111052018000609

SECURITIES AND EXCHANGE COMMISSION

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Company Information

SEC Registration No.	0000006030
Company Name	SECURITY BANK CORP.
Industry Classification	
Company Type	Stock Corporation

Document Information

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COVER SHEET

6030

SEC Registration Number

SECURITY BANK CORPORATION

(Company's Full Name)

Security Bank Centre, 6776 Ayala Avenue, Makati City

(Business Address: No. Street City/Town/Province)

Joselito E. Mape

(Contact Person)

867-6788

(Company Telephone Number)

09 30

Month *Day*

(Fiscal Year)

17-Q

(Form Type)

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Month *Day*

(Annual Meeting)

(Secondary License Type, If Applicable)

CFD

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Amended Articles Number/Section

Total Amount of Borrowings

2,177

Total No. of Stockholders

Domestic

Foreign

To be accomplished by SEC Personnel concerned

File Number

LCU

Document ID

Cashier

S T A M P S

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SECURITIES AND EXCHANGE COMMISSION

SEC FORM 17-Q

QUARTERLY REPORT PURSUANT TO SECTION 17 OF THE SECURITIES REGULATION CODE AND SRC RULE 17(2)(b) THEREUNDER

1. For the quarterly period ended **September 30, 2018**

2. Commission identification number **6030** 3. BIR Tax Identification No. **000-498-020**

4. Exact name of issuer as specified in its charter - **SECURITY BANK CORPORