**	999,992,600
	2,000,000,000	1,681,756,400
Surplus	**1,492,551,831**	1,025,345,873
Surplus reserve	**181,969,853**	–
Remeasurement gains on retirement liabilities (Note 19)	**59,500,259**	60,238,093
Share in other comprehensive income of an associate (Note 10)	**6,707,174**	2,777,611
Net unrealized losses on financial assets at fair value through other comprehensive income (Note 7)	**(47,530,915)**	–
Net unrealized losses on available-for-sale investments (Note 7)	–	(7,640,320)
	3,693,198,202	2,762,477,657
	₱15,134,225,222	₱12,148,696,676

See accompanying Notes to Financial Statements.

CARD BANK, INC.
(A MICROFINANCE-ORIENTED RURAL BANK)
STATEMENTS OF INCOME

	Years Ended December 31	
	2018	2017
INTEREST INCOME ON		
Loans and receivables (Note 9)	**₱4,485,685,850**	₱3,487,634,488
Investment securities (Notes 7 and 8)	**65,223,537**	19,606,806
Due from other banks (Note 6)	**55,032,894**	29,254,191
	4,605,942,281	3,536,495,485
INTEREST EXPENSE ON		
Deposit liabilities (Notes 13 and 22)	**208,483,125**	150,969,073
Bills payable (Note 14)	**30,633,662**	46,128,757
	239,116,787	197,097,830
NET INTEREST INCOME	**4,366,825,494**	3,339,397,655
Miscellaneous (Note 18)	**11,394,087**	14,460,885
TOTAL OPERATING INCOME	**4,378,219,581**	3,353,858,540
OPERATING EXPENSES		
Compensation and benefits (Notes 19 and 22)	**1,280,653,532**	1,065,535,236
Taxes and licenses (Note 21)	**249,534,020**	191,447,502
Transportation and travel	**223,118,786**	196,816,601
Rent (Notes 20 and 22)	**168,530,444**	144,166,947
Stationery and office supplies	**149,352,822**	101,227,269
Information and technology (Note 22)	**130,806,286**	175,327,157
Depreciation and amortization (Note 11)	**106,645,220**	107,826,908
Security, messengerial and janitorial	**89,240,544**	78,604,798
Employee trainings (Note 22)	**85,556,039**	64,946,032
Postage, telephone and cable	**69,582,154**	54,540,300
Members training and development (Note 22)	**41,762,370**	50,745,604
Power, light and water	**39,687,381**	33,014,091
Insurance	**22,474,482**	17,022,878
Repairs and maintenance	**20,291,201**	12,267,735
Management and other professional fees	**19,491,615**	21,193,110
Directors' fee	**17,130,970**	19,045,876
Seminars and meetings (Note 22)	**17,752,239**	13,403,705
Program monitoring and evaluation	**8,702,324**	6,509,929
Provision for (recovery from) credit losses (Note 9)	**(35,123,428)**	771,917
Miscellaneous (Notes 18 and 22)	**106,139,728**	63,352,315
	2,811,328,729	2,417,765,910
INCOME BEFORE SHARE IN NET INCOME OF AN ASSOCIATE	**1,566,890,852**	936,092,630
SHARE IN NET INCOME OF AN ASSOCIATE (Note 10)	**142,982,847**	88,560,569
INCOME BEFORE TAX	**1,709,873,699**	1,024,653,199
PROVISION FOR INCOME TAX (Note 21)	**467,868,612**	283,057,923
NET INCOME	**₱1,242,005,087**	₱741,595,276

See accompanying Notes to Financial Statements.

CARD BANK, INC.
(A MICROFINANCE-ORIENTED RURAL BANK)
STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31	
	2018	2017
NET INCOME	**₱1,242,005,087**	₱741,595,276
OTHER COMPREHENSIVE INCOME (LOSS)		
Items that may not be reclassified to profit or loss:		
Remeasurement gain (loss) on retirement liabilities (Note 19)	**(1,054,048)**	62,472,651
Income tax effects (Note 21)	**316,214**	(18,741,795)
	(737,834)	43,730,856
Items that may be reclassified to profit or loss:		
Changes in net unrealized losses on:		
Financial assets through other comprehensive income (Note 7)	**(57,002,642)**	–
Available-for-sale investments (Note 7)	–	(5,796,190)
Income tax effects (Note 21)	**17,112,047**	1,738,857
	(39,890,595)	(4,057,333)
Share in other comprehensive income of an associate (Note 10)	**3,929,563**	11,469,655
	(35,961,032)	7,412,322
TOTAL COMPREHENSIVE INCOME	**₱1,205,306,221**	₱792,738,454

See accompanying Notes to Financial Statements.

CARD BANK, INC.
(A MICROFINANCE-ORIENTED RURAL BANK)
STATEMENTS OF CHANGES IN EQUITY

	Preferred Stock (Note 17)	Common Stock (Note 17)	Surplus	Surplus Reserve	Remeasurement Gains on Retirement Liabilities (Note 19)	Share in Other Comprehensive Income (Loss) of an Associate (Note 10)	Net Unrealized Losses on Financial Assets at Fair Value Through Other Comprehensive Income and Available-for-sale Investments (Note 7)	Total
Balance at January 1, 2018, as previously reported	**₱681,763,800**	**₱999,992,600**	**₱1,025,345,873**	**₱–**	**₱60,238,093**	**₱2,777,611**	**(₱7,640,320)**	**₱2,762,477,657**
Effect of adopting Philippine Financial Reporting Standard (PFRS) 9 (Note 2)	–	–	**49,655,713**	–	–	–	–	**49,655,713**
Balance at January 1, 2018, as restated	**681,763,800**	**999,992,600**	**1,075,001,586**	–	**60,238,093**	**2,777,611**	**(7,640,320)**	**2,812,133,370**
Total comprehensive income	–	–	**1,242,005,087**	–	**(737,834)**	**3,929,563**	**(39,890,595)**	**1,205,306,221**
Issuance of shares of stocks	**318,146,400**	–	–	–	–	–	–	**318,146,400**
Collection of subscription receivable (Note 23)	**89,800**	**7,400**	–	–	–	–	–	**97,200**
Transfers to surplus reserve	–	–	**(181,969,854)**	**181,969,854**	–	–	–	–
Cash dividends (Note 17)	–	–	**(642,484,988)**	–	–	–	–	**(642,484,988)**
Balance at December 31, 2018	**₱1,000,000,000**	**₱1,000,000,000**	**₱1,492,551,831**	**₱181,969,854**	**₱59,500,259**	**₱6,707,174**	**(₱47,530,915)**	**₱3,693,198,202**
Balance at January 1, 2017	₱570,827,000	₱543,185,700	₱1,192,135,303	₱–	₱16,507,237	(₱8,692,044)	(₱3,582,987)	₱2,310,380,209
Total comprehensive income	–	–	741,595,276	–	43,730,856	11,469,655	(4,057,333)	792,738,454
Issuance of shares of stocks	56,853,600	–	–	–	–	–	–	56,853,600
Collection of subscription receivable (Note 23)	54,083,200	81,814,300	–	–	–	–	–	135,897,500
Stock dividends (Note 17)	–	374,992,600	(374,992,600)	–	–	–	–	–
Cash dividends (Note 17)	–	–	(533,392,106)	–	–	–	–	(533,392,106)
Balance at December 31, 2017	₱681,763,800	₱999,992,600	₱1,025,345,873	₱–	₱60,238,093	₱2,777,611	(₱7,640,320)	₱2,762,477,657

See accompanying Notes to Financial Statements.

CARD BANK, INC.
(A MICROFINANCE-ORIENTED RURAL BANK)
STATEMENTS OF CASH FLOWS

	Years Ended December 31	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before income tax	**₱1,709,873,698**	₱1,024,653,199
Adjustments for:		
Share in net income of an associate (Note 10)	**(142,982,847)**	(88,560,569)
Depreciation and amortization (Note 11)	**106,645,220**	107,826,908
Provision for (recovery from) credit losses (Note 8)	**(35,123,428)**	771,917
Retirement expense (Note 19)	**16,785,329**	29,760,603
Amortization of transaction costs (Note 14)	**2,412,936**	4,801,468
Amortization of net discount on held-to-maturity investments (Note 9)	**(1,944,104)**	516,497
Amortization of net premium on FVOCI (Note 7)	**(1,631,476)**	691,740
Gain on disposal of property and equipment (Note 18)	**(436,158)**	(1,598,854)
Assets disposed as expenses	**793,035**	–
Dividend received from unquoted equity security (Note 7)	**–**	(141,540)
Net unrealized gains on foreign exchange transactions	**(244,376)**	(80,493)
Operating income before changes in operating assets and liabilities:	**1,654,147,829**	1,078,640,876
Increase in the amounts of:		
Loans and receivables	**(2,473,630,489)**	(1,592,687,190)
Other assets	**(14,687,170)**	(8,187,670)
Increase (decrease) in the amounts of:		
Deposit liabilities	**2,215,038,505**	2,053,375,833
Other liabilities	**97,762,934**	(7,951,336)
Net cash generated from operations	**1,478,451,606**	1,523,190,513
Income taxes paid	**(324,411,459)**	(284,358,003)
Contribution to retirement fund (Note 19)	**(14,468,132)**	–
Net cash provided by operating activities	**1,139,572,016**	1,238,832,510
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisitions of:		
Financial assets at FVOCI	**(531,207,527)**	–
Available-for-sale investments	**–**	(150,981,046)
Property and equipment (Note 11)	**(81,322,993)**	(75,196,919)
Financial assets at amortized cost (Note 9)	**(489,064,462)**	(50,000,000)
Software costs (Note 12)	**(1,963,740)**	(2,869,954)
Dividends received (Notes 7 and 10)	**70,250,000**	48,141,540
Additional investment in an associate (Notes 10 and 23)	**–**	(25,000,000)
Proceeds from:		
Maturity of financial assets at amortized cost (Note 9)	**196,142,033**	49,015,000
Disposal of property and equipment (Note 11)	**1,809,970**	9,239,349
Net cash used in investing activities	**(836,519,414)**	(197,652,030)

(Forward)

	Years Ended December 31	
	2018	2017
CASH FLOWS FROM FINANCING ACTIVITIES		
Settlements of bills payable (Note 14)	**(₱583,160,000)**	(₱963,160,000)
Availments of bills payable (Note 14)	**199,268,493**	498,282,877
Proceeds from (Note 17):		
Collection of subscriptions receivable on common stock	**7,400**	81,814,300
Collection on issuance of preferred stock	**318,146,400**	56,853,600
Collection of subscriptions receivable on preferred stock	**89,800**	54,083,200
Dividends paid (Note 17)	**(626,120,915)**	(492,542,947)
Net cash used in financing activities	**(691,768,821)**	(764,668,970)
EFFECTS OF EXCHANGE RATE CHANGES IN CASH AND CASH EQUIVALENTS	**244,376**	80,493
NET DECREASE IN CASH AND CASH EQUIVALENTS	**(388,471,844)**	276,592,003
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		
Cash and other cash items	**143,046,805**	146,860,868
Due from Bangko Sentral ng Pilipinas	**256,064,797**	189,947,924
Due from other banks	**1,948,860,842**	1,734,571,649
	2,347,972,444	2,071,380,441
CASH AND CASH EQUIVALENTS AT END OF YEAR		
Cash and other cash items	**135,437,786**	143,046,805
Due from Bangko Sentral ng Pilipinas	**323,613,641**	256,064,797
Due from other banks	**1,500,449,173**	1,948,860,842
	₱1,959,500,600	₱2,347,972,444

OPERATIONAL CASH FLOWS FROM INTEREST AND DIVIDENDS

	Years Ended December 31	
	2018	2016
Interest received	**₱4,481,458,237**	₱3,453,540,896
Interest paid	**241,246,741**	139,519,723

See accompanying Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

1. Corporate Information

CARD Bank, Inc. (A Microfinance-Oriented Rural Bank) (the Bank) was incorporated in the Philippines on July 1, 1997. The Bank was granted the authority to operate by the Bangko Sentral ng Pilipinas (BSP) on August 25, 1997 and formally opened for business on September 1, 1997.

It is currently engaged in extending microcredit and rural credit to small farmers and tenants and to deserving rural industries or enterprises. The Bank offers a wide range of products and services such as deposit products, loans, and treasury that serve mainly to the consumer market.

On April 16, 2011, the Bank's Board of Directors (BOD) and stockholders approved the amendment to the Articles of Incorporation, adding to the Bank's purpose the function to act as a micro-insurance agent for the presentation, marketing, sale, and servicing of micro-insurance products. This was subsequently approved by the BSP and the Insurance Commission on February 10, 2012 and January 17, 2012, respectively. The Philippine Securities and Exchange Commission (SEC) approved and issued the certificate of filing of amended Articles of Incorporation on June 29, 2012.

The Bank is a member of Center for Agriculture and Rural Development (CARD) - Mutually Reinforcing Institutions (MRI).

As at December 31, 2018 and 2017, the Bank is 29.57% and 37.48% owned by CARD, Inc., respectively.

The Bank's executive office is located at 20 M. L. Quezon Street, City Subdivision, San Pablo City, Laguna. The head office is located at No. 35 P. Burgos, corner M. Paulino Street, San Pablo City, Laguna. As at December 31, 2018 and 2017, the Bank has 92 and 86 branches, respectively.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements have been prepared on a historical cost basis except for financial assets at fair value through other comprehensive income (FVOCI) / available-for-sale investments (AFS) that have been measured at fair value. The financial statements are presented in Philippine peso (₱), which is the Bank's presentation currency. All values are rounded to the nearest peso, except when otherwise indicated.

The financial statements of the Bank include the accounts maintained in the Regular Banking Unit (RBU) and Foreign Currency Deposit Unit (FCDU). The functional currency of the RBU and the FCDU is the Philippine peso and United States dollar (USD), respectively. For financial reporting purposes, FCDU accounts and foreign currency-denominated accounts in the RBU are translated into their equivalents in Philippine pesos (see accounting policy on Foreign Currency Transactions and Translation). The financial statements of these units are combined after eliminating inter-unit accounts and transactions.

Statement of Compliance

The financial statements of the Bank have been prepared in compliance with Philippine Financial Reporting Standards (PFRS).

Presentation of Financial Statements
The statements of financial position of the Bank are presented in order of liquidity. An analysis regarding recovery of assets or settlement of liabilities within 12 months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in Note 16.

Financial assets and financial liabilities are offset, and the net amount is reported in the statement of financial position if and only if there is a currently enforceable legal 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 Bank assesses that it has a currently enforceable right of offset if the right is not contingent on a future event, and is legally enforceable in the normal course of business, event of default, and event of insolvency or bankruptcy of the Bank and all of the counterparties.

The Bank has no offsetting arrangements with its counterparties.

Income and expenses are not offset in the statement of income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Bank.

Changes in Accounting Policies and Disclosures
The accounting policies adopted are consistent with those of the previous financial year except for the adoption of the following amended standards, which became effective as of January 1, 2018. Except as otherwise indicated, these changes in the accounting policies did not have any significant impact on the financial position or performance of the Bank:

New and Amended Standards

- Amendments to PFRS 2, *Share-based Payment*, *Classification and Measurement of Share-based Payment Transactions*
- Amendments to PFRS 4, *Insurance Contracts, Applying PFRS 9, Financial Instruments, with PFRS 4, Insurance Contracts*
- PFRS 15, *Revenue from Contracts with Customers*
  PFRS 15 supersedes PAS 11, *Construction Contracts*, PAS 18, *Revenue* and related Interpretations and it applies, with limited exceptions, to all revenue arising from contracts with customers. PFRS 15 establishes a five-step model to account for revenue arising from contracts with customers and requires that revenue be recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. In addition, guidance on interest and dividend income have been moved from PAS 18 to PFRS 9 without significant changes to the requirements. The adoption of PFRS 15 has no significant impact to the Bank, since its revenue, primarily interest income from loans and receivables, are outside the scope of such standard.
- Philippine Interpretation IFRIC 22, *Foreign Currency Transactions and Advance Consideration*

Annual Improvements to PFRSs (2014 - 2017 Cycle)

- Amendments to PAS 28, *Investments in Associates and Joint Ventures, Measuring an Associate or Joint Venture at Fair Value* (Part of Annual Improvements to PFRSs, 2014 – 2016 Cycle).
- Amendments to PAS 40, *Investment Property*, *Transfers of Investment Property*

Standard that has been adopted and that is deemed to have significant impact on the financial statements or performance of the Bank is described below:

PFRS 9 (2014), *Financial Instruments*

The Bank adopted the final version of PFRS 9 effective January 1, 2018. As a result, the Bank changed to the following accounting policies beginning 2018.

a. Classification and Measurement
The 2009 version of PFRS 9 in December 2010 specified how an entity should classify and measure its financial assets. It required all financial assets to be classified in their entirety on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. Financial assets are measured either at amortized cost or fair value.

The final version of PFRS 9 introduced a new FVOCI classification for debt instruments where the objective of the business model is both to collect contractual cash flows and to realize fair value changes. As a result, the Bank reclassified certain financial assets to amortized cost while certain debt financial assets to amortized cost while certain debt securities to FVTOCI.

As of January 1, 2018, all of the Bank's financial assets were determined to have passed the contractual cash flow test as the cash flows are consistent with basic lending arrangement and asset portfolio are managed based on return of principal and carried at agreed yields.

b. Impairment
The Bank records expected credit losses (ECL) for all loans and other debt financial assets not classified as FVTPL.

ECL represents credit losses that reflect an unbiased and probability-weighted amount which is determined by evaluating a range of possible outcomes, the time value of money and reasonable and supportable information about past events, current conditions and forecasts of future economic conditions. ECL allowances are measured at amounts equal to either (i) 12-month ECL or (ii) lifetime ECL for those financial instruments which have experienced a significant increase in credit risk (SICR) since initial recognition (General Approach). The 12-month ECL is the portion of lifetime ECL that results from default events on a financial instrument that are possible within the 12 months after the reporting date. Lifetime ECL are credit losses that results from all possible default events over the expected life of a financial instrument.

For non-credit-impaired financial instruments:

- Stage 1 is comprised of all non-impaired financial assets which have not experienced a SICR since initial recognition or is considered of low credit risk as of the reporting date. The Bank recognizes a 12-month ECL for Stage 1 financial instruments.
- Stage 2 is comprised of all non-impaired financial assets which have experienced a SICR since initial recognition. The Bank recognizes a lifetime ECL for Stage 2 financial instruments.

For credit-impaired financial instruments:

- Stage 3 is comprised of all financial assets that have objective evidence of impairment as a result of one or more loss events that have occurred after initial recognition with a negative impact on the estimated future cash flows of a loan or a portfolio of loans. The Bank recognizes a lifetime ECL for impaired financial instruments.

Definition of "default" and "restored"
The Bank classifies loans and receivables, or any financial asset as in default when it is credit impaired, becomes past due on its contractual payments in case of microfinance loans and for more than 90 days in case of other credit exposures, considered non-performing, under litigation or is classified as doubtful or loss. As part of a qualitative assessment of whether a customer is in default, the Bank considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted. An instrument is considered to be no longer in default (i.e. restored) if there is sufficient evidence to support that full collection is probable and payments are received for all maturing dues.

Credit risk at initial recognition
The Bank uses internal credit assessment and approvals at various levels to determine the credit risk of exposures at initial recognition. Assessment can be quantitative or qualitative and depends on the materiality of the facility or the complexity of the portfolio to be assessed.

Significant increase in credit risk
The assessment of whether there has been a significant increase in credit risk is based on an increase in the probability of a default occurring since initial recognition. The SICR criteria 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 require close monitoring or with well- defined credit weaknesses. For exposures without internal credit grades, if contractual payments are one day past due, the credit risk is deemed to have increased significantly since initial recognition. 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. Due dates are determined without considering any grace period that might be available to the borrower. 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

ECL parameters and methodologies
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 judgment.

The PD is an estimate of the likelihood of default over a 12-month horizon for Stage 1 or lifetime horizon for Stages 2 and 3. The PD for each individual instrument is modelled based on historic data and is estimated based on current market conditions and reasonable and supportable information about future economic conditions. The Bank segments its credit exposures based on homogenous risk characteristics and developed a corresponding PD methodology for each portfolio. The PD methodology for each relevant portfolio is determined based on the underlying nature or characteristic of the portfolio, behavior of the accounts and materiality of the segment as compared to the total portfolio.

LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from any collateral. It makes use of defaulted accounts that have either been identified as cured, restructured, or liquidated. The Bank segmented its LGD based on homogenous risk characteristics and calculated the corresponding segment-level averages.

EAD is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on committed facilities.

Forward-looking information
The Bank incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. A broad range of forward-looking information are considered as economic inputs, such as GDP growth, exchange rate, interest rate, inflation rate and other economic indicators. The inputs and models used for calculating ECL may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material.

The key forward-looking economic variables used in each of the economic scenarios for the ECL calculations are remittances, retail price index, calamity damage and unemployment rate.

The following table reconciles the aggregate opening allowances for credit losses under PAS 39 to ECL allowances under PFRS 9 on January 1, 2018:

	PAS 39 Category	Amount	Reclassifications	Remeasurement ECL*	PFRS 9 Category	Amount
Assets						
Cash and other cash items	Loans and receivables	₱143,046,805	–	₱–	Amortized cost	₱143,046,805
Due from Bangko Sentral ng Pilipinas	Loans and receivables	256,064,797	–	–	Amortized cost	256,064,797
Due from other banks	Loans and receivables	1,948,860,842	–	–	Amortized cost	1,948,860,842
Loans and receivables	Loans and receivables	7,993,833,454	(162,710,754)	49,655,713	Amortized cost	7,760,185,967
AFS investments/ Financial assets at FVOCI	AFS financial assets	376,124,647	–	–	FVOCI	376,124,647
HTM investments/ Investment securities and amortized cost	HTM financial assets	246,475,260	162,710,754	–	Amortized cost	409,186,014
		₱10,964,405,805	–	₱49,655,713		₱10,964,405,805

**Net of deferred tax adjustment of 21,281,020*

c. Hedge accounting
   The new hedge accounting model under PFRS 9 aims to simplify hedge accounting, align the accounting for hedge relationships more closely with an entity's risk management activities and permit hedge accounting to be applied more broadly to a greater variety of hedging instruments and risks eligible for hedge accounting.

   Adoption of these amendments did not have an impact on the Bank's financial statements as it does not apply hedge accounting.

Foreign Currency Transactions and Translation
Transactions and balances
The books of accounts of the RBU are maintained in Philippine peso, the RBU's functional currency, while those of the FCDU are maintained in USD, the FCDU's functional currency. For financial reporting purposes, the foreign currency-denominated monetary assets and monetary liabilities in the RBU are translated in Philippine peso based on the Bankers Association of the Philippines (BAP) closing rates prevailing at end of the year and foreign currency-denominated income and expenses based on the exchange rates at transaction dates. Foreign exchange differences arising from restatements of foreign currency-denominated assets and liabilities in the RBU are credited to or charged against the operations in the period which the rates change. Non-monetary items that are

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

FCDU
As at reporting date, the assets and liabilities of the FCDU are translated into the Bank's presentation currency, the Philippine peso, using PDS closing exchange rates and its income and expenses are translated at PDS weighted average rate (WAR) for the year.

Exchange differences arising on translation are taken directly to the statement of comprehensive income under 'Translation adjustment'. Upon actual remittance of FCDU income to RBU, the related exchange differences arising from translation lodged under 'Miscellaneous income or expense' is reclassified to the statement of income in the RBU books.

Fair Value Measurement
For measurement and disclosure purposes, the Bank determines the fair value of an asset or liability at initial measurement or at each reporting date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:
- in the principal market for the asset or liability, or
- in the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible to the Bank.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

If the asset or liability measured at fair value has a bid and ask price, the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value, regardless of where the input is categorized within the fair value hierarchy.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 - Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable

- Level 3 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

For assets and liabilities that are recognized in the financial statements at fair value on a recurring basis, the Bank determines whether transfers have occurred between levels in the hierarchy by reassessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy (see Note 4).

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and other cash items, due from BSP and other banks that are highly liquid, readily convertible to known amounts of cash with original maturities of three months or less from dates of placements and which are subject to insignificant risk of changes in value. Due from BSP includes statutory reserves required by the Bank which the Bank considers as cash and cash equivalents as withdrawals can be made to meet the Bank's cash requirements as allowed by the BSP.

Financial Instruments - Initial Recognition and Subsequent Measurement

Date of recognition

Regular way purchases or sales of financial assets that require delivery of the assets within the time frame established by regulation or convention in the market are recognized on settlement date. Settlement date accounting refers to (a) the recognition of an asset on the day it is received by the Bank, and (b) the derecognition of an asset and recognition of any gain or loss on disposal on the day that such asset is delivered by the Bank. Deposits and receivables from borrowers are recognized when cash is received or advanced to the borrowers.

Initial recognition of financial instruments

All financial instruments are initially recognized at fair value. Except for financial instruments at fair value through profit or loss (FVPL), the initial measurement of financial instruments includes transaction costs.

'Day 1' difference

Where the transaction price in a non-active market is different from the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Bank recognizes the difference between the transaction price and fair value (a 'Day 1' difference) in the statement of income under 'Miscellaneous' unless it qualifies for recognition as some other type of asset or liability. In cases where the transaction price used is made of data which is not observable, the difference between the transaction price and model value is only recognized in the statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Bank determines the appropriate method of recognizing the 'Day 1' difference amount.

Classification and Measurement of Financial Assets (policies applicable beginning January 1, 2018)

For purposes of classifying financial assets, an instrument is an 'equity instrument' if it is a non-derivative and meets the definition of 'equity' from the point of view of the issuer (under PAS 32, *Financial Instruments: Presentation*), except for certain non-derivative puttable instruments presented as equity by the issuer. All other non-derivative financial instruments are 'debt instruments'.

Business model assessment
The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- how the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel
- the risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed
- the expected frequency, value and timing of sales are also important aspects of the Bank's assessment

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realized in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

The Banks's measurement categories are described below:

The solely payments of principal and interest (SPPI) test
As a second step of its classification process the Bank assesses the contractual terms of financial assets to identify whether they meet the SPPI test.

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortization of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVTPL.

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

- the asset is held within the Bank's business model whose objective is to hold assets in order to collect contractual cash flows; 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 impairment in value, with the interest calculated recognized as ‘Interest income’ in the statement of income. The Bank classified cash and other cash items (COCI), due from BSP, due from other banks, investment securities at amortized cost, loans and receivables, security deposits (included under “other assets”) as financial assets at amortized cost.

Financial assets at FVTPL
Debt financial assets 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 fair value through profit or loss. Equity investments are classified as at FVTPL, unless the Bank designates an investment that is not held for trading as at FVOCI at initial recognition.

A financial asset is held for trading if:

- it has been acquired principally for the purpose of selling it in the near term; or
- 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 a financial guarantee.

As of December 31, 2018, the Bank has not designated any debt instrument that meets the amortized cost criteria as FVTPL. The Bank does not have financial assets at FVTPL as of reporting date.

The fair value of financial assets denominated in a foreign currency is determined in that foreign currency and translated at the Bankers Association of the Philippines (BAP) closing rate at the statements of reporting date. The foreign exchange component forms part of its fair value gain or loss.

Financial assets at FVOCI
The Bank applies the new category under PFRS 9 of debt and equity instruments measured at FVOCI when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets
- The contractual terms of the financial asset meet the SPPI test

Financial assets at FVOCI are subsequently measured at fair value with gains and losses arising due to changes in fair value recognized in OCI. Interest income and foreign exchange gains and losses are recognized in profit or loss in the same manner as for financial assets measured at amortized cost. On derecognition, cumulative gains or losses previously recognized in OCI are reclassified from OCI to profit or loss.

Reclassification of financial assets
The Bank can reclassify financial assets if the objective of its business model for managing those financial assets changes. The Bank is required to reclassify the following financial assets:

- from amortized cost to FVTPL if the objective of the business model changes so that the amortized cost criteria are no longer met; and
- from FVTPL to amortized cost if the objective of the business model changes so that the amortized cost criteria start to be met and the instrument’s contractual cash flows meet the amortized cost criteria.; and

- from FVOCI to amortized cost if the objective of the business model changes so that the fair value criteria are no longer met but the amortized cost
- criteria is still met and the instrument's contractual cash flows meet the amortized cost criteria.

Reclassification of financial assets designated as at FVTPL or equity financial assets at FVOCI at initial recognition is not permitted.

A change in the objective of the Bank's business model must be effected before the reclassification date. The reclassification date is the beginning of the next reporting period following the change in the business model.

Financial Liabilities at Amortized Cost

This category represents issued financial instruments or their components, which are not designated at FVPL where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares. The financial liabilities at amortized cost are classified under the statement of the financial position captions 'Deposit liabilities' and 'Bills payable', and financial liabilities presented under 'Other liabilities'. The components of issued financial instruments that contain both liability and equity elements are accounted for separately, with the equity component being assigned the residual amount after deducting from the instrument as a whole the amount separately determined as the fair value of the liability component on the date of issue.

After initial measurement, financial liabilities are subsequently measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any discount or premium on the issue and fees that are integral part of the EIR.

This accounting policy relates to the balance sheet captions 'Deposit liabilities', 'Bills payable' and financial liabilities presented under 'Other liabilities'.

Restructured loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered as past due.

Management continuously reviews restructured loans to ensure that all criteria are met and that future payments are likely to occur. The loan continues to be subject to an individual impairment calculated using the original EIR or collective impairment.

Impairment of Financial Assets

The Bank records the allowance for expected credit losses for all loans and receivables and other debt financial assets not held at FVTPL. Equity investment are not subject to impairment under PFRS 9. The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime ECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12-month ECL, as outlined in Note 2 *Changes in Accounting Policies*. The Bank's policies for determining if there has been a significant increase in credit risk are set out in Note 2 *Changes in Accounting Policies*.

Both lifetime ECL and 12-month ECL are calculated on an individual and collective basis.

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument. This is further explained in Note 2 *Changes in Accounting Policies*.

Debt instruments measured at fair value through OCI
The ECLs for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets are measured at amortized cost is recognized in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognized in OCI is recycled to the profit and loss upon derecognition of the assets.

Classification and Impairment of Financial Assets (Prior to Adoption of PFRS 9)
The Bank classifies its financial assets in the following categories: financial assets at FVPL, held-to-maturity (HTM) financial assets, AFS financial assets, and loans and receivables while financial liabilities are classified as financial liabilities at FVPL and financial liabilities carried at amortized cost. The classification depends on the purpose for which the investments were acquired and whether they are quoted in an active market. Management determines the classification of its investments at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

Financial assets and financial liabilities at FVPL
Financial assets and financial liabilities at FVPL include financial assets and liabilities held for trading purposes, financial assets and financial liabilities designated upon initial recognition as at FVPL, and derivative instruments.

Financial instruments held for trading
Financial instruments held for trading (HFT) include government debt securities purchased and held principally with the intention of selling them in the near term.

These securities are carried at fair value, and the realized and unrealized gains and losses on these instruments are recognized as 'Trading and securities gains' in the statement of income. Interest earned or incurred on financial instruments held for trading is reported in the statement of income under 'Interest income' (for financial assets) and 'Interest expense' (for financial liabilities).

As of December 31, 2017, the Bank does not have financial assets at FVPL that are classified as HFT.

HTM financial assets
HTM financial assets are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Bank's management has the positive intention and ability to hold to maturity. Where the Bank would sell other than an insignificant amount of HTM financial assets, the entire category would be tainted and reclassified as AFS financial assets and the Bank would be prohibited from classifying any financial asset under HTM category during the current year and two succeeding years thereafter unless for sales or reclassifications that:

- are so close to maturity or the financial asset's call date (for example, less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;
- occur after the entity has collected substantially all of the financial asset's original principal through scheduled payments or prepayments; or

- are attributable to an isolated event that is beyond the entity's control, is non-recurring and could not have been reasonably anticipated by the entity.

After initial measurement, these investments are subsequently measured at amortized cost using the effective interest method, less any impairment in value. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate (EIR). The amortization is included in 'Interest income' in the statement of income. Gains and losses are recognized in income when the HTM financial assets are derecognized and impaired, as well as through the amortization process. The losses arising from impairment of such investments are recognized in the statement of income under 'Provision for impairment and credit losses'. The effects of translation of foreign currency-denominated HTM financial assets are recognized in profit or loss. As of December 31, 2017, this account consists of government debt securities.

Loans and receivables
This accounting policy relates to 'Due from BSP, 'Due from other banks', accounts reported under 'Cash and cash equivalents', 'Loans and receivables', and financial assets reported under 'Other assets'.

Loans and receivables are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market other than:
- those that the Bank intends to sell immediately or in the near term and those that the Bank upon initial recognition designates as at FVPL;
- those that the Bank, upon initial recognition, designates as AFS financial assets; or
- those for which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration.

After initial recognition, loans and receivables are subsequently measured at cost (or amortized cost) using the effective interest method, less allowance for impairment and credit losses. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the EIR. The amortization is included under 'Interest income' in the statement of income. The losses arising from impairment are recognized under 'Provision for impairment and credit losses' in the statement of income.

AFS financial assets
AFS financial assets are those which are designated as such or do not qualify to be classified as financial assets at FVPL, HTM financial assets or loans and receivables. They are purchased and held indefinitely, and may be sold in response to liquidity requirements or changes in market conditions. They include debt and equity securities.

After initial measurement, AFS financial assets are subsequently measured at fair value. The effective yield component of AFS debt securities, as well as the impact of translation of foreign currency-denominated AFS debt securities, is reported in the statement of income. The unrealized gains and losses arising from the fair valuation of AFS financial assets are excluded, net of tax, from reported earnings and are included in 'Net unrealized losses on AFS financial assets' under OCI.

When the security is disposed of, the cumulative gain or loss previously recognized in OCI is recognized in 'Trading and securities gains' in the statement of income. Where the Bank holds more than one investment in the same security, these are deemed to be disposed of on a specific identification basis. Interest earned on holding AFS debt securities are reported as 'Interest income' using the EIR. Dividends earned on holding AFS equity securities are recognized in the statement of income as 'Miscellaneous income' when the right to receive the payment has been established. The losses arising from impairment of such investments are recognized as 'Provision for impairment and credit losses' in the statement of income.

Other financial liabilities
This accounting policy relates to the statement of financial position captions 'Deposit liabilities', 'Accrued interest and other expenses' and financial liabilities under 'Other liabilities'. These are issued financial instruments or their components which are not designated as at FVPL and where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of its own equity shares. The components of issued financial instruments that contain both liability and equity elements are accounted for separately, with the equity component being assigned the residual amount after deducting from the instrument as a whole the amount separately determined as the fair value of the liability component on the date of issue.

After initial measurement, other financial liabilities not qualified and not designated as at FVPL are subsequently measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any discount or premium on the issue and fees that are an integral part of the EIR.

Reclassification of Financial Assets (prior to adoption of PFRS 9)
The Bank may reclassify, in rare circumstances, non-derivative financial assets out of the HFT investments category and into the AFS financial assets, Loans and receivables or HTM financial assets categories. The Bank may also reclassify, in certain circumstances, financial instruments out of the AFS financial assets to loans and receivables category. Reclassifications of financial assets carried at fair value are recorded at fair value at the date of reclassification, which becomes the new amortized cost.

The Bank may reclassify a non-derivative trading asset out of HFT investments and into the Loans and Receivable category if it meets the definition of loans and receivables, the Bank has the intention and ability to hold the financial assets for the foreseeable future or until maturity and only in rare circumstances. If a financial asset is reclassified, and if the Bank subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognized as an adjustment to the EIR from the date of the change in estimate.
For a financial asset reclassified out of the AFS financial assets category, any previous gain or loss on that asset that has been recognized in OCI is amortized to profit or loss over the remaining life of the investment using the effective interest method. Any difference between the new amortized cost and the expected cash flows is also amortized over the remaining life of the asset using the effective interest method. If the asset is subsequently determined to be impaired then the amount recorded in OCI is recycled to the statement of income. Reclassification is at the election of management, and is determined on an instrument by instrument basis. The Bank does not reclassify any financial instrument into the FVPL category after initial recognition.

Impairment of Financial Assets (prior to adoption of PFRS 9)
The Bank assesses at each statement of financial position date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired, if and only if, there is objective evidence as a result of one or more events that had occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be

reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Financial assets carried at amortized cost
The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. For individually assessed financial assets, the amount of the loss is measured 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). The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate (EIR). If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flow that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. The carrying amount of the asset is reduced through the use of an allowance account and the amount of loss is recognized in 'Provision for credit losses' in the statement of income. Interest income continues to be recognized based on the original EIR of the asset. Loans and receivables, together with the associated allowance accounts, are written off when there is no realistic prospect of future recovery and all collateral has been realized. If, in a subsequent year, the amount of the impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write off is later recovered, the recovery is credited to 'Recovery on charged-off assets' in the statement of income.

If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed 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.

For the purpose of a collective assessment of impairment, financial assets are grouped on the basis of the industry of the borrower. Future cash flows on a group of financial assets that are collectively assessed for impairment are estimated on the basis of historical loss experience for the 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 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 reflect, and are directionally consistent with, changes in related observable data from year to year. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is reduced by adjusting the allowance account. If a previous write-off is later recovered, any amount formerly charged is credited to 'Miscellaneous income' in the statement of income.

Financial assets carried at cost
If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, the amount of loss is measured

as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

AFS financial assets
For AFS financial assets, the Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. In the case of equity investments classified as AFS financial assets, this would include:

- a 'significant' or 'prolonged' decline in the fair value of the investments below its cost; and /or
- other information about the issuer that may negatively affect an equity issuer's performance

The Bank treats 'significant' generally as 20.00% and 'prolonged' generally as greater than one year. Where there is evidence of impairment, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the statement of income, is removed from the statement of comprehensive income and recognized in the statement of income.

Impairment losses on equity securities are not reversed through the statement of income. Increases in fair value after impairment are recognized directly in the statement of comprehensive income.

In the case of debt securities classified as AFS financial assets, impairment is assessed based on the same criteria as financial assets carried at amortized cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortized cost and the current fair value, less any impairment loss previously recognized in profit or loss. Future interest income is based on the reduced carrying amount and is accrued based on the rate of interest used to discount future cash flows for the purpose of measuring impairment loss. Such accrual is recorded as part of 'Interest income' in the statement of income. If, in the subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the statement of income, the impairment loss is reversed through 'Miscellaneous income' in the statement of income.

Restructured loans
Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered as past due.

Management continuously reviews restructured loans to ensure that all criteria are met and that future payments are likely to occur. The loan continues to be subject to an individual impairment calculated using the original EIR or collective impairment.

<u>Derecognition of Financial Assets and Financial Liabilities</u>
Financial assets
A financial asset (or, where applicable a part of a financial asset or part of a group of financial assets) is derecognized when:
- the rights to receive cash flows from the asset have expired; or
- the Bank retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a pass-through arrangement; or
- the Bank has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained the risks and rewards of the asset, but has transferred control over the asset.

Where the Bank has transferred its rights to receive cash flows from an asset or has entered into a "pass-through" arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control over the asset, the asset is recognized to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

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

Write-offs
Financial assets are written off either partially or in their entirety when the Bank no longer expects collections or recoveries within a foreseeable future. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense.

Investments in Associates
An associate is an entity over which the Bank has a significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies. The Bank's investment in an associate is accounted for using the equity method.

Under the equity method, investment in an associate is initially recognized at cost. The carrying amount of the investment is adjusted to recognize changes in the Bank's share of net assets of the associate since the acquisition date. Goodwill relating to the associate is included in the carrying amount of the investment and is not tested for impairment separately.

The statement of income reflects the Bank's share of the results of operations of the associate. Any change in OCI of the associate is presented as part of the Bank's OCI. In addition, when there has been a change recognized directly in the equity of the associate, the Bank recognizes its share of any changes, when applicable, in the statement of changes in equity. Unrealized gains and losses resulting from transactions between the Bank and associate are eliminated to the extent of the interest in the associate'.

The financial statements of the associate are prepared for the same reporting period as the Bank. The associate's accounting policies conform to those used by the Bank for like transactions and events in similar circumstances.

Upon loss of significant influence over the associate, the Bank measures and recognizes any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognized in statement of income.

Property and Equipment
Land is stated at cost less any impairment in value while depreciable property and equipment such as furniture, fixtures and equipment, building, transportation equipment, leasehold improvements, and

land improvements are stated at cost less accumulated depreciation and amortization and any impairment in value.

Construction in progress is stated at cost less any impairment in value. The initial cost is comprised of construction costs and any other directly-attributable costs of bringing asset to its working condition and location for its intended use, including borrowing costs. Construction in progress is not depreciated until such time that the relevant assets are completed and are ready for use.

Depreciation and amortization commences once the property and equipment are available for use and is computed using the straight-line method over the estimated useful lives (EUL) of the respective assets, except for leasehold improvements which are amortized over the shorter of the EUL of the improvements or the terms of the related leases. The EUL of the depreciable assets are as follows:

Building	7 to 15 years
Furniture, fixtures and equipment	3 to 7 years
Leasehold improvements	3 years or the terms of the related leases, whichever is shorter
Land improvements	5 years
Transportation equipment	3 years

The EUL, residual value and depreciation and amortization method are reviewed periodically to ensure that these are consistent with the expected pattern of economic benefits from items of property and equipment.

Fully depreciated assets are retained in the accounts until they are no longer in use and no further depreciation is credited against profit or loss.

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected for its use or disposal. Any resulting gain or loss arising on the derecognition of the asset (calculated as the difference between the net disposal proceeds and carrying amount of the asset) is included in the statement of income in the year the asset is derecognized.

Intangible Assets

Intangible assets consist of software costs that are recognized under ‘Other assets’ in the statement of financial position. Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses.

Intangible assets are amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense on intangible assets is recognized in the statement of income in the expense category that is consistent with the function of the intangible assets.

If the entity acquires intangible assets by subcontracting other parties (e.g., development-and-supply contracts or research and development contracts), the entity must exercise judgment in determining whether it is acquiring an intangible asset or whether it is obtaining goods and services that are being used in the development of an intangible asset by the entity itself. In the latter case, the entity will only be able to recognize an intangible asset if the expenditures meet the criteria which confirm that the related activity is at a sufficiently advanced stage of development, which shall be both technically and commercially viable and includes only directly attributable costs.

Only expenditure arising from the development phase can be considered for capitalization, with all expenditure on research being recognized as an expense when it is incurred.

Software costs recognized as assets are amortized on a straight-line basis over the EUL of three (3) to ten (10) years. The amortization period and method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortization period or method, as appropriate, and are treated as changes in accounting estimates. Software costs under development are not amortized until available for use.

Impairment of Nonfinancial Assets
At each reporting date, the Bank assesses whether there is any indication that its nonfinancial assets (e.g., investment in an associate, property and equipment, and intangible assets) may be impaired. When an indicator of impairment exists or when an annual impairment testing for an asset is required, the Bank makes a formal estimate of recoverable amount.

Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case the recoverable amount is assessed as part of the cash generating unit (CGU) to which it belongs. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset (or CGU) is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset (or CGU).

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation and amortization, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the statement of income. After such a reversal, the depreciation expense is adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining life.

Revenue Recognition
Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured, regardless of when payment is being made. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duty. The Bank assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal. The Bank has concluded that it is acting as a principal in all of its revenue arrangements.

Effective January 1, 2018, under PFRS 15, revenue from contracts with customers is recognized when control of the services is transferred to the customer at an amount that reflects the consideration to which the Company expects to be entitled in exchange for those services. Prior to January 1, 2018, under PAS 18, Revenue, revenue is recognized to the extent that it is probable that economic benefits will flow to the Company and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received. The Company assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent. The Company has generally concluded that it is the principal in its revenue arrangements.

Unearned revenue represents revenues collected but not earned as of the reporting date

Cost and expenses are decreases in economic benefits during the accounting period in the form of outflows or decrease of assets or incurrence of liabilities that result in decrease in equity, other than those relating to distributions to equity participants. These are recognized as incurred.

The following specific recognition criteria must also be met before revenue is recognized:

Interest income
For all financial instruments measured at amortized cost and AFS investments, income is recorded at EIR, which is the rate that exactly discounts estimated future cash flows through the expected useful life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options), includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses. The adjusted carrying amount is calculated based on the original EIR. The change in carrying amount is recorded as 'Interest income' in the statement of income.

Once the recorded value of a financial asset or group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original EIR applied to the new carrying amount.

Under PFRS 9, when a financial asset becomes credit-impaired and is, therefore, regarded as Stage 3 (as discussed in "Impairment of Financial Assets" above), the Bank calculates interest income by applying the EIR to the net amortized cost of the financial asset. If the financial asset cures and is no longer credit-impaired, the Bank reverts to calculating interest income on a gross basis. Under PAS 39, once the recorded value of a financial asset or group of similar financial assets carried at amortized cost has been reduced due to an impairment loss, interest income continues to be recognized using the original EIR applied to the new carrying amount. The unearned discount is taken up to interest income over the installment terms and is computed using the EIR method.

Commission income, deposit-related fees, penalties and bank charges
Commissions are accrued when earned. Using an output method, revenue is recognized if the Bank has a right to invoice the customer for services directly corresponding to performance completed to date. These includes deposit-related fees, penalties and bank charges are recognized only upon collection or where there is a reasonable degree of certainty as to their collectability. These items are reported under 'Miscellaneous' in the statement of income.

The Bank assessed that there is no difference in accounting for service fees and commission income under PFRS 15 and PAS 18.

Rental income
Rental income arising on leased properties is accounted for on a straight-line basis over the lease terms on ongoing leases and is recorded in the statement of income under 'Miscellaneous'.

Expense Recognition
Expense is recognized when it is probable that decrease in the future economic benefits related to decrease in an asset or an increase in liability has occurred and that the decrease in economic benefits can be measured reliably. Expense is recognized when incurred.

Interest expense
Interest expense for all interest-bearing financial liabilities is recognized in 'Interest expense' in the statement of income using the EIR of the financial liabilities to which they relate.

Other expenses
Expenses encompass losses as well as those expenses that arise in the ordinary course of business of the Bank. Expenses are recognized when incurred.

Retirement Benefits
The Bank operates a defined benefit retirement plan and a defined contribution plan, which require contributions to be made to a separately administered fund.

Defined benefit retirement plan
The net defined benefit liability or asset is the aggregate of the present value of the defined benefit obligation at the reporting date reduced by the fair value of plan assets, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling (if any). The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The cost of providing benefits under the defined benefit plans is actuarially determined using the projected unit credit method.

Defined benefit costs comprise the following:
- Service cost
- Net interest on the net defined benefit liability or asset
- Remeasurements of net defined benefit liability or asset

Service costs which include current service costs, past service costs and gains or losses on non-routine settlements are recognized as expenses in the statement of income. Past service costs are recognized when plan amendment or curtailment occurs. These amounts are calculated periodically by independent qualified actuaries.

Net interest on the net defined benefit liability or asset is the change during the period in the net defined benefit liability or asset that arises from the passage of time which is determined by applying the discount rate based on government bonds to the net defined benefit liability or asset. Net interest on the net defined benefit liability or asset is recognized as expense or income in the statement of income.

Remeasurements comprising actuarial gains and losses, return on plan assets and any change in the effect of the asset ceiling (excluding net interest on defined benefit liability) are recognized immediately in the statement of financial position with a corresponding debit or credit to 'Remeasurement gains (losses) on retirement liabilities' under OCI in the period in which they arise. Remeasurements are not reclassified to the statement of income in subsequent periods.

Plan assets are assets that are held by a long-term employee benefit fund. Plan assets are not available to the creditors of the Bank, nor can they be paid directly to the Bank. Fair value of plan assets is based on market price information. When no market price is available, the fair value of plan assets is estimated by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligations). If the fair value of the plan assets is higher than the present value of the defined benefit obligation, the measurement of the resulting defined benefit asset is limited to the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

Defined contribution plan
The Bank also operates defined contribution plan referred to as "Hybrid Plan" which provides a retirement benefit equal to 100% of the member's employer accumulated value, if any, provided that in no case shall 100% of the employee accumulated value in Fund A be less than 100% of plan salary for every year of credited service. As at December 31, 2018 and 2017, the Bank does not value its defined benefit assets (liability) for the contributions made to the Hybrid Plan.

Employee leave entitlement
Employee entitlements to annual leave are recognized as a liability when they are accrued to the employees. The undiscounted liability for leave expected to be settled after the end of the annual reporting period is recognized for services rendered by employees up to the end of the reporting period. For leave entitlements expected to be settled for more than twelve months after the reporting date, the estimated liability is actuarially determined and reported under 'Other Liabilities' in the statement of financial position.

Equity
Capital stock
Capital stock is measured at par value for all shares issued and outstanding. When the Bank issues more than one class of stock, a separate account is maintained for each class of stock and the number of shares issued. Incremental costs incurred directly attributable to the issuance of new shares are shown in equity as deduction from proceeds, net of tax. The subscribed capital stock is reported in equity less the related subscription receivable.

Surplus
Surplus represents cumulative balance of periodic net income or loss, dividend distributions, if any, to the shareholders, effect of changes in accounting policy, and all other capital adjustments.

Dividends
Dividends on preferred and common shares are recognized as a liability and deducted from retained earnings when approved by the BOD of the Bank. Dividends declared during the year that are approved after the reporting date are dealt with as an event after the reporting date.

Leases
The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires 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.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios ‘a’, ‘c’ or ‘d’ above, and at the date of renewal or extension period for scenario ‘b’.

Bank as lessee
Leases where the lessor retains substantially all the risks and rewards of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense under ‘Rent’ in the statement of income on a straight-line basis over the lease term.

Bank as lessor
Leases where the Bank does not transfer substantially all the risk and benefits of ownership of the assets are classified as operating leases. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognized over the lease term on the same basis as the rental income. Contingent rents are recognized as revenue in the year in which they are earned.

Provisions and Contingencies
Provisions are recognized when the Bank has a present obligation (legal or constructive), as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Where the Bank expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of income, net of any reimbursement. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized under ‘Interest expense’ in the statement of income.

Contingent liabilities are not recognized but are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized but are disclosed in the financial statements when an inflow of economic benefits is probable.

Income Taxes
Current tax
Current tax assets and liabilities for the current and prior year periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted as at the reporting date.

Deferred tax
Deferred tax is provided, using the statement of financial position liability method, on all temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognized for all taxable temporary differences. Deferred tax assets are recognized for all deductible temporary differences, carryforward of unused tax credits from excess minimum corporate income tax (MCIT) over regular corporate income tax (RCIT) and unused net operating loss carryover (NOLCO), to the extent that it is probable that future taxable income will be available against which the deductible temporary differences and carryforward of unused excess

MCIT over RCIT and unused NOLCO can be utilized. Deferred tax assets, however, is not recognized when it arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of transaction, affects neither the accounting income nor taxable income.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient future taxable income will be available to allow all or part of the deferred tax asset to be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are applicable to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Current tax and deferred tax relating to items recognized directly in equity is recognized in OCI, and not in the statement of income.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and deferred taxes relates to the same taxable entity and the same taxation authority.

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

Standards Issued but not yet Effective
There are new PFRSs, amendments, interpretation and annual improvements, to existing standards effective for annual periods subsequent to 2018, which are adopted by the Financial Reporting Standards Council. 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:

Effective beginning on or after January 1, 2019

- PFRS 16, *Leases*. This sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under PAS 17, *Leases*. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less).

  At the commencement date of a lease, a lessee will recognize a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognize the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

  Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognize the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under PFRS 16 is substantially unchanged from today's accounting under PAS 17. Lessors will continue to classify all leases using the same classification principle as in PAS 17 and distinguish between two types of leases: operating and finance leases.

PFRS 16 also requires lessees and lessors to make more extensive disclosures than under PAS 17.

Early application is permitted, but not before an entity applies PFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs.

Upon adoption of this standard, the Bank expect to recognize a right of use asset and lease liability for covered lease contracts. Management is currently assessing the impact of this new standard in the financial statements.

- PFRS 9 (Amendment), *Prepayment Features with Negative Compensation*. Under PFRS 9, a debt instrument can be measured at amortized cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to PFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract. The amendments should be applied retrospectively and are effective from January 1, 2019, with earlier application permitted. Management has assessed that the amendment has no impact on the financial statements.

- PAS 19 (Amendments), *Employee Benefits, Plan Amendment, Curtailment or Settlement*. The amendments to PAS 19 address the accounting when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments specify that when a plan amendment, curtailment or settlement occurs during the annual reporting period, an entity is required to:

  - Determine current service cost for the remainder of the period after the plan amendment, curtailment or settlement, using the actuarial assumptions used to remeasure the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event

  - Determine net interest for the remainder of the period after the plan amendment, curtailment or settlement using: the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event; and the discount rate used to remeasure that net defined benefit liability (asset).

  The amendments also clarify that an entity first determines any past service cost, or a gain or loss on settlement, without considering the effect of the asset ceiling. This amount is recognized in profit or loss. An entity then determines the effect of the asset ceiling after the plan amendment, curtailment or settlement. Any change in that effect, excluding amounts included in the net interest, is recognized in other comprehensive income.

  Early application is permitted. These amendments will apply only to any future plan amendments, curtailments, or settlements of the Bank.

- PAS 28 (Amendments), *Long-term Interests in Associates and Joint Ventures.* The amendments clarify that an entity applies PFRS 9 to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in the associate or joint venture (long-term interests). This clarification is relevant because it implies that the expected credit loss model in PFRS 9 applies to such long-term interests.

  The amendments also clarified that, in applying PFRS 9, an entity does not take account of any losses of the associate or joint venture, or any impairment losses on the net investment, recognized as adjustments to the net investment in the associate or joint venture that arise from applying PAS 28, *Investments in Associates and Joint Ventures*.

  The amendments should be applied retrospectively, with early application permitted. Since the Ban does not have much long-term interests in its associate and joint venture, the amendments will not have an impact on its financial statements.

- IFRIC 23, *Uncertainty over Income Tax Treatments*. The interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of PAS 12, *Income Taxes*, and does not apply to taxes or levies outside the scope of PAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments.

  The interpretation specifically addresses the following:
  - Whether an entity considers uncertain tax treatments separately
  - The assumptions an entity makes about the examination of tax treatments by taxation authorities
  - How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates
  - How an entity considers changes in facts and circumstances

  An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed.

  This interpretation is not relevant to the Bank because there is no uncertainty involved in the tax treatments made by management in connection with the calculation of current and deferred taxes as of December 31, 2018 and 2017.

  <u>*Annual improvements to PFRS 2015-2017 Cycle*</u>
  These improvements include:
  Amendments to PFRS 3 and PFRS 11 - *Previously held interest in a joint operation*
  The amendments clarify that, when an entity obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. In doing so, the acquirer remeasures its entire previously held interest in the joint operation. A party that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes a business as defined in PFRS 3. The amendments clarify that the previously held interests in that joint operation are not remeasured. An entity applies those amendments to transactions in which it obtains joint control on or after the beginning of the first annual reporting period beginning on or after January 1, 2019, with early application permitted. These amendments are currently not applicable to the Bank but may apply to future transactions.

- Amendments to PAS 12, *Income Tax Consequences of Payments on Financial Instruments Classified as Equity*. The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognizes the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognized those past transactions or events.

- Amendments to PAS 23, *Borrowing Costs, Borrowing Costs Eligible for Capitalization*. The amendments clarify that an entity treats as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete.

An entity applies those amendments to borrowing costs incurred on or after the beginning of the annual reporting period in which the entity first applies those amendments. Early application is permitted.

Effective beginning on or after January 1, 2020
- Amendments to PFRS 3, *Definition of a Business*. The amendments to PFRS 3 clarify the minimum requirements to be a business, remove the assessment of a market participant's ability to replace missing elements, and narrow the definition of outputs. The amendments also add guidance to assess whether an acquired process is substantive and add illustrative examples. An optional fair value concentration test is introduced which permits a simplified assessment of whether an acquired set of activities and assets is not a business.
- An entity applies those amendments to transactions in which it obtains joint control on or after the beginning of the first annual reporting period beginning on or after January 1, 2019, with early application permitted. These amendments are currently not applicable to the Bank but may apply to future transactions.
- Earlier application is permitted.

- Amendments to PAS 1, *Presentation of Financial Statements, and PAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, Definition of Material*. The amendments refine the definition of material in PAS 1 and align the definitions used across PFRSs and other pronouncements. They are intended to improve the understanding of the existing requirements rather than to significantly impact an entity's materiality judgments. An entity applies those amendments to transactions in which it obtains joint control on or after the beginning of the first annual reporting period beginning on or after January 1, 2019, with early application permitted. These amendments are currently not applicable to the Bank but may apply to future transactions. Earlier application is permitted.

Effective beginning on or after 1 January 2021
PFRS 17, *Insurance Contracts*

- PFRS 17 is a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, PFRS 17 will replace PFRS 4 Insurance Contracts (PFRS 4) that was issued in 2005. PFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features. A few scope exceptions will apply. The overall objective of PFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers. In contrast to the requirements in PFRS 4, which are largely based on grandfathering previous local accounting policies, PFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects. The core of PFRS 17 is the general model, supplemented by:

- A specific adaptation for contracts with direct participation features (the variable fee approach)
- A simplified approach (the premium allocation approach) mainly for short-duration contracts

PFRS 17 is effective for reporting periods beginning on or after January 1, 2021, with comparative figures required. Early application is permitted, provided the entity also applies PFRS 9 and PFRS 15 on or before the date it first applies IFRS 17.

Early application is permitted. This standard has no impact on the Bank as it has no insurance operations.

Deferred effectivity

- Amendments to PFRS 10, *Consolidated Financial Statements, and PAS 28, Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*. The amendments address the conflict between PFRS 10 and PAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that a full gain or loss is recognized when a transfer to an associate or joint venture involves a business as defined in PFRS 3. Any gain or loss resulting from the sale or contribution of assets that does not constitute a business, however, is recognized only to the extent of unrelated investors' interests in the associate or joint venture.

  On January 13, 2016, the Financial Reporting Standards Council deferred the original effective date of January 1, 2016 of the said amendments until the International Accounting Standards Board (IASB) completes its broader review of the research project on equity accounting that may result in the simplification of accounting for such transactions and of other aspects of accounting for associates and joint ventures.

3. Significant Accounting Judgments and Estimates

The preparation of the Bank's financial statements in accordance with PFRS requires the management to make judgments and estimates that affect the reported amounts of assets, liabilities, revenue and expenses and disclosure of contingent assets and contingent liabilities at reporting date. Future events may occur which will cause the judgments used in arriving at the estimates to change. The effects of any change in estimates are reflected in the financial statements as they become reasonably determinable.

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.

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

a. *Business model test*
The Bank manages its financial assets based on business models that maintain adequate level of financial assets to match expected cash outflows and maintain adequate level of high quality liquid assets while maintaining a strategic portfolio of financial assets for trading activities.

The Bank's business model can be to hold financial assets to collect contractual cash flows even when sales of certain financial assets occur. PFRS 9, however, emphasizes that if more than an infrequent number of sales are made out of a portfolio of financial assets carried at amortized cost and those sales are more than insignificant in value (either individually or in aggregate), the 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 the circumstances surrounding the disposal as well as the requirements of BSP Circular No. 1011, *Guidelines on the adoption of PFRS 9.*

b. *Cash flow characteristics test*
In determining the classification of financial assets under PFRS 9, the Bank assesses whether the contractual terms of these financial assets give rise on specified dates to cash flows that are solely payments of principal and interest 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 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

c. *Determination of significant influence over another entity*
The determination of significant influence over another entity, other than the rebuttable presumption of ownership over twenty percent (20.0%), requires significant judgment. In making judgment, the Bank evaluates existence of the following:
- representation on the Board of Directors (BOD) or equivalent governing body of the investee;
- participation in policy-making processes, including participation in decisions about dividends or other distributions;
- material transactions between the entity and its investee;
- interchange of managerial personnel; or
- provision of essential technical information.

As at December 31, 2018 and 2017, the Bank determined that it exercises significant influence over, and CARD MRI Rizal Bank, Inc. (CMRBI) in which it holds a 40.00% ownership interest for both years. Although the Bank holds less than 20.0% of the ownership interest and voting rights in Microfinance Information Data Sharing Inc. (MIDAS), the Bank considers that it exercises significant influence through both its significant shareholding and its representation in MIDAS' BOD. As at December 31, 2018 and 2017, entities on which the Bank has significant influence are disclosed in Note 10.

Estimates

a. *Credit losses on loans and receivables, HTM financial assets, AFS debt securities and financial assets under 'Other assets' (prior to adoption of PFRS 9)*
The Bank reviews its loans and receivables, HTM financial assets, AFS debt securities and financial assets under 'Other assets' at each reporting date to assess whether an allowance for impairment and credit losses should be recorded in the statement of financial position and any changes thereto in the statement of income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on assumptions about a number of factors. Actual results may differ, resulting in future changes to the allowance.

In addition to specific allowance against individually significant financial assets, the Bank also makes a collective impairment assessment against exposures which, although not specifically identified as requiring an allowance, have a greater risk of default than when originally granted. This collective impairment assessment is based on any deterioration in the credit quality of a group of financial assets with similar credit risk characteristics. The collective impairment assessment considers factors such as deterioration in country risk, industry, and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

As at December 31, 2018 and 2017, the carrying value of AFS debt securities and loans and receivables as of December 31, 2017 are disclosed in Notes 7 and 9, respectively.

As of December 31, 2017 HTM financial assets were unimpaired. The carrying values of HTM financial assets are disclosed in Note 8.

b. *Impairment of financial assets (PFRS 9)*

Effective on or after January 1, 2018
The measurement of impairment losses under PFRS 9 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- Internal credit grading model, which assigns PDs to the individual grades
- Criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a life time CL basis and the qualitative assessment
- The segmentation of financial assets when their ECL is assessed on a collective basis
- Development of ECL models, including various formulas and the choice of inputs
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models

The ECL models and all ECL-related policies are approved by the Risk Oversight Committee and the Board of Directors. The Risk Management Unit in collaboration with the Data Collection Center calculates the ECL for all credit risk exposures. The total ECL that will be booked by the

Finance and Accounting Division is approved by both the Director for Finance and Accounting and the Director of Risk Management Unit.

The related allowance for credit losses of financial assets are disclosed in Note 9.

c. *Net plan assets and retirement expense*
Net plan assets and retirement expense are dependent on the selection of certain assumptions used by the actuary in calculating such amounts. Those assumptions are described in Note 19 and include, among others, discount rates, future salary increases and mortality rates, and average remaining working lives of employees. While management believes that the assumptions are reasonable and appropriate, significant differences in the Bank's actual experience or significant changes in the assumptions may materially affect the pension and other retirement obligation.

Since there is no deep market in high-quality corporate bonds in the Philippines, the Bank's discount rate for the defined benefit obligation was determined by considering the yields on long-term government securities. A lower discount rate would increase the present value of benefit obligations. The expected rate of salary increase was determined by considering the inflation, seniority, promotion and other market factors. The Bank evaluates these assumptions on a periodic basis taking into consideration current market conditions and historical market data.

Mortality rate is based on publicly available mortality tables for the specific country and is modified accordingly with estimates of mortality improvements, while future salary increases is based on the budgeted salary rate increase approved by the BOD. While the Bank believes that the assumptions are reasonable and appropriate, significant differences between actual experience and assumptions may materially affect the cost of employee benefits related to obligations. Employee turnover was assumed based on the multiple turnover experience rates with margins for fluctuations.

As at December 31, 2018 and 2017, the present value of retirement obligation and fair value of plan assets of the Bank are disclosed in Note 19.

4. **Fair Value Measurement**

The fair values of cash and cash equivalents, current loans and receivables, refundable deposits, current portion of deposit liabilities, current portion of bills payable and financial liabilities under 'Other liabilities' approximate their carrying values in view of the relatively short-term maturities of these instruments. Significant amount of loans and receivables are due within 1 year from the reporting date.

Financial asset at FVOCI investments and Hold-to-Collect Investments
Quoted government securities are generally based on quoted market prices, which is within the bid-ask price. FVOCI and Hold-to-collect investments of the Bank are categorized as Level 2 in the absence of bid-offer as at reporting date and due to low volume of trading activity in the market.

Loans and receivables
Fair values are estimated using the discounted cash flow methodology, using the Bank's current incremental lending rates for similar types of receivables or securities. The discount rates used in estimating the fair value of loans and receivables are the incremental lending rates ranging from 3.25% to 7.25% in 2018 and 2.29% to 6.15% in 2017.

The discount rates used in estimating the fair values of unquoted debt securities are the incremental lending rates ranging from 3.55% to 6.75% in 2017.

Noncurrent portion of deposit liabilities and bills payable
Fair values of noncurrent deposit liabilities are estimated using the discounted cash flow methodology, using the Bank's current incremental borrowing rates for similar borrowings, ranging from 3.7% to 6.8% and 3.9% to 4.1% in 2018 and 2017, respectively, with maturities consistent with those remaining for the liability being valued, if any.

Fair values of long-term bills payable were based on interpolation of Philippine zero rate of 4.7% and 4.7% in 2018 and 2017, respectively.

Fair Value Hierarchy
The following table summarizes the carrying amounts and the fair values by level of the fair value hierarchy of the Bank's financial assets and liabilities that are carried at fair value or for which fair value is disclosed as at December 31, 2018 and 2017 (amounts in thousands):

	2018				
	Carrying Value	**Level 1**	**Level 2**	**Level 3**	**Total**
Recurring fair value measurements					
Financial assets at FVOCI					
Government debt securities	**₱851,523**	**₱627,476**	**₱224,047**	**₱–**	**₱851,523**
Assets and liabilities for which fair values are disclosed:					
Financial assets					
Financial assets at amortized cost					
Government debt securities	**704,053**	**–**	**456,367**	**75,070**	**531,436**
Loans and receivables					
Receivables from borrowers	**30,974**	**–**	**–**	**27,074**	**27,074**
Financial liabilities carried at amortized cost					
Bills payable	**529,496**	**–**	**–**	**502,845**	**502,845**
Deposit liabilities					
Special savings	**841,066**	**–**	**–**	**793,733**	**793,733**

	2017				
	Carrying Value	Level 1	Level 2	Level 3	Total
Recurring fair value measurements					
AFS investments	₱375,725	₱243,645	₱132,080	₱–	₱375,725
Assets and liabilities for which fair values are disclosed:					
Financial assets					
HTM investments	246,475	–	238,834	–	238,834
Loans and receivables					
Unquoted debt securities classified as loans (UDSCL)	73,008	–	–	66,890	66,890
Receivables from borrowers	51,695	–	–	30,513	30,513
Financial liabilities					
Bills payable	412,549	–	–	434,855	434,855
Deposit liabilities					
Special savings	5,938	–	–	5,883	5,883

As at December 31, 2018 and 2017, there were no transfers of financial instruments between Levels 1, 2, and 3.

5. **Financial Risk Management Objectives and Policies**

In the course of the business cycle, the Bank has exposure to the following risks from its use of financial instruments:

- Credit risk
- Market risk
- Liquidity risk

The Bank adheres to the proactive and prudent approach of managing the business that recognizes and manages risks to continuously provide quality financial services to clients and to protect shareholders' value.

Risk management process involves identifying and assessing the risk, taking actions to mitigate the risks through defined roles and responsibilities, close monitoring of the scenarios, and adjustment of the systems and policies necessary to effectively minimize risk level.

The BOD, through its Risk Oversight Committee (ROC), is responsible for monitoring the Bank's implementation of risk management policies and procedures and for reviewing the adequacy of risk management framework in relation to the risks faced by the Bank.

The ROC regularly reports to the BOD the results of reviews of actual implementation of risk management policies. The risk management of the Bank is strengthened in conjunction with Audit Committee (AC) and Internal Audit (IA) functions. IA undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the AC.

In addition, an Asset Liability Committee (ALCO) with members from Executive Committee and Management Committee of the Bank, together with the Senior Finance and Accounting officers regularly performs analysis of the operating and financial status of the Bank. In addition, ALCO handles the financial risk management of the Bank.

Credit Risk

Credit risk is the risk of financial loss to the Bank if the counterparty to a financial instrument fails to meet its contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for industry concentrations, and by monitoring exposures in relation to such limits.

Management of credit risk

Credit risk is being managed by instilling credit discipline both among the staff and the borrowers. Staff performs close-monitoring and assessment of account throughout the borrowing period, hence, on-time service delivery motivate the borrowers to fulfill their financial obligation to the highest standards. Borrowers are well-oriented and committed on the credit repayment design they undertake. In general, borrowers are also perpetual savers. Consequently, their pledge savings balances serve as guarantee to their loans, which increase their borrowing capacity.

Each business unit has a Unit Manager who reports on all credit related matters to the local management consisting of the Branch Manager and the Regional Director. Each business unit is responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolio. Regular audits of business units and credit processes are undertaken by IA. Field operations per unit are frequently monitored by the Executive Committee and Management Committee by actual visitations at the center level and unit office covered area.

In line with the Bank's mission of "*providing continued access to integrated microfinance and social development services to an expanding membership base by organizing and empowering women and their families*", microfinance services are part of the major programs of the Bank. Accordingly, the microfinance loans portfolio represents the bulk of the Bank's assets.

In microfinance lending operations, the field operations personnel are provided with thorough skills training for effective and efficient service delivery. The operations manual is a reference for every operations personnel.

The manual is customized for microfinance clients and is being updated as often as new policies and procedures are finalized and approved by the BOD based on client and staff satisfaction surveys, staff and management program review, and planning meetings and workshops. A codified signing authority is in place for every level of loan processing and approval.

Credit worthiness of microfinance clients is deepened through ownership of the Bank's preferred stock, opportunity for their children to avail scholarship program, and chance to become a regular staff of CARD-MRI. Maximum loan amount per account holder is below 2.0% of the Bank's equity and does not fall under directors, officers, stockholders and related interests (DOSRI) classification.

Consistent monitoring for the all past due or impaired accounts are established by competent and diligent staff to maximize recovery. Incentives for bad debts collection have been established and subjected to review and assessment periodically. These were given to staff to recover from the accounts and to fully install credit discipline to clients. Writing off bad accounts are approved by the BOD and reported to the BSP in compliance with the rules and regulations for banks.

An independent research unit continuously conducts market research as a tool for updating and developing loan products responsive to the needs and demands of existing and potential clients. Hence, individual loans for advance microfinance clients have been developed and are being tested as a complement to their micro-entrepreneurial capacities. Loans under this system are fully backed-up by their savings balances and/or collateral required as appropriate.

The ROC closely monitors the overall credit operations. Identified existing and potential risks are acted upon appropriately and are reported during monthly BOD meeting.

Maximum exposure to credit risk
The carrying values of the financial assets and liabilities best represent the maximum exposure to credit risk. The table below shows the analysis of the maximum exposure to risk, net of allowance for credit losses, for financial assets as at December 31, 2018 and 2017

	2018			
	Maximum Exposure*	**Fair Value of Collateral**	**Financial Effect of Collateral**	**Net Exposure**
Receivables from borrowers	**₱10,407,292,246**	**₱7,850,451,329**	**₱5,293,610,412**	**₱2,556,840,917**

**Includes accrued interest receivable, net of allowance for credit losses on receivables from borrowers*

	2017			
	Maximum Exposure*	**Fair Value of Collateral**	**Financial Effect of Collateral**	**Net Exposure**
Receivables from borrowers	₱7,774,674,230	₱5,218,558,209	₱1,910,065,050	₱2,556,116,021

**Includes accrued interest receivable, net of allowance for credit losses on receivables from borrowers*

Credit enhancement on receivable from borrowers pertains to deposit hold-out from pledge savings equivalent to 15.0% of the original amount of the loan to the member, deed of assignment, and real estate mortgage as at December 31, 2018 and 2017 (Note 13).

As at December 31, 2018 and 2017, the Bank has no financial assets with rights to offset in accordance with PAS 32. There are also no financial assets that are subject to an enforceable master netting arrangements or similar agreements which require disclosure in the financial statements in accordance with the offsetting disclosure requirements of PFRS 7.

Additionally, the tables below show the distribution of maximum credit exposure by industry sector of the Bank as at December 31, 2018 and 2017 (in thousands):

	2018				
	Loans and Receivables*	**Financial assets at FVOCI**	**Financial assets at amortized cost**	**Security Deposits****	**Total**
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods	**₱8,943,711**	**₱–**	**₱–**	**₱–**	**₱8,943,711**
Real estate, renting and business activities	**1,140,569**	–	–	–	**1,140,569**
Financial institutions	**1,339,820**	–	–	–	**1,339,820**
Government	**505,799**	**851,523**	**704,053**	–	**2,061,375**
Agriculture, hunting and forestry	**292,680**	–	–	–	**292,680**
Education	**107,284**	–	–	–	**107,284**
Other community, social and personal service activities	**36,120**	–	–	**43,637**	**79,757**
Manufacturing	**16,104**	–	–	–	**16,104**
	12,382,087	**851,523**	**704,053**	**43,637**	**13,981,300**
Less allowance for credit losses	**150,731**	–	–	–	**150,731**
Total	**₱12,231,355**	**₱851,523**	**₱704,053**	**₱43,637**	**₱13,830,568**

**Consist of due from BSP and other banks, receivable from borrowers and other receivables*
***Reported under 'Other Assets'*

	2017				
	Loans and Receivables*	AFS Investments	HTM Investments	Security Deposits**	Total
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods	₱3,842,544	₱–	₱–	₱–	₱3,842,544
Agriculture, hunting and forestry	2,350,970	–	–	–	2,350,970
Financial institutions	1,519,870	–	–	–	1,519,870
Other community, social and personal service activities	1,020,993	–	–	39,259	1,060,252
Government	859,736	375,725	246,475	–	1,481,936
Real estate, renting and business activities	604,685	–	–	–	604,685
Education	143,666	–	–	–	143,666
Manufacturing	109,558	–	–	–	109,558
	10,452,022	375,725	246,475	39,259	11,113,481
Less allowance for credit losses	256,822	–	–	–	256,822
Total	₱10,195,200	₱375,725	₱246,475	₱39,259	₱10,856,659

**Consist of due from BSP and other banks, receivable from borrowers, and other receivables*
***Reported under 'Other Assets'*

Credit quality per class of financial assets
The credit quality of financial assets is monitored and managed based on the credit standing and history.

Further, the financial assets are also grouped according to stage whose description is explained as follows:

Stage 1 - those that are considered current and up to 90 days past due, and based on change in rating, delinquencies and payment history, do not demonstrate significant increase in credit risk.

Stage 2 - those that, based on change in rating, delinquencies and payment history, demonstrate significant increase in credit risk, and/or are considered more than 90 days past due but does not demonstrate objective evidence of impairment as of reporting date.

Stage 3 - those that are considered in default or demonstrate objective evidence of impairment as of reporting date.

The following tables illustrate the Bank's credit exposures as at December 31, 2018 and 2017:

	2018				2017
	ECL Staging				
	Stage 1	**Stage 2**	**Stage 3**		
Due from BSP	12-month ECL	Lifetime ECL	Lifetime ECL	**Total**	Total
Neither past due nor impaired					
High grade	**₱323,613,641**	**₱–**	**₱–**	**₱323,613,641**	₱256,064,797
Standard grade	–	–	–	–	–
Past due but not impaired	–	–	–	–	–
Past due and impaired	–	–	–	–	–
Gross carrying amount	**₱323,613,641**	**₱–**	**₱–**	**₱323,613,641**	₱256,064,797

	2018				2017
	ECL Staging				
	Stage 1	**Stage 2**	**Stage 3**		
Due from other banks	12-month ECL	Lifetime ECL	Lifetime ECL	**Total**	Total
Neither past due nor impaired					
High grade	**₱21,555,959**	**₱–**	**₱–**	**₱21,555,959**	₱1,947,508,226
Standard grade	**1,332,357,489**	–	–	**1,332,357,489**	1,352,616–
Past due but not impaired	–	–	–	–	–
Past due and impaired	–	–	–	–	–
Gross carrying amount	**₱1,500,449,173**	**₱–**	**₱–**	**₱1,500,449,173**	₱1,948,860,842

Financial assets at FVOCI	2018 ECL Staging Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total	2017 Total
Neither past due nor impaired					
High grade	**₱851,523,493**	**₱–**	**₱–**	**₱851,523,493**	**₱375,724,647**
Standard grade	–	–	–	–	–
Past due but not impaired	–	–	–	–	–
Past due and impaired	–	–	–	–	–
Gross carrying amount	**₱851,523,493**	**₱–**	**₱–**	**₱851,523,493**	**₱375,724,647**

Receivable from borrowers

Microfinance loans	2018 ECL Staging Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total	2017 Total
Neither past due nor impaired					
High grade	**₱**	**₱–**	**₱–**	**₱–**	₱–
Standard grade	**8,619,610,173**	–	–	**8,619,610,173**	6,399,099,789
Past due but not impaired	–	–	**36,703,443**	**36,703,443**	14,638,337
Past due and impaired	–	–	**153,782,707**	**153,782,707–**	132,932,885
Gross carrying amount	**₱8,619,610,173**	**₱–**	**₱190,486,150**	**₱8,810,096,323**	₱6,546,671,011

Other loans	2018 ECL Staging Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total	2017 Total
Neither past due nor impaired					
High grade	**₱1,471,968,678**	**₱–**	**₱–**	**₱1,471,968,678**	₱–
Standard grade	–	–	–	–	1,387,009,351
Past due but not impaired	–	**5,837,488**	–	**5,837,488**	4,494,075
Past due and impaired	–	–	**11,785,941**	**11,785,941–**	12,433,725
Gross carrying amount	**₱1,471,968,678**	**₱5,837,488**	**₱11,785,941**	**₱8,810,096,323**	₱1,403,937,151

Other receivables

Accrued interest receivables	2018 ECL Staging Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total	2017 Total
Neither past due nor impaired					
High grade	**₱21,555,959**	**₱–**	**₱–**	**₱21,555,959**	₱9,242,485
Standard grade	**232,917,044**	–	–	**232,917,044**	120,746,473
Past due but not impaired	–	–	–	–	–
Past due and impaired	–	–	–	–	–
Gross carrying amount	**₱254,473,003**	**₱–**	**₱–**	**₱254,473,003**	₱129,988,958

Accounts receivables	2018 ECL Staging Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total	2017 Total
Neither past due nor impaired					
High grade	**₱–**	**₱–**	**₱–**	**₱–**	₱–
Standard grade	**3,862,293**	–	–	**3,862,293**	3,789,081
Past due but not impaired	–	–	–	–	–
Past due and impaired	–	–	–	–	–
Gross carrying amount	**₱–**	**₱3,862,293**	**₱–**	**₱3,862,293**	₱3,789,081

Financial assets at amortized cost	2018 ECL Staging Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total	2017 Total
Neither past due nor impaired					
High grade	**₱704,052,547**	**₱–**	**₱–**	**₱704,052,547**	₱246,475,260
Standard grade	–	–	–	–	–
Past due but not impaired	–	–	–	–	–
Past due and impaired	–	–	–	–	–
Gross carrying amount	**₱704,052,547**	**₱–**	**₱–**	**₱704,052,547**	₱246,475,260

	2018				2017
	ECL Staging				
	Stage 1	**Stage 2**	**Stage 3**		
Security deposits	12-month ECL	Lifetime ECL	Lifetime ECL	**Total**	Total
Neither past due nor impaired					
High grade	**₱–**	**₱–**	**₱–**	**₱–**	₱–
Standard grade	**43,637,024**	**–**	**–**	**43,637,024**	39,259,267
Past due but not impaired	**–**	**–**	**–**	**–**	–
Past due and impaired	**–**	**–**	**–**	**–**	–
Gross carrying amount	**₱43,637,024**	**₱–**	**₱–**	**₱43,637,024**	₱39,259,267

The description of the financial assets grading used by the Bank is as follows:

- *High grade* - These are receivables and investments which have a high probability of collection. The counterparty has the apparent ability to satisfy its obligation and the securities on the receivables are readily enforceable. These also include deposits with reputable institutions from which the deposits may be withdrawn and recovered with certainty.

- *Standard grade* - These are deposits, receivables and investments where collections are probable due to the reputation and the financial ability of the counterparty to pay but with experience of default.

As at December 31, 2018 and 2017, the Bank's receivables that are past due for more than 90 days are considered impaired.

Aging analysis of past due but not impaired loans and receivables
The following table shows the total aggregate amount of loans and receivables that are contractually past due but not considered as impaired per delinquency bucket as at December 31, 2018 and 2017:

	2018			
	Less than 30 Days	**31 to 60 Days**	**61 to 90 Days**	**Total**
Microfinance	**₱12,636,786**	**₱7,688,692**	**₱16,377,966**	**₱36,703,443**
Regular	**2,443,575**	**1,234,856**	**2,006,490**	**5,684,920**
Agri-agra	**81,147**	**27,332**	**44,089**	**152,567**
	₱15,161,507	**₱10,157,906**	**₱17,656,910**	**₱42,540,931**

	2017			
	Less than 30 Days	31 to 60 Days	61 to 90 Days	Total
Microfinance	₱6,814,526	₱3,077,634	₱4,746,177	₱14,638,337
Agri-agra	910,889	302,277	1,070,204	2,283,370
Regular	2,101,752	44,501	64,452	2,210,705
	₱9,827,167	₱3,424,412	₱5,880,833	₱19,132,412

Carrying amount per class of loans and receivables which terms have been renegotiated
Restructured receivables have principal terms and conditions that have been modified in accordance with an agreement setting forth a new plan of payment or a schedule of payment on a periodic basis.

When the receivable account becomes past due and is being restructured or extended, the approval of the BOD is required before loan booking and is always governed by the BSP rules on restructuring.

As at December 31, 2018 and 2017, the Bank's outstanding restructured receivables tagged as impaired account amounted ₱0.3 million.

Impairment assessment (prior to adoption of PFRS 9)
The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than ninety (90) days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed impairment and collectively assessed impairment.

Individually assessed impairment
The Bank determines the allowances appropriate for each significant loan or advances on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realizable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed impairment
Allowances are assessed collectively for losses on loans and advances that are not individually significant (including residential mortgages and unsecured consumer lending) and for individually significant loans and advances that have no objective evidence as a result of individual impairment assessment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no objective evidence of impairment yet in an individual assessment. Impairment losses are estimated by taking the following information into consideration: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired.
Management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

Impairment assessment (PFRS 9)
The Bank recognizes a credit loss allowance on a financial asset based on whether it has had a significant increase in credit risk since initial recognition. Accordingly, the Bank categorizes its financial assets into three categories:
- stage 1 - financial asset that has not had a significant increase in credit risk;
- stage 2 - financial asset that has had a significant increase in credit risk; and
- stage 3 - financial asset in default.

Generally, the Bank applies a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 90 days past due.

Further, the Bank considers a financial asset as in default when (a) as a result of one or more loss events, there is objective evidence that its recoverable value is less than its carrying amount; (b) it is classified as doubtful or loss under prudential reporting; (c) it is in litigation; and/or (d) full repayment of principal and interest is unlikely without foreclosure of collateral, if any. When applicable, the Bank also applies a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due unless the Bank has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate.

The Bank then measures the credit loss allowance on a financial instrument at an amount equal to 12-month expected credit losses for items categorized as stage 1 and lifetime credit losses to items categorized as stage 3.

Two modeling approaches were employed to build a consistent framework for the development of all ECL models of the Bank. Both modeling approaches consider past events, current conditions and forecast of economic conditions in assessing impairment.

The complex model approach is used for portfolios with a significant number of historical defaults. This approach was applied to the consumer loan portfolios. These quantitative models are built by applying statistical, economic, financial or mathematical theories, techniques and assumptions to calculate provisions. Where historical data are insufficient to develop statistical models, the simplified ECL approach was employed.

Default and Cure
As a part of a qualitative assessment of whether a customer is in default, the Bank considers a variety of instances that may indicate unlikeliness to pay. The Bank's definition of default is aligned with the non-performing loan criteria as prescribed in BSP Circular No. 941. Defaults refer to loans, investments, receivables, or any financial asset, even without missed contractual payments, that satisfy any of the following conditions (1) impaired under existing accounting standards, (2) classified as doubtful or loss, (3) in litigation, (4) and/or there is evidence that full repayment of principal and interest is unlikely without foreclosure of collateral, if any. All other loans, even if not considered impaired, shall be considered non-performing if any principal and/or interest are (5) unpaid for more than ninety (90) days from contractual due date, or accrued interests for more than ninety (90) days have been capitalized, refinanced, or delayed by agreement. (6) Microfinance and other small loans with similar credit characteristics shall be considered non-performing after contractual due date or after it has become past due. (7) Restructured loans shall be considered nonperforming. However, if prior to restructuring, the loans were categorized as performing, such classification shall be retained. Defaults are characterized by financial assets that have objective evidence of impairment at the reporting date and as such classified under Stage 3 ECL treatment.

An instrument is considered to be no longer in default, i.e., to have cured, when it no longer meets any of the default criteria above and there is sufficient evidence to support full collection through payments received for at least 6 months. Cured accounts are classified under Stage 1 ECL treatment.

Exposure at Default (EAD)
The Bank defines EAD as the principal and interests that would not be collected assuming the borrower's defaults during a future point in time. The Bank computes for a financial asset's EAD using the expected contractual cash flows during the contractual life of the financial instrument. A financial asset's EAD is defined as the sum of EAD from principal and EAD from interest.

Probability of default (PD)
The Bank uses forward-looking PD estimates that are unbiased and probability-weighted using a range of possible outcomes. The PD for each individual instrument is modelled based on historical data and is estimated based on current market conditions and reasonable and supportable information about future economic conditions. The Bank segmented its credit exposures based on homogenous risk characteristics and developed a corresponding PD methodology for each portfolio. The PD methodology for each relevant portfolio is determined based on the underlying nature or characteristic of the portfolio, behavior of the accounts and materiality of the segment as compared to the total portfolio. The Bank's PDs are mainly categorized into the following: (a) corporate and commercial loans; (b) small and medium-size enterprise financing; (c) auto and housing loans; and (d) personal and consumption loans.

Loss given default (LGD)
The Bank's LGD model considers certain factors such as the historical cash flow recovery and reasonable and supportable information about future economic conditions, where appropriate. Generally, the model utilizes the Bank's existing loan exposure rating system which is designed to capture these factors as well as the characteristics of collaterals related to an exposure. In cases wherein this does not apply, the Bank looks into the standard characteristics of collaterals (e.g., auto and housing loans) in order to estimate an LGD factor.

Economic Overlays
The Bank's incorporates economic overlays into the measurement of ECL to add a forward-looking risk measure parallel to the expected future macroeconomic atmosphere. A broad range of economic indicators were considered for the economic inputs. The inputs and models used for calculating ECL may not always capture all characteristics of the market at the date of the financial statements. To address this, quantitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material. The Bank's loans and receivables consist of different portfolios, such as corporate and commercial loans and consumer loans, as well as other receivables (e.g., sales contract receivables). In compliance with PFRS 9, the Bank developed ECL parameters and methodologies for each portfolio, using historical data as well as forward-looking inputs and assumptions.

Liquidity Risk
Liquidity risk is generally defined as the current and prospective risk to earnings or capital arising from the Bank's inability to meet its obligations when they come due without incurring unacceptable losses or costs.

Liquidity risk is managed by the Bank through holding sufficient liquid assets and appropriate assessment to ensure short-term funding requirements are met and by ensuring the high collection performance at all times. Deposits with banks are made on a short-term basis with almost all being available on demand or within one month.

Through CARD-MRI's Treasury Group uses liquidity forecast models that estimate the Bank's cash flow needs based on the Bank's actual contractual obligations and under normal circumstances and extraordinary circumstances. The Bank expects that majority of the depositors will not request payment on the earliest date that the Bank could be required to pay.

The ALCO is responsible in formulating the Bank's liquidity risk management policies. Liquidity management is among the most important activities conducted within the Bank. The Bank manages its liquidity risk through analyzing net funding requirements under alternative scenarios, diversification of funding sources, and contingency planning. The Bank utilizes a diverse range of sources of funds, although short-term deposits made with the Bank's network of domestic branches comprise the majority of such funding. Core deposits composed mainly of microfinance savings.

The tables below summarize the maturity profile of the financial instruments of the Bank based on contractual undiscounted cash flows (in thousands):

	2018					
	On Demand	**Less than 30 days**	**30 to 90 days**	**91 to 360 days**	**More than 360 days**	**Total**
Financial Assets						
Cash and other cash items	**₱135,438**	**₱–**	**₱–**	**₱–**	**₱–**	**₱135,438**
Due from BSP	**323,614**	**–**	**–**	**–**	**–**	**323,614**
Due from other banks	**357,659**	**744,623**	**398,167**	**–**	**–**	**1,500,449**
Financial assets at FVOCI*	**–**	**–**	**–**	**222,450**	**637,405**	**859,855**
Loans and receivables*						
Microfinance	**9,309,182**	**13,648**	**25,992**	**102,936**	**63,221**	**9,514,979**
Others	**1,589,723**	**2,727**	**3,578**	**9,138**	**3,520**	**1,608,686**
Total Financial Assets	**11,715,616**	**759,785**	**427,737**	**323,315**	**704,146**	**13,943,021**
Financial Liabilities						
Deposit liabilities						
Demand	**223,493**	**–**	**–**	**–**	**–**	**223,493**
Savings	**8,581,610**	**329,435**	**159,245**	**367,038**	**576,779**	**10,014,106**
Bills payable	**–**	**50,388**	**50,000**	**183,998**	**248,940**	**533,326**
Other liabilities	**331,206**	**–**	**–**	**–**	**–**	**331,206**
Total Financial Liabilities	**9,136,308**	**379,823**	**209,245**	**551,035**	**825,719**	**11,102,131**
Net	**₱2,579,307**	**₱381,175**	**₱216,512**	**(₱227,720)**	**(₱131,942)**	**₱2,008,582**

**includes future interest*

	2017					
	On Demand	Less than 30 days	30 to 90 days	91 to 360 days	More than 360 days	Total
Financial Assets						
Cash and other cash items	₱143,047	₱–	₱–	₱–	₱–	₱143,047
Due from BSP	256,065	–	–	–	–	256,065
Due from other banks	310,431	–	1,009,331	629,099	–	1,948,861
AFS investments*		119	3,570	19,683	652,220	675,592
Loans and receivables*						
Microfinance	6,657,696	8,916	7,933	47,713	87,572	6,809,830
Others	1,128,414	911	1,372	4,921	5,160	1,140,778
Total Financial Assets	8,495,653	9,946	1,022,206	701,416	744,952	10,974,173
Financial Liabilities						
Deposit liabilities						
Demand	185,941	–	–	–	–	185,941
Savings	6,589,166	247,244	399,694	600,514	0	7,836,618
Bills payable	-	139,617	64,195	412,485	381,198	997,495
Other liabilities	291,655	–	–	–	–	291,655
Total Financial Liabilities	7,066,762	386,861	463,889	1,012,999	381,198	9,311,709
Net	₱1,428,891	(₱376,915)	₱558,317	(₱311,583)	₱363,754	₱1,662,464

**includes future interest*

Market Risk

Market risk is the risk of loss to future earnings, fair values or future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates. The financial instruments of the Bank have fixed interest rates, and therefore are not subject to any interest rate risk.

Interest rate risk

The Bank's receivables earn fixed interest rates ranging from 6.0% to 28.0% per annum with equivalent EIR ranging from 16.0% to 52.0% in 2018 and 2017. The shortest term of loan is one (1) month while the longest term is twelve (12) years.

The Bank's savings deposit liabilities include compulsory and voluntary savings that earn 0.3% to 6.0% per annum in 2018 and 2017. Special savings deposits have interest rates of 2.0% to 4.3% in 2018 and 2017.

The Bank pays fixed interest rates on its bills payables from 5.4% to 6.5% and 3.0% to 6.5% per annum in 2018 and 2017, respectively, and payable within 6 months to 7 years in 2018 and 2017.

In order to manage its net interest margin, the Bank places its excess funds in high yield investments and other short-term time deposits.

Fair value interest rate risk
Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in interest rates. The Bank's exposure to fair value interest rate risk relates primarily to investments in FVOCI and AFS debt securities.

The table below demonstrates the sensitivity to a reasonably possible change in interest rates with all other variables held constant, of the Bank's OCI through the impact of interest on FVOCI/AFS debt securities:

	Changes in interest rates (in basis points)			
	2018		2017	
	+10.0	**-10.0**	+10.0	-10.0
Sensitivity of equity	**(₱20,139,088)**	**₱20,951,912**	(₱368,154)	383,542

Cash flow interest rate risk
The exposure to cash flow interest rate risk results primarily from financial instruments which carry floating interest rates that are reset as market rates changes. As at December 31, 2018 and 2017, the Bank has no FVOCI, AFS investments, financial assets at amortized cost, HTM investments, and financial liabilities that have floating interest rates, therefore no exposure to cash flow interest risk.

Foreign currency risk
The Bank's exposure to foreign exchange risk is minimal as it arises mainly from foreign currency-denominated liabilities (foreign currency liabilities).

Foreign currency liabilities generally consist of foreign currency deposits in the Bank's FCDU account made in the Philippines or which are generated from remittances to the Philippines by Filipino expatriates and overseas Filipino workers who retain for their own benefit or for the benefit of a third party, foreign currency deposit accounts with the Bank and foreign currency-denominated borrowings appearing in the regular books of the Bank.

Foreign currency deposits are generally used for those depositors accepting and will accept remittance from abroad. Banks are required by the BSP to match the foreign currency assets with the foreign currency liabilities held through FCDUs.

The Bank's policy is to maintain foreign currency exposure within existing regulations and within acceptable risk limits. The Bank believes in ensuring its foreign currency exposure is, at all times, within limits presented for a financial institution engaged in the type of business in which the Bank is engaged in. As at December 31, 2018 and 2017, the Bank has no significant foreign currency exposure since its transactions and balances in FCDU are only minimal.

6. Due from BSP and Other Banks

'Due from BSP' account represents the aggregate balance of noninterest-bearing peso deposit account with the BSP which the Bank maintains primarily to meet reserve requirements and to serve as a clearing account for interbank claims (Note 13).

Due from other banks represent funds deposited with domestic banks which are used as part of the Bank's operating funds.

As at December 31, 2018 and 2017, due from other banks include dollar-denominated deposits amounting to $0.3 million (₱16.0 million) and $0.2 million (₱11.2 million), respectively.

Peso-denominated deposits pertain to demand, savings, and time deposit accounts that earn interest at annual rates ranging from nil to 7.0% and nil to 2.3% in 2018 and 2017, respectively. Dollar-denominated deposits earn interest at annual rates ranging from 0.1% to 0.3% in 2018 and 2017.

Total interest income earned on deposits from other banks amounted to ₱55.0 million and ₱29.3 million in 2018 and 2017, respectively. Of these amounts, ₱17,748 and ₱15,675 pertain to interest income from USD deposits in 2018 and 2017, respectively.

7. Financial Assets at Fair Value through Other Comprehensive Income/Available-for-Sale Investments

This account consists of:

	2018	2017
Quoted government debt securities	**₱851,523,493**	₱375,724,647
Unquoted equity security (Note 10)	–	400,000
	₱851,523,493	₱376,124,647

Debt securities at FVOCI consists of government debt securities that earn nominal interest rates ranging from 3.5% to 5.4% in 2018 and 2017. Effective interest rates range from 3.4% to 8.6% and 3.4% to 3.8% on 2018 and 2017, respectively.

Unquoted equity security in 2017 represents the Bank's 10.7% ownership for interest in MIDAS Corporation. As of December 31, 2018, the Bank did not receive any dividend income from MIDAS Corporation. This was reclassified to investment in associate because of the Bank's significant influence in the Board (Note 10).

Interest income on Financial asset at FVOCI investments amounted to ₱37.8 million and ₱10.0 million in 2018 and 2017, respectively. Amortized premium on AFS investments amounted to ₱1.6 million in 2018 and 2017.

The movements in the net unrealized losses on financial assets at FVOCI/AFS investments of the Bank follow:

	2018	2017
	FVOCI	AFS
Balance at January 1	**(₱7,640,320)**	(₱3,582,987)
Fair value changes during the year	**(57,002,642)**	(5,796,190)
Income tax effects	**17,112,047**	1,738,857
	(39,890,595)	(4,057,333)
Balance at December 31	**(₱47,530,915)**	(₱7,640,320)

8. Investment Securities at Amortized Cost/Held-to-Maturity Investments

This account consists of:

	2018	2017
	Investments at amortized cost	HTM
Quoted debt securities	**₱579,479,455**	₱246,475,260
Unquoted debt securities (Note 9)	**124,573,093**	–
	₱704,052,548	₱246,475,260

Quoted debt securities
Government debt securities have fixed annual interest rates ranging from 2.0% to 5.8% in 2018 and and EIR ranging from 1.9% to 8.6% in 2018.

The terms of these investments range from 3 to 10 years in 2018.

Unquoted debt securities
Unquoted debt securities consists of short-term non-negotiable Micro, Small and Medium Enterprise (MSME) notes issued by Small Business Corporation and long-term certificates of Agrarian Reform (AR) bonds issued by the National Government. As of December 31, 2017, these were classified as UDSCL under loans and receivables and subsequently reclassified as part of held-to-collect investment upon adoption of PFRS 9.

As at December 31, 2018 and 2017, MSME notes amounted to ₱42.4 million in 2018 and ₱95.8 million in 2017 with a term of one (1) to five (5) years. These notes bear annual interest rates ranging from 2.0% to 2.5% in 2018 and from 1.8% to 2.5% in 2017. Income earned from this account amounted to ₱3.9 million in 2018 and ₱1.7 million in 2017.

The AR bonds, which were acquired in 2017, bear annual interest rates based on the 91-day Treasury bill and is subject to repricing. Interest income on investments in AR bonds amounted to ₱0.9 million and ₱1.6 million and amortized discount amounted to ₱1.7 million and ₱0.3 million in 2018 and 2017, respectively.

These instruments are acquired in compliance with the requirements set by Republic Act 9501 and Agri Agra Reform Credit Act of 2000 (Republic Act 10000) that lending institutions or any party otherwise required to make a mandatory allocation of credit resources to MSMEs and Agri Agra, shall be deemed as compliance with the mandated loan portfolio allocation percentage.

Interest income on investment securities at amortized cost follows:

	2018	2017
Quoted debt securities	**₱23,498,567**	₱–
Unquoted debt securities	**3,923,104**	–
HTM investments	–	9,574,086
Balance at end of year	**₱27,421,671**	₱9,574,086

9. Loans and Receivables

This account consists of:

	2018	2017
Receivables from borrowers		
Microfinance loans* (Note 14)	**₱8,422,669,734**	₱6,546,671,011
Regular loans	**1,273,552,319**	1,140,473,418
Agricultural-agrarian loans	**603,466,374**	263,158,574
Restructured loans	–	305,159
	10,299,688,427	7,950,608,162
Other receivables:		
Accrued interest receivable	**254,473,003**	129,988,958
Accounts receivable (Note 22)	**3,862,293**	3,789,081
UDSCL (Note 8)	–	162,710,754
	10,558,023,723	8,247,096,955
Less allowance for credit losses	**150,731,477**	256,822,115
	₱10,407,292,246	₱7,990,274,840

**Include microfinance loans used to secure bills payable amounting to ₱0.2 billion and ₱1.2 billion as at December 31, 2018 and 2017, respectively.*

Regular loans include salary loans granted to the Bank's employees and officers and government and schools employees amounting to ₱26.3 million and ₱31.6 million as at December 31, 2018 and 2017, respectively, and earning fixed annual interest rates ranging from 6.0% to 28.0% in 2018 and 2017 (see Note 22).

Interest income on receivables from borrowers amounted to ₱4.5 billion and ₱3.5 billion in 2018 and 2017, respectively. Receivables from borrowers earn interest with effective interest rates ranging from 33.5% to 57.9% in 2018 and 2017. Nominal interest rates of these receivables range from 16.0% to 28.0% in 2018 and 2017.

BSP Reporting
In accordance with BSP regulations, the Bank considers a loan as part of portfolio-at-risk (PAR) when an installment payment that is past due for one day. As at December 31, 2018 and 2017, the Bank's PAR amounted to ₱208.1 million and ₱164.5 million, respectively.

Generally, NPLs refer to loans whose principal and/or interest is unpaid for thirty days or more after due date or after they have become past due in accordance with existing BSP rules and regulations. This shall apply to loans payable in lump sum and loans payable in quarterly, semi-annual, or annual installments, in which case, the total outstanding balance thereof shall be considered nonperforming.

In the case of microfinance loans, past due/PAR accounts are considered as NPLs.

Loans are classified as nonperforming in accordance with BSP regulations, or when, in the opinion of management, collection of interest is doubtful. Loans are not reclassified as performing until interest and principal payments are brought current or the loans are restructured in accordance with existing BSP regulations, and future payments appear assured.

As at December 31, 2018 and 2017, based on the revised definition of NPLs under Circular No. 772, NPLs of ₱9.4 million and ₱15.1 million which the Bank reported to the BSP are net of specific allowance amounting to ₱196.3 million and ₱149.4 million, respectively.

The following table shows the secured and unsecured portions of receivables from borrowers as at December 31, 2018 and 2017:

	2018		**2017**	
	Amount	**%**	**Amount**	**%**
Secured portion				
Deposit hold-out (Note 13)	**₱10,273,709,984**	**99.8%**	₱7,918,454,441	99.6%
Deed of assignment	**3,446,980**	**0.0%**	3,974,232	0.1%
Real estate mortgage	**222,402**	**0.0%**	1,325,941	0.0%
Unsecured portion	**22,309,061**	**0.2%**	26,853,548	0.3%
	₱10,299,688,427	**100.0%**	₱7,950,608,162	100.0%

As at December 31, 2018 and 2017, information on the concentration of gross loans and receivables as to industry follows (amounts in thousands):

	2018		2017	
	Amount	**%**	Amount	%
Wholesale and retail trade	**₱8,943,711**	**84.7%**	₱3,842,544	46.6%
Real estate renting and business activities	**1,140,569**	**10.8%**	604,685	7.3%
Agriculture, hunting and forestry	**292,680**	**2.8%**	2,350,970	28.5%
Education	**107,284**	**1.0%**	143,666	1.8%
Other community, social and personal service activities	**36,120**	**0.3%**	1,020,993	12.4%
Manufacturing	**16,104**	**0.2%**	109,558	1.3%
Government	**14,093**	**0.1%**	73,612	0.9%
Financial institutions	**7,463**	**0.1%**	101,069	1.2%
	₱10,558,024	**100.0%**	₱8,247,097	100.0%

The BSP considers that loan concentration of credit exists when the total loan exposure to a particular industry or economic sector exceeds 30.00% of total loan portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

The movements in allowance for credit losses on loans and receivables from borrowers follow:

	2018	2017
Balance at beginning of year, as previously reported	**₱256,822,115**	₱266,653,007
PFRS 9 ECL transition adjustment (Note 2)	**(70,936,732)**	–
Balance at beginning of year, as restated	**185,885,383**	266,653,007
Provision for (Recovery from) credit losses	**(35,123,428)**	771,917
Accounts written-off	**(30,478)**	(10,602,809)
Balance at end of year	**₱150,731,477**	₱256,822,115

The tables below illustrate the movements of the allowance for impairment and credit losses during the year (effect of movements in ECL due to transfers between stages are shown in the total column):

	2018		
	ECL Staging		
	Stage 1 12-month ECL	Stage 3 Lifetime ECL	Total
Loss allowance at January 1, 2018, as restated	**₱69,228,373**	**₱50,578,433**	**₱119,806,807**
Movements with P&L impact			
Transfers:			
Transfer from Stage 1 to Stage 3	**(111,685)**	**111,685**	–
Transfer from Stage 3 to Stage 1	**53,230**	**(53,230)**	–
New financial assets originated or purchased	**34,626,207**	**60,160,545**	**94,786,753**
Changes in PDs/LGDs/EADs	**(59,952)**	**6,634,331**	**6,574,379**
Financial assets derecognized during the period	**(69,065,060)**	**(27,261,208)**	**(96,326,268)**
Total net P&L charge during the period	**34,671,114**	**116,060,363**	**124,841,670**
Other movements without P&L impact			
Write-offs and other movements	–	**25,889,807**	–
Total movements without P&L impact	–	**25,889,807**	**9,469,328**
Loss allowance at December 31, 2018	**₱34,671,114**	**₱116,060,363**	**₱124,841,670**

The movements in gross carrying amount of receivables from customers between stages follow:

	2018		
	ECL Staging		
	Stage 1 **12-month ECL**	**Stage 3** **Lifetime ECL**	**Total**
Gross carrying amount as at January 1, 2018	**₱7,560,282,389**	**₱339,720,822**	**₱7,900,003,211**
Transfers:			
Transfer from Stage 1 to Stage 3	**(10,033,124)**	**10,033,124**	–
Transfer from Stage 3 to Stage 1	118,966.51	118,966.51	–
New financial assets originated or purchased	**10,200,792,735.44**	**138,844,450.52**	**10,339,637,185.96**
Movements in outstanding balances	**1,952,586**	**(9,547,423)**	**(7,594,838)**
Financial assets derecognized during the period	**(7,546,226,661.09)**	**(272,494,984.08)**	**(7,818,721,645.18)**
Write-offs and other movements	–	**(857,163)**	**(857,163)**
Gross carrying amount as at December 31, 2018	**₱10,206,886,892**	**₱206,437,022**	**₱10,413,323,914**

10. **Investment in Associates**

This account consists of:

	2018	2017
Acquisition cost		
Balance at beginning of year, as previously reported	**₱108,350,000**	₱83,350,000
PFRS 9 reclassification from AFS investments	**400,000**	–
Balance at beginning of year, as restated	**108,750,000**	83,350,000
Additional investments during the year (Note 23)	–	25,000,000
	108,750,000	108,350,000
Accumulated equity in net earnings		
Balance at beginning of year	**206,084,967**	117,524,398
Share in net income of an associate	**142,982,847**	88,560,569
	349,067,814	206,084,967
Accumulated equity in other comprehensive income (loss)		
Balance at beginning of year	**2,777,611**	(8,692,044)
Share in other comprehensive income of an associate	**3,929,563**	11,469,655
	6,707,174	2,777,611
Dividends		
Balance at beginning of year	**(70,400,000)**	(22,400,000)
Dividends	**(70,250,000)**	(48,000,000)
	(140,650,000)	(70,400,000)
Investment in CARD MRI Rizal Bank, Inc.	**323,474,988**	246,812,578
Investment in MIDAS	**400,000**	–
	₱323,874,988	₱246,812,578

The Bank's investment in an associate represents the carrying value of its 40.0% interest in CARD MRI Rizal Bank, Inc. (CMRBI), formerly Rizal Bank, Inc. CMRBI is involved in the business of rural banking as defined in and authorized under Republic Act No. 3779, as amended. CMRBI's primary activities include granting loans to small farmers and to deserving rural enterprises, as well as receiving deposits in accordance with the law. CMRBI is not listed on any public exchange and there are no quoted market prices available for its shares. The primary place of business of CMRBI is at P. Guevarra St., Cor. Aguirre St., Brgy. Poblacion 2, Sta. Cruz, Laguna.

Investment in MIDAS represents the Bank's 10.7% ownership for interest in the Corporation. MIDAS is not listed on any public exchange and there are no quoted market prices available for its shares. The primary place of business of MIDAS is at TSKI Corporate Office, National Highway, Brgy. Mali-ao, Pavia, Iloilo.

The following table illustrates the summarized financial information in the statements of financial position, statements of income and statements of comprehensive income of CMRBI (amounts in millions):

	2018	2017
Current assets	**₱3,919.4**	₱2,532.4
Noncurrent assets	**190.2**	191.7
Current liabilities	**2,508.3**	1,938.7
Noncurrent liabilities	**775.4**	211.5
Revenue	**1,243.6**	753.6
Expenses	**886.2**	525.2
Net income	**357.5**	228.4
Other comprehensive income	**3.0**	8.2
Total comprehensive income	**360.4**	236.6

As at December 31, 2018 and 2017, there were no agreements entered into by the Bank and CMRBI that may restrict dividends and other capital distributions to be paid and the Bank has no share on commitments and contingencies of CMRBI.

11. **Property and Equipment**

The composition of and movements in this account follow:

	Land	**Building**	**Furniture, Fixtures and Equipment**	**Leasehold Improvements**	**Land Improvements**	**Transportation Equipment**	**Construction in Progress**	**Total**
December 31, 2018								
Cost								
Balance at beginning of year	**₱197,662,431**	**₱309,195,769**	**₱331,035,219**	**₱119,644,051**	**₱6,179,149**	**₱22,119,759**	**₱5,979,503**	**₱991,815,881**
Additions	–	**21,108,699**	**32,644,388**	**4,078,292**	**412,096**	–	**23,079,518**	**81,322,993**
Disposals	–	–	**(3,141,437)**	**(169,577)**	–	**(2,298,570)**	–	**(5,609,584)**
Reclassification (Note 12)	–	–	**(141,799)**	–	–	–	**(24,296,916)**	**(24,438,715)**
Balance at end of year	**197,662,431**	**330,304,468**	**360,396,371**	**123,552,767**	**6,591,245**	**19,821,189**	**4,762,104**	**1,043,090,575**
Accumulated Depreciation and Amortization								
Balance at beginning of year	–	**134,507,732**	**245,114,536**	**69,324,634**	**1,992,977**	**22,118,718**	–	**473,058,597**
Depreciation and amortization	–	**34,609,673**	**43,282,273**	**14,662,597**	**1,311,381**	**31**	–	**93,865,952**
Disposals	–	–	**(3,083,269)**	**(169,577)**	–	**(2,298,570)**	–	**(5,551,416)**
Balance at end of year	–	**169,117,405**	**285,313,540**	**83,817,653**	**3,304,357**	**19,820,179**	–	**561,373,133**
Net Book Value	**₱197,662,431**	**₱161,187,063**	**₱75,082,831**	**₱39,735,114**	**₱3,286,888**	**₱1,010**	**₱4,762,104**	**₱481,717,442**

	Land	Building	Furniture, Fixtures and Equipment	Leasehold Improvements	Land Improvements	Transportation Equipment	Construction in Progress	Total
December 31, 2017								
Cost								
Balance at beginning of year	₱205,109,592	₱305,966,266	₱296,971,235	₱94,517,515	₱3,747,000	₱25,603,780	₱–	₱931,915,388
Additions	–	2,628,503	38,429,228	5,391,161	750,000	–	27,998,027	75,196,919
Disposals	(7,447,161)	–	(740,244)	–	–	(3,484,021)	–	(11,671,426)
Reclassification (Note 12)	–	601,000	(3,625,000)	19,735,375	1,682,149	–	(22,018,524)	(3,625,000)
Balance at end of year	197,662,431	309,195,769	331,035,219	119,644,051	6,179,149	22,119,759	5,979,503	991,815,881
Accumulated Depreciation and Amortization								
Balance at beginning of year	–	95,442,166	199,016,353	55,583,903	1,041,350	25,593,931	–	376,677,703
Depreciation and amortization	–	39,065,566	46,645,093	13,740,731	951,627	8,808	–	100,411,825
Disposals	–	–	(546,910)	–	–	(3,484,021)	–	(4,030,931)
Balance at end of year	–	134,507,732	245,114,536	69,324,634	1,992,977	22,118,718	–	473,058,597
Net Book Value	₱197,662,431	₱174,688,037	₱85,920,683	₱50,319,417	₱4,186,172	₱1,041	₱5,979,503	₱518,757,284

Depreciation and amortization presented in the statements of income follow:

	2018	2017
Property and equipment	**₱93,865,952**	₱100,411,825
Intangible assets (Note 12)	**12,779,268**	7,415,083
	₱106,645,220	₱107,826,908

Cost of fully depreciated assets still in use as at December 31, 2018 and 2017 amounted to ₱301.5 million and ₱251.54 million, respectively.

In 2017, the Bank reclassified its property and equipment amounting to ₱3.63 million to 'Others' under 'Other Assets' as the management determined that the asset is not used in the normal business operations.

12. Other Assets

This account consists of:

	2018	2017
Financial assets		
Security deposits	**₱44,173,614**	₱39,259,267
Nonfinancial assets		
Stationeries and supplies	**74,752,260**	67,758,467
Intangible assets	**18,752,741**	29,568,269
Prepaid expenses	**13,436,631**	10,410,034
Others (Note 11)	**4,525,049**	4,575,983
	111,466,681	112,312,753
	₱155,640,295	₱151,572,020

Security deposits pertain to refundable deposits on the Bank's leased office spaces, and staff house premises and leased IT equipment with CLFC.

Intangible assets include purchased licenses and softwares.

The movements of intangible assets follow:

	2018	2017
Cost		
Balance at beginning of year	**₱41,016,520**	₱38,146,566
Additions	**1,963,740**	2,869,954
Balance at end of year	**42,980,260**	41,016,520
Accumulated Amortization		
Balance at beginning of year	**11,448,251**	4,033,168
Amortization (Note 11)	**12,779,268**	7,415,083
Balance at end of year	**24,227,520**	11,448,251
Net Book Value	**₱18,752,741**	₱29,568,269

13. **Deposit Liabilities**

The Bank's savings deposit liabilities include pledge savings amounting to ₱6.9 billion and ₱5.2 billion as at December 31, 2018 and 2017, respectively. These represent the aggregate compulsory savings of ₱50.0 per week collected from each member and earn an annual interest rate of 2.0% in 2018 and 2017. Under an assignment agreement, the pledge savings balances serve as security for loans granted by the Bank to its members. Pledge savings equivalent to 15.0% of the loan proceeds serves as guarantee fund of the outstanding loan receivable from members.

Savings deposits include regular and special savings deposit. Regular savings deposits include "Kayang-kaya", "Tagumpay", "Maagap", "Matapat" and "Dollar" savings. These savings accounts bear annual fixed interest rates ranging from 0.3% to 6.0% in 2018 and 2017. Special savings deposits include "Tiwala" savings with annual interest rates ranging from 2.0% to 4.3% in 2018 and 2017. Interest expense on deposit liabilities amounted to ₱208.5 million and ₱151.0 million in 2018 and 2017, respectively.

BSP Circular No. 830 requires reserves against deposit liabilities. As at December 31, 2018 and 2017, due from BSP amounting to ₱323.6 million and ₱256.1 million, respectively, were set aside as reserves for deposit liabilities per latest report submitted by the Bank to the BSP. As at December 31, 2018 and 2017, the Bank is in compliance with such regulation.

14. **Bills Payable**

The Bank's bills payable consists of payables to local banks and to International Finance Corporation (IFC). The movements in the account follow:

	2018	2017
Face Value		
Balance at beginning of year	**₱915,260,000**	₱1,378,420,000
Availments	**200,000,000**	500,000,000
Principal payments	**(583,160,000)**	(963,160,000)
Balance at end of year	**532,100,000**	915,260,000
Unamortized Transaction Costs		
Balance at beginning of year	**(4,285,232)**	(7,369,577)
Availments	**(731,507)**	(1,717,123)
Amortization	**2,412,937**	4,801,468
Balance at end of year	**(2,603,802)**	(4,285,232)
Carrying Value	**₱529,496,198**	₱910,974,768

<u>Local banks</u>
Bills payable of ₱199.4 million and ₱498.7 million as at December 31, 2018 and 2017, respectively, pertain to promissory notes obtained from various local banks for working capital requirements with a tenor of six (6) months to one (1) year in 2018 and 2017, and annual interest rates ranging from 3.0% to 5.4% and 3.0% to 3.3% in 2018 and 2017, respectively.

IFC
On December 16, 2015, the Bank entered into a Loan Agreement (Agreement) with IFC for the availment of loan amounting to ₱540.0 million (the Loan). The purpose of the Loan is to provide funds to be used by the Bank for financing its lending operations to small and medium-sized enterprises and microfinance entities. The note bears a Philippine fixed base rate of 6.5%, inclusive of 2.7% spread and has a tenor of seven (7) years.

As at December 31, 2018 and 2017, carrying value of the loan amounted to ₱330.1 million and ₱412.3 million, respectively.

Borrowings from IFC contain the following embedded derivatives:

a. prepayment option which allows the Bank to redeem the Loan (or portion of the loan not less than ₱45.0 million) prior to the respective maturities; and
b. cross currency swap which allows the parties to exchange interest payments and principals denominated in different currencies (in USD and Philippine Pesos).

The Bank assessed that these embedded derivatives are clearly and closely related to the host loan instruments, since their redemption price approximate the loans' amortized cost on redemption dates. Accordingly, these embedded derivatives were not accounted for separately from the host loan instrument.

Debt covenants
The Agreement covering the loan with IFC provide for restrictions and requirements which includes the following negative and financial covenants, among others:

a. Negative covenants

   Unless IFC otherwise agrees, the Bank shall not take action on the following, among others:

   - declare or pay any dividend or make any distribution on its share capital (other than dividends or distribution payable in shares of the Bank), unless the proposed payment or distribution is out of net income of the current financial year, no event of default or potential event of default has occurred and is then continuing; and after giving effect to any such action the Bank is in compliance with the financial covenants stated in the agreement;
   - purchase, redeem or otherwise acquire any shares of the Bank or any option over them;
   - incur, create, assume or permit to exist any liability that is covered or ranks prior or senior to the Loan, except those that is in existence of the date of Agreement;
   - create or permit to exist any lien on any property, revenues or other assets, present or future, of the Bank subject to exceptions indicated in the Agreement;
   - enter into any transaction except in the ordinary course of business on ordinary commercial terms and on the basis of arm's-length arrangements;
   - enter into or establish any partnership, profit-sharing or royalty agreement or other similar arrangement whereby the Bank's income or profits are, or might be, shared with any other person; or enter into any management contract or similar arrangement whereby its business or operations are managed by any other persons;

- have any subsidiaries subject to exceptions indicated in the Agreement;
- change its charter in any manner which would be inconsistent with the provisions of the agreement or any other transaction document; its financial year; or the nature or scope of its present or contemplated business or operations;
- undertake or permit any merger, spin-off, consolidation or reorganization; or sell, transfer, lease or otherwise dispose of all or a substantial part of its assets, other than assets acquired in the enforcement of security created in favor of the Bank in the ordinary course of its banking business, whether in a single transaction or in a series of transaction; and
- prepay or repurchase any long-term debt (other than the Loan) subject to conditions indicated the agreement.

b. Financial covenants

The Bank agreed to prudently manage its financial position in accordance with sound banking and financial practices, applicable laws and the prudential standards of the BSP. To the extent that the banking regulation imposes financial requirements or ratios that are more stringent than the following, the Bank shall observe and comply with those more stringent requirements or ratios.

- risk weighted capital adequacy ratio of not less than 10.0%;
- equity to assets ratio of not less than 5.0%;
- economic group exposure ratio of not more than 15.0%;
- aggregate large exposure ratio of not more than 400.0%;
- related party exposure ratio of not more than 15.0%;
- open credit exposures ratio of not more than 25.0%;
- fixed assets plus equity participants ratio of not more than 35.0%;
- aggregate foreign exchange risk ratio of not more than 25.0%;
- single currency foreign exchange risk ratio of not more than 10.0%;
- interest rate risk ratio of not less than -10.0% and not more than 10.0%;
- aggregate interest rate risk ratio of not less than -20.0% and not more than 20.0%;

The period of compliance with the above covenants commenced on March 31, 2016. As at December 31, 2018 and 2017, the Bank is in compliance with the above covenants.

Receivable from borrowers amounting to ₱0.2 billion and ₱1.2 billion secure the above borrowings as at December 31, 2018 and 2017, respectively (Note 8).

The Bank has undrawn credit line amounting to ₱1.6 billion and ₱1.5 billion in 2018 and 2017, respectively.

Changes in liabilities arising from financing activities

	January 1, 2018	Cash flows	Amortization	December 31, 2018
Bills payable	₱910,974,768	(₱383,891,507)	₱2,412,937	₱529,496,198

Interest expense recognized in the statements of income amounted to ₱30.6 million and ₱46.1 million in 2018 and 2017, respectively. Unpaid interest as at December 31, 2018 and 2017 amounted to ₱1.2 million and ₱2.9 million, respectively, is presented under 'Accrued expense' (Note 15).

15. **Other Liabilities**

This account consists of:

	2018	2017
Financial liabilities		
Accrued expenses	**₱159,563,465**	₱133,513,008
Dividends payable (Note 17)	**66,818,789**	50,454,716
Accrued interest on deposit liabilities (Note 22)	**57,619,575**	58,036,558
Accounts payable (Note 22)	**44,777,445**	45,565,115
Accrued interest on bills payable (Note 14)	**1,225,732**	2,885,135
Refundable deposits	**1,200,818**	1,200,818
	331,205,824	291,655,350
Nonfinancial liabilities		
Accrued taxes	**63,559,649**	18,825,945
Accrued vacation leaves	**26,967,522**	26,967,522
Withholding taxes payable	**21,557,938**	15,191,212
	112,085,109	60,984,679
	₱443,290,933	₱352,640,029

Accrued expenses include accrued rent, Philippine Deposit Insurance Corporation premium and other operating expenses.

Accounts payable include due to suppliers and contractors, due to staff, due to Social Security System for collection remittances, Automated Teller Machine overages, statutory payables on employee compensation, and due to related parties (Note 22).

16. Maturity Analysis of Assets and Liabilities

The following table presents the Bank's assets and liabilities as at December 31, 2018 and 2017 analyzed according to when they are expected to be recovered or settled within one year and beyond one year from respective reporting date (in thousands):

	2018			2017		
	Within one year	**Beyond one year**	**Total**	Within one year	Beyond one year	Total
Financial Assets						
Cash and other cash items	**₱135,438**	**₱–**	**₱135,438**	₱143,047	₱–	₱143,047
Due from BSP	**323,614**	**–**	**323,614**	256,065	–	256,065
Due from other banks	**1,500,449**	**–**	**1,500,449**	1,948,861	–	1,948,861
Financial assets at FVOCI	**–**	**851,523**	**851,523**			
AFS investments	**–**	**–**	**–**	–	376,125	376,125
Loans and receivables	**8,193,604**	**53,493**	**10,558,024**	8,193,604	53,493	8,247,097
Investment securities at amortized costs	**–**	**704,053**	**704,053**			
HTM investments				27,312	219,163	246,475
Security deposits	**–**	**48,637**	**48,637**	–	39,259	39,259
Nonfinancial Assets						
Investments in associates	**–**	**323,875**	**323,875**	–	246,813	246,813
Property and equipment	**–**	**959,273**	**959,273**	–	991,816	991,816
Retirement asset	**–**	**248,783**	**248,783**	–	252,155	252,155
Deferred tax assets	**–**	**1,840**	**1,840**	–	18,553	18,553
Other assets	**88,189**	**23,777**	**136,231**	82,744	41,017	123,761
Total Assets	**₱10,651,633**	**₱2,238,394**	**12,890,027**	₱10,651,633	₱2,238,394	12,890,027
Less: Allowance for credit losses			**150,731**			256,823
Accumulated depreciation and amortization			**453,328**			484,507
			₱15,134,225			₱12,148,697

	2018			2017		
	Within one year	**Beyond one year**	**Total**	Within one year	Beyond one year	Total
Financial liabilities						
Deposit liabilities	**₱9,874,142**	**₱363,457**	**₱10,237,599**	₱8,016,622	₱5,939	₱8,022,561
Bills payable	**283,160**	**248,940**	**532,100**	534,062	381,198	915,260
Other liabilities:						
Accrued expenses	**157,650**	**1,913**	**159,563**	131,600	1,913	133,513
Accrued interest	**58,845**	**–**	**58,845**	60,922	–	60,922
Dividends payable	**66,819**	**–**	**66,819**	50,455	–	50,455
Accounts payable	**44,777**	**–**	**44,777**	45,565	–	45,565
Refundable deposits	**–**	**1,201**	**1,201**	–	1,201	1,201
Nonfinancial liabilities						
Income tax payable	**230,641**	**–**	**230,641**	100,044	–	100,044
Other liabilities:						
Accrued vacation leaves	**3,065**	**23,902**	**26,967**	2,895	24,072	26,967
Accrued taxes	**63,560**	**–**	**63,560**	18,826	–	18,826
Withholding taxes payable	**21,558**	**–**	**21,558**	15,191	–	15,191
Total Liabilities	**₱10,804,217**	**₱639,413**	**11,443,630**	₱8,976,182	₱414,322	9,390,504
Less: Unamortized discount onbills payable			**2,604**			4,285
			₱11,441,027			₱9,386,219

17. **Equity**

Capital Stock

As at December 31, 2018 and 2017, the Bank's capital stock consists of:

	2018		2017	
	Shares	**Amount**	Shares	Amount
Preferred stock - ₱200 par value, 5,000,000 authorized shares				
Issued and outstanding				
Beginning of year	**3,408,819**	**₱681,763,800**	2,850,706	₱570,141,200
Application of deposit for future stock subscription to issued shares	**1,590,732**	**318,146,400**	–	–
Issuance of shares of stocks	–	–	284,268	56,853,600
Issuance of shares of stocks from settlement of subscriptions receivables	**449**	**89,800**	270,416	54,083,200
Preferred stock at the end of the year	**5,000,000**	**₱1,000,000,000**	3,407,428	681,078,000
Subscribed	–	–	2,980	596,000
Subscription receivable	–	–	(449)	(89,800)
	5,000,000	**₱1,000,000,000**	3,408,819	₱681,763,800
Common stock - ₱100 par value, 10,000,000 authorized shares				
Issued and outstanding				
Beginning of year	**9,999,926**	**₱999,992,600**	3,932,933	₱393,293,300
Issuance of shares of stocks from settlement of subscriptions receivables	**74**	**7,400**	818,143	81,814,300
Stock dividends	–	–	3,749,926	374,992,600
Common stock at the end of the year	**10,000,000**	**1,000,000,000**	8,501,200	850,100,200
Subscribed	–	–	1,498,924	149,892,400
	10,000,000	**₱1,000,000,000**	9,999,926	₱999,992,600

Preferred has the following features: (a) 8.0% cumulative dividends, (b) non-participating, and (c) non-redeemable. As at December 31, 2018 and 2017, cumulative dividends amounted to ₱260.0 million and ₱204.5 million, respectively.

Dividend Declaration

2018 Cash Dividends

On March 17, 2018, the BOD declared cash dividends of 12.0% and ₱15.0 per share to its preferred and common stockholders, respectively, to stockholders of record as at February 28, 2018. Cash dividends declared amounting to ₱232.5 million were paid starting April 2, 2018 to preferred and common stockholders of record as at February 28, 2018.

On September 15, 2018, the BOD declared and approved another cash dividends of 8.0% and ₱15.0 per share to its preferred and common stockholders, respectively to stockholder of record as at July 31, 2018. Cash dividends declared amounting to ₱230.0 million were paid starting September 26, 2018 to preferred and common stockholders.

On December 14, 2018, the BOD declared and approved another cash dividend of 6.0% and ₱12.0 per share to its preferred and common stockholders, respectively, to its stockholders of record as at November 30, 2018. Cash dividends declared amounting to ₱180.0 million were paid starting December 20, 2018 to preferred and common stockholders.

2017 Cash and Stock Dividends
On March 17, 2017, the BOD declared and approved cash dividends of 20.0% and ₱30.0 per share to its preferred and common stockholders, respectively, and ₱30.0 per share of stock dividends to its common stockholders of record as at February 28, 2017. Cash dividends declared amounting to ₱312.5 million were paid starting March 21, 2017 to preferred and common stockholders of record as at February 28, 2017.

On August 28, 2017, the BOD declared and approved another cash dividends of 8.0% and ₱12.0 per share to its preferred and common stockholders, respectively. Cash dividends declared amounting to ₱149.9 million were paid starting September 6, 2017 to preferred and common stockholders.

On September 16, 2017, the BOD declared and approved stock dividends of ₱8.0 per share to all common stockholders of record as at July 31, 2017.

On December 15, 2017, the BOD declared approved another cash dividend of 4.0% and ₱5.0 per share to its preferred and common stockholders, respectively and ₱ 14.0 per share stock dividend to its common stockholders of record as at November 30, 2017. Cash dividends declared amounting to ₱71.0 million were paid starting December 19, 2017 to preferred and common stockholders.

Capital Management
The Bank's capital management aims to ensure that it complies with regulatory capital requirements and it maintains strong credit ratings and healthy capital ratios in order to support and sustain its business growth towards maximizing the shareholders' value.

The Bank manages its capital structure and appropriately effect adjustment according to the changes in economic conditions and the risk level it recognizes at every point of time in the course of its business operations.

In order to maintain or adjust for good capital structure, the Bank carefully measures the amount of dividend payment to shareholders, call payment due from the capital subscribers or issue capital securities as necessary. No changes were made in the objectives, policies and processes from the previous years.

Regulatory Qualifying Capital
Under existing BSP regulations, the determination of the Bank's compliance with regulatory requirements and ratios is based on the amount of the Bank's unimpaired capital (regulatory capital) reported to the BSP, determined on the basis of regulatory accounting policies, which differ from PFRS in some aspects. The computation of surplus available for dividend declaration in accordance with SEC Memorandum Circular No. 11 issued in December 2008 differs to a certain extent from the computation following BSP guidelines. As at December 31, 2018 and 2017, the Bank was in compliance with the risk-based capital adequacy ratio (CAR).

BSP Circular No. 688, Revised Risk-Based Capital Adequacy Framework for stand-alone thrift banks, rural banks and cooperative banks which took effect on January 1, 2012 represents BSP's commitment to align existing prudential regulations with international standards consistent with the BSP's goal of promoting the soundness and stability of individual banks and of the banking system as a whole. BSP Circular No. 688 replaced BSP Circular No. 280 which is primarily based on Basel 1.

Under current banking regulations, the combined capital accounts of each bank should not be less than an amount equal to ten percent (10.0%) of its risk assets. The qualifying capital of the Bank for purposes of determining the capital-to-risk assets ratio to total equity excluding:

- unbooked valuation reserves and other capital adjustments as may be required by the BSP;
- total outstanding unsecured credit accommodations to directors, officers, stakeholders and DOSRI;
- deferred tax asset or liability; and
- other regulatory deductions.

Risk assets consist of total assets after exclusion of cash and other cash items, due from BSP, loans covered by hold-out on or assignment of deposits, loans or acceptances under letters of credit to the extent covered by margin deposits, and other non-risk items as determined by the Monetary Board of the BSP.

Under BSP Circular No. 360, effective July 1, 2003, the CAR is to be inclusive of a market risk charge. BSP Circular No. 560 dated January 31, 2007 which took effect on February 22, 2007, requires the deduction of unsecured loans, other credit accommodations and guarantees granted to subsidiaries and affiliates from capital accounts for purposes of computing CAR.

On October 9, 2014, the BSP issued BSP Circular No. 854 which amends the provisions of the Manual of Regulations for Banks on the minimum capitalization of banks and on the prerequisites for the grant of authority to establish a branch. Based on this circular, the Bank is required to maintain a minimum capitalization of ₱400.0 million.

Regulatory capital consists of Tier 1 capital, which comprises share capital, share premium, retained earnings including current year profit. The other component of regulatory capital is Tier 2 capital, which includes revaluation reserves. Certain adjustments are made to PFRS-based results and reserves, as prescribed by the BSP.

The CAR of the Bank as at December 31, 2018 and 2017, as reported to the BSP, is shown in the table below (amounts in millions):

	2018	2017
Tier 1 capital	**₱2,324.8**	₱1,857.0
Tier 2 capital	**963.2**	664.0
Total qualifying capital	**₱3,288.0**	₱2,521.0
Risk weighted assets	**₱11,698.8**	₱9,938.7
Tier 1 capital ratio	**19.9%**	18.7%
Tier 2 capital ratio	**8.2%**	6.7%
Total CAR	**28.1%**	25.4%

As at December 31, 2018 and 2017, the Bank's CAR is in compliance with the regulatory requirements.

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios adopted by the BSP in supervising the Bank.

Financial Performance

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

	2018	2017
Return on average equity	**38.8%**	29.5%
Return on average assets	**9.5%**	6.7%
Net interest margin	**34.6%**	34.8%

Covered banks and quasi-banks are enjoined to consider the forthcoming regulatory changes in capital planning exercises and conduct preliminary assessments of the likely impact of the changes.

18. **Miscellaneous Income and Expenses**

Miscellaneous income consists of:

	2018	2017
Rental income	**₱5,285,190**	₱3,925,669
Recoveries of written-off account	**1,098,652**	1,952,286
Deposit-related fees and other charges	**1,077,536**	4,059,606
Commission income	**700,808**	520,058
Gain on disposal of property and equipment	**436,158**	1,598,854
Others (Note 22)	**2,795,745**	2,404,412
	₱11,394,087	₱14,460,885

Others include service charges on remittances and insurance claims for transportation equipment.

Miscellaneous expense consists of the following:

	2018	2017
Other donations and charitable expenses (Note 22)	**₱73,574,500**	₱35,167,542
Medical and other related expenses	**11,364,446**	5,878,653
Representation and entertainment (Note 21)	**1,618,745**	1,463,967
Advertising and promotions	**1,387,265**	1,202,123
Penalties and other service charges	**17,495**	27,800
Others	**18,177,276**	19,612,230
	₱106,139,728	₱63,352,315

Others include notarial and other legal expenses, foreign currency exchange loss, and other small value expenses that are non-recurring.

19. **Retirement Benefits**

The Bank, CARD MRI Development Institute, Inc. (CMDI), CARD Mutual Benefit Association (MBA), Inc., CARD SME Bank, Inc., CARD MRI Insurance Agency (CAMIA), Inc., CARD Business Development Service Foundation, Inc. (BDSFI), Inc., CARD MRI Information Technology, Inc. (CMIT), CARD Employees Multi-Purpose Cooperative (EMPC), Responsible Investments for Solidarity and Empowerment Financing Co. (RISE), BotiCARD Inc., CARD Leasing and Finance Corporation (CLFC), CMRBI, CARD, Inc. and Mga Likha ni Inay Inc. (MLNI), maintain a funded and formal noncontributory defined benefit retirement plan - the CARD MRI Multi-Employer Retirement Plan (MERP) - covering all of their regular employees and CARD Group Employees' Retirement Plan (Hybrid Plan) applicable to employees hired on or after July 1, 2016. MERP and Hybrid Plan comply with the requirements of Republic Act No. 7641 (Retirement Pay Law).

MERP is valued using the projected unit cost method and is financed solely by the Bank and its related parties. MERP provides lump sum benefits equivalent to up to 120% of final salary for every year of credited service, a fraction of at least six (6) months being considered as one whole year, upon retirement, death, total and permanent disability, or voluntary separation after completion of at least one year of service with the participating companies.

The date of the latest actuarial valuation report for MERP is December 31, 2018.

Changes in net retirement asset in 2018 and 2017 are as follows:

2018

	Net benefit cost in statements of income*						Remeasurements in other comprehensive income							
	January 1	**Current service cost**	**Net interest**	**Subtotal**	**Transfer to the plan**	**Benefits paid**	**Return on plan assets (excluding amount included in net interest)**	**Experience adjustments**	**Actuarial changes arising from changes in demographic assumptions**	**Actuarial changes arising from changes in financial assumptions**	**Effect of asset ceiling**	**Subtotal**	**Contribution by employer**	**December 31**
Fair value of plan assets	**₱605,680,263**	**₱–**	**₱35,213,917**	**₱ 35,213,917**	**₱67,577**	**(₱5,309,854)**	**(₱5,171,144)**	**₱–**	**₱–**	**₱–**	**₱–**	**(₱5,171,144)**	**₱14,468,132**	**₱644,948,891**
Present value of defined benefit				**(47,307,193)**										
obligation	**(272,207,538)**	**(31,600,818)**	**(15,706,375)**	**(4,692,053)**	**(67,577)**	**5,309,854**	**–**	**(40,690,729)**	**5,250,594**	**81,352,505**	**–**	**45,912,370**	**–**	**(268,360,084)**
Effect of asset ceiling	**(81,318,073)**	**–**	**(4,692,053)**		**–**	**–**	**–**	**–**	**–**	**–**	**(41,795,274)**	**(41,795,274)**	**–**	**(127,805,400)**
Net retirement asset	**₱252,154,652**	**(₱31,600,818)**	**₱14,815,489**	**(₱16,785,329)**	**₱–**	**₱–**	**(₱5,171,144)**	**(₱40,690,729)**	**₱5,250,594**	**₱81,352,505**	**(₱41,795,274)**	**(₱1,054,048)**	**₱14,468,132**	**₱248,783,407**

**The net benefit cost is included in 'Compensation and benefits' in the statements of income.*

2017

	Net benefit cost in statements of income*						Remeasurements in other comprehensive income							
	January 1	Current service cost	Net interest	Subtotal	Transfer to the plan	Benefits paid	Return on plan assets (excluding amount included in net interest)	Experience adjustments	Actuarial changes arising from changes in demographic assumptions	Actuarial changes arising from changes in financial assumptions	Effect of asset ceiling	Subtotal	Contribution by employer	December 31
Fair value of plan assets	₱583,343,108	₱–	₱34,089,950	₱34,089,950	₱1,062,050	(₱4,268,752)	(₱8,546,093)	₱–	₱–	₱–	₱–	(₱8,546,093)	₱–	₱605,680,263
Present value of defined benefit obligation	(318,789,148)	(42,525,984)	(18,681,044)	(61,207,028)	(1,062,050)	4,268,752	–	4,671,804	4,033,813	95,876,319	–	104,581,936	–	(272,207,538)
Effect of asset ceiling	(45,111,356)	–	(2,643,525)	(2,643,525)	–	–	–	–	–	–	(33,563,192)	(33,563,192)	–	(81,318,073)
Net retirement asset	₱219,442,604	(₱42,525,984)	₱12,765,381	(₱29,760,603)	₱–	₱–	(₱8,546,093)	₱4,671,804	₱4,033,813	₱95,876,319	(₱33,563,192)	₱62,472,651	₱–	₱252,154,652

**The net benefit cost is included in 'Compensation and benefits' in the statements of income.*

The maximum economic benefit of plan assets available is a combination of expected refunds from the plan and reduction in future contributions. The fair value of plan assets by each class as at the end of the reporting period are as follow:

	2018	2017
Cash and other cash items	**₱286,486,297**	₱249,600,836
Government securities	**308,672,539**	307,503,870
Mutual funds	**–**	2,846,697
Other bonds	**14,188,876**	–
Loans and receivables	**–**	37,915,585
Other assets	**35,601,179**	7,813,275
Fair value of plan assets	**₱644,948,891**	₱605,680,263

All plan assets do not have quoted prices in an active market except for government securities. Cash and other cash items are deposited in reputable financial institutions and related parties and are deemed to be standard grade. Mutual fund, loans and receivables and other assets are unrated.

The plan assets have diverse investments and do not have any concentration risk other than those in government securities which are of low risk.

The cost of defined retirement plan as well as the present value of the defined benefit obligation is determined using actuarial valuations. The actuarial valuation involves making various assumptions. The principal assumptions used in determining pension for the defined benefit plans are shown below:

	2018	2017
Discount rates		
January 1	**5.8%**	5.9%
December 31	**7.7%**	5.8%
Future salary increases	**5.0%**	5.0%

The sensitivity analysis below has been determined based on reasonably possible changes of each significant assumption on the defined benefit obligation as at the end of the reporting period, assuming if all other assumptions were held constant:

	2018		2017	
	+100	**-100**	+100	-100
Discount rates	**(₱31,560,611)**	**₱38,249,858**	(₱39,186,527)	₱67,296,507
Future salary increases	**38,926,752**	**(32,578,138)**	45,814,926	(50,484,796)

As at December 31, 2018, the average duration of defined benefit obligations is 13 years.

Shown below is the maturity analysis of the undiscounted benefit payments:

	2018	2017
Less than 1 year	**₱20,110,923**	₱–
More than 1 year to 5 years	**79,968,613**	5,761,914
More than 5 years to 10 years	**146,887,244**	11,898,767
More than 10 years to 15 years	**246,089,792**	34,730,275
More than 15 years to 20 years	**433,588,541**	286,691,639
More than 20 years to 25 years	**657,518,253**	963,765,857
More than 25 years	**2,127,646,584**	11,032,199,741

20. **Leases**

Office spaces and staff house
The Bank leases the premises occupied by some of its branches in which lease payments are subjected to escalation clauses at 5.0% to 10.0% starting either on the second or third year of lease. The lease contracts are for the periods ranging from one (1) to ten (10) years and are renewable upon mutual agreement between the Bank and the lessors.

Lease expense presented under 'Rent' in the statements of income amounted to ₱116.3 million and ₱96.1 million in 2018 and 2017, respectively.

Future minimum rental lease payments on operating leases of the Bank are as follows:

	2018	2017
Within one year	**₱107,536,550**	₱82,829,275
Beyond one year but not beyond five years	**165,885,293**	88,643,017
	₱273,421,843	₱171,472,292

Transportation and IT equipment
The Bank leases transportation and IT equipment from CLFC. The lease contracts have a term of eighteen (18) months to twenty-four (24) months and eighteen months in 2018 and 2017, respectively.

Lease for transportation equipment recorded under 'Rent' in 2018 and 2017 amounted to ₱37.3 million and ₱29.0 million, respectively. Lease for IT equipment recorded under 'Rent' amounted to ₱14.9 million and ₱19.1 million in 2018 and 2017, respectively.

Future minimum rental lease payments on the operating leases of the Bank follow:

	2018	2017
Within one year	**₱33,232,567**	₱36,235,737
Beyond one year but not beyond five years	**6,441,883**	6,930,727
	₱39,674,450	₱43,166,464

21. **Income Taxes**

Under Philippine tax laws, the Bank is subject to percentage and other taxes as well as income taxes. Percentage and other taxes paid consist principally of gross receipts tax (GRT) and documentary stamp taxes presented as 'Taxes and licenses' in the statements of income.

Income taxes include corporate income tax, as discussed below, and 20.0% final withholding tax on gross interest income from government securities and other deposit substitutes.

Current tax regulations provide that RCIT rate shall be 30.0%. It further states that nondeductible interest expense shall likewise be reduced to 33.0% of interest income subjected to final tax.

The Bank allocates common expenses in computing its taxable income based on Revenue Regulations 4-2011, which prescribes the proper allocation of costs and expenses amongst income earnings of banks and other financial institutions for income tax reporting purposes.

An optional standard deduction (OSD) equivalent to 40.0% of gross income may be claimed as an alternative deduction in computing for the RCIT. For the 2018 and 2017 RCIT computation, the Bank elected to claim itemized expense deductions instead of the OSD.

Current tax regulations also provide for the ceiling on the amount of entertainment, amusement and recreation (EAR) expense that can be claimed as a deduction against taxable income. Under the regulation, EAR expense allowed as a deductible expense is limited to the actual EAR paid or incurred but not to exceed 1.0% of the Bank's net revenue. The regulations also provide for MCIT of 2.0% on modified gross income and allow a NOLCO. The MCIT and NOLCO may be applied against the Bank's income tax liability and taxable income, respectively, over a three-year period from the year of inception.

Provision for income tax consists of:

	2018	2017
Current:		
RCIT	**₱432,941,614**	₱276,377,354
Final tax	**22,067,008**	9,565,747
	455,008,622	285,943,101
Deferred	**12,859,990**	(2,885,178)
	₱467,868,612	₱283,057,923

Components of net deferred tax assets are as follows:

	2018	2017
Deferred tax asset		
Allowance for credit and impairment losses	**₱45,219,443**	₱77,046,635
Unrealized loss on financial assets at FVOCI/AFS investments	**20,386,470**	3,274,423
Accrued rent and vacation leave	**9,197,329**	11,572,373
Unamortized past service cost	**1,745,295**	2,330,064
	76,548,538	94,223,495
Deferred tax liability		
Retirement asset	**(74,635,022)**	(75,646,396)
Unrealized foreign exchange gain	**(73,313)**	(24,148)
	(74,708,335)	(75,670,544)
	₱1,840,203	₱18,552,951

The income tax effect arising from retirement asset recognized in 2018 and 2017 in other comprehensive income amounted to a provision of ₱0.3 million and ₱18.7 million, respectively.

The income tax effect arising from unrealized losses on financial assets at FVOCI/AFS investments recognized in statements of other comprehensive income amounted to a benefit of ₱17.1 million and ₱1.7 million in 2018 and 2017, respectively.

As at December 31, 2018 and 2017, the Bank has no unrecognized deferred tax assets.

The reconciliation between the statutory income tax and effective income tax follow:

	2018	2017
Statutory income tax	**₱512,962,109**	₱307,395,960
Income tax effects of:		
Nontaxable income	**(42,894,854)**	(26,615,160)
Interest income subject to final tax	**(36,071,594)**	(4,271,253)
Nondeductible interest expense and other expenses	**33,872,950**	6,637,540
Provision for income tax	**₱467,868,612**	₱283,057,923

22. Related Party Transactions

Related party relationship exists when one party has the ability to control, directly, or indirectly through one or more intermediaries, the other party or exercises significant influence over the other party in making financial and operating decisions. The Bank's related parties include:

- key management personnel, close family members of key management personnel and entities which are controlled, significantly influenced by or for which significant voting power is held by key management personnel or their close family members,
- post-employment benefit plans for the benefit of the Bank's employees, and
- other related parties within the CARD-MRI Group.

Transactions with Retirement Plans
Under PFRS, certain post-employment benefit plans are considered as related parties. CARD-MRI's MERP is a stand-alone entity assigned in facilitating the contributions to retirement starting 2015. The plan assets are mostly invested in time deposits and special savings of related party banks and government bonds (Note 19). As of December 31, 2018 and 2017, the retirement funds do not hold or trade the Bank's shares of stock.

Remunerations of Key Management Personnel
Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly. The Bank considers the members of the senior management to constitute key management personnel for purposes of PAS 24.

The compensation of key management personnel included under 'Compensation and benefits' in the statements of income are as follows (in millions):

	2018	2017
Short-term employee benefits	**₱32.4**	₱23.2
Post-employment benefits	**12.7**	12.5
	₱45.1	₱35.7

The Bank also provides banking services to directors and other key management personnel and persons connected to them. These transactions are presented in the tables that follow.

Other related party transactions
Transactions between the Bank and its key management personnel meet the definition of related party transactions. Transactions between the Bank and related parties within the CARD-MRI Group, also qualify as related party transactions.

Deposit liabilities, accounts receivable, accounts payable and miscellaneous income
Deposit liabilities, accounts receivable, accounts payable and miscellaneous income held by the Bank for key management personnel, shareholder and other related parties as at December 31, 2018 and 2017 follow:

	December 31, 2018		
Category	**Amount/Volume**	**Outstanding Balance**	**Nature, Terms and Conditions**
Key Management Personnel			
Deposit liabilities		**₱159,174,940**	These are demand and savings accounts with annual interest rates ranging from 1.5% to 6.0%.
Deposits	**₱152,834,836**		
Withdrawals	**34,529,407**		
Shareholders*			
Deposit liabilities		**757,103,170**	These are demand and savings accounts maintained by shareholders with the Bank with annual interest rates ranging from nil to 4.3%.
Deposits	**6,305,997,222**		
Withdrawals	**5,548,894,053**		
Accounts receivable		**391,117**	This amount represents the shareholders' share in expenses still payable to the Bank.
Share in expenses	**2,119,613**		
Collections	**1,728,497**		
Accounts payable		**729,768**	This amount represents the Bank's share in expenses still payable to its shareholders.
Share in expenses	**33,020,633**		
Remittances	**32,290,864**		
Other Related Parties**			
Deposit liabilities		**494,465,385**	These are demand and savings accounts with annual interest rates ranging from nil to 4.3%
Deposits	**2,951,352,024**		
Withdrawals	**2,456,886,639**		

(Forward)

		December 31, 2018	
Category	**Amount/Volume**	**Outstanding Balance**	**Nature, Terms and Conditions**
Accounts receivable		**₱–**	This amount represents other related parties' share in expenses still payable to the Bank.
Share in expenses	**₱1,744,389**		
Collections	**1,890,384**		
Accounts payable		**2,095,776**	This amount represents the Bank's share in expenses still payable to its other related parties.
Share in expenses	**319,829,567**		
Remittances	**317,733,791**		

**Include transactions with CARD EMPC, CARD MBA and CARD Inc.*
***Include transactions with BotiCARD CARD SME, CMIT, CMDI, CLFC, MLNI, CAMI, BDSF, CMPH, CPMI, CMPIand CMHT*

		December 31, 2017	
Category	Amount/Volume	Outstanding Balance	Nature, Terms and Conditions
Key Management Personnel			
Deposit liabilities		₱159,174,940	These are demand and savings accounts with annual interest rates ranging from 1.5% to 6.0%.
Deposits	₱152,834,836		
Withdrawals	34,529,407		
Shareholders*			
Deposit liabilities		383,781,007	These are demand and savings accounts maintained by shareholders with the Bank with annual interest rates ranging from nil to 4.3%.
Deposits	1,712,227,947		
Withdrawals	1,441,205,187		
Accounts receivable		1,151,575	This amount represents the shareholders' share in expenses still payable to the Bank.
Share in expenses	5,788,440		
Collections	5,641,780		
Accounts payable		8,610,919	This amount represents the Bank's share in expenses still payable to its shareholders.
Share in expenses	14,422,079		
Remittances	6,131,270		
Other Related Parties**			
Deposit liabilities		748,631,891	These are demand and savings accounts with annual interest rates ranging from nil to 4.3%
Deposits	1,639,485,167		
Withdrawals	1,003,611,523		
Accounts receivable		145,995	This amount represents other related parties' share in expenses still payable to the Bank.
Share in expenses	4,059,920		
Collections	3,934,470		
Accounts payable		4,114,511	This amount represents the Bank's share in expenses still payable to its other related parties.
Share in expenses	42,153,103		
Remittances	39,109,665		

**Include transactions with CARD EMPC, CARD MBA and CARD Inc.*
***Include transactions with BotiCARD, CMIT, CMDI, CLFC, MLNI and CAMIA*

Others

Other related party transactions of the Bank are as follows:

	2018	2017	**Nature, Terms and Conditions**
Statement of Financial Position			
Key management personnel			
Dividends paid	**₱44,604,308**	₱35,021,956	Relates to common and preference shares of the Bank held by key management personnel
Associate			
Additional investments	–	25,000,000	Pertains to additional investments of the Bank in RBI
Shareholders*			
Dividends paid	**642,484,988**	184,600,000	Pertains to dividends on common and preference shares of the Bank held by its shareholders
Dividends payable	**66,818,789**	50,454,716	Pertains to unpaid dividends on common and preference shares of the Bank held by its shareholders
Statement of Comprehensive Income			
Key management personnel			
Interest expense	–	256,112	Pertains to interest on demand and savings accounts with annual rates ranging from nil to 4.5%
Associate			
Miscellaneous income	–	180,000	Pertains to management fee income for services to RBI regarding compliance tasks
Dividends received	**70,250,000**	48,000,000	Pertains to income received by the Bank from RBI as an associate
Shareholders*			
Rent	**9,306,763**	8,588,133	Certain establishments are being owned by shareholders leased to the Bank. The lease

	2018	2017	Nature, Terms and Conditions
			contracts have a three-year term with no escalation clause and five to six-year term with escalation clause of 10% every after 2 years.
Interest expense	–	8,392,138	Pertains to interest on savings accounts with annual interest rates ranging from 1.5% to 4.3%
Other related parties**			
Interest expense	–	2,391,903	Pertains to interest on savings accounts with annual interest rates ranging from 1.5% to 4.3%
Seminars and training	**83,570,154**	77,097,721	The Bank engaged CMDI for training and development of its members and employees (shown as part of 'Employee trainings' and 'Members training and development' and 'Seminars and meetings' in the statements of income.)
Information and technology	**130,806,286**	175,318,656	Pertains to the CMIT's rendered services in relation to system maintenance agreement and upgrade of the Bank's core banking system
Rent	**52,287,573**	54,827,831	Pertains to the rental of transportation and office equipment of the Bank to CLFC
Miscellaneous expense	**73,574,500**	35,000,000	Pertains to the Bank's donation to CMDI
Retirement Plan			
Contributions	**14,468,132**	7,025,488	Pertains to the funded and formal noncontributory defined benefit retirement plan of the Bank that is handled by CARD MERP (see Note 19)

**Include transactions with CARD EMPC, CARD MBA and CARD Inc.*
***Include transactions with BotiCARD, CMIT, CMDI, CLFC, MLNI and CAMIA*

Transitioned branches from CARD, Inc. to the Bank were 2 both in 2018 and 2017. The BOD passed a resolution for the transition of the branches from CARD, Inc. after receipt of approval from the BSP to establish additional microfinance-oriented branches on May 13, 2014 with 21 branches to be opened within three (3) years from date of approval.

Regulatory Reporting

As required by BSP, the Bank discloses loan transactions with investees and with certain DOSRI. Existing banking regulations limit the amount of individual loans to DOSRI, 70.0% of which must be secured, to the total of their respective deposits and book value of their respective investments in the lending company within the Bank.

In the aggregate, loans to DOSRI generally should not exceed total equity or 15.0% of total loan portfolio, whichever is lower. As at December 31, 2018 and 2017, the Bank is in compliance with the regulatory requirements.

BSP Circular No. 423 dated March 15, 2004 amended the definition of DOSRI accounts.
On October 8, 2010, BSP Circular No. 695 is issued to provide guidance on the definition of Related Interest. BSP Circular No. 749, dated February 6, 2012, provides that related party transactions are expected to cover a wider definition than DOSRI under existing regulations and a broader spectrum of transactions (i.e., not limited to credit exposures).

As at December 31, 2018 and 2017, DOSRI accounts under the existing regulations are shown in the table below (as reported to BSP):

	2018	2017
Total outstanding DOSRI accounts	**₱852,953**	₱523,355
Percent of DOSRI accounts granted prior to effectivity of BSP Circular No. 423 to total loans	**0.0%**	0.0%
Percent of DOSRI accounts granted after effectivity of BSP Circular No. 423 to total loans	**0.0%**	0.0%
Percent of DOSRI accounts to total loans	**0.0%**	0.0%
Percent of unsecured DOSRI accounts to total DOSRI accounts	**0.0%**	0.0%
Percent of past due DOSRI accounts to total DOSRI accounts	**0.0%**	0.0%
Percent of non-accruing DOSRI accounts to total DOSRI accounts	**0.0%**	0.0%

23. Notes to Statements of Cash Flows

The following is the summary of noncash activities in 2018 and 2017:

	2018	2017
Noncash investing activity:		
Reclassification from AFS investments to investment in an associate	₱400,000	₱–

The following table shows the reconciliation analysis of liabilities arising from financing activities for the year ended December 31, 2018 and 2017, respectively:

	January 1, 2018	**Cash flows**	**Dividend declaration**	**Amortization of discount**	**December 31, 2018**
Bills payable (Note 14)	₱910,974,768	(₱383,160,000)	₱–	₱1,681,429	₱529,496,198
Dividends payable	50,454,716	(626,120,914)	642,484,988	–	66,818,789
Total liabilities from financing activities	₱961,429,484	(₱968,431,755)	₱642,484,988	₱1,681,429	₱637,895,653

	January 1, 2017	**Cash flows**	**Dividend declaration**	**Amortization of discount**	**December 31, 2017**
Bills payable (Note 14)	₱1,371,050,423	(₱464,877,123)	₱–	₱4,801,469	₱910,974,768
Dividends payable	9,605,557	(492,542,947)	533,392,106	–	50,454,716
Total liabilities from financing activities	₱1,380,655,980	(₱957,420,070)	₱533,392,106	₱4,801,469	₱961,429,484

24. Approval of the Issuance of the Financial Statements

The accompanying financial statements of the Bank were approved and authorized for issue by the BOD on April 9, 2019.

25. Supplementary Information Required under Revenue Regulations 15-2010

The components of 'Taxes and licenses' recognized in the statement of income for the year ended December 31, 2018, follow:

Gross receipt tax (GRT)	₱233,469,274
Business permits and licenses	9,722,628
Documentary stamp (DST)	2,248,747
Real property tax	2,801,968
Others	1,291,402
	₱249,534,020

GRT in 2018 consists of taxes on:

Interest income on loans	₱224,253,738
Other income	9,217,767
	₱233,471,505

DST in 2018 consists of taxes on special savings account, loans, and capital increase.

Withholding taxes in 2018 are categorized into:

Paid:	
Expanded withholding tax	₱19,627,414
Withholding taxes on compensation and benefits	5,744,648
Final withholding tax on interest expense and dividends declared	35,350,299
	60,722,361
Accrued:	
Expanded withholding tax	4,240,387
Withholding taxes on compensation and benefits	1,281,099
Final withholding tax on interest expense	16,036,452
Documentary stamp tax	–
	21,557,938
	₱82,793,786

Tax Assessment and Cases

The Bank has an outstanding tax assessment and legal cases filed in courts as at December 31, 2018.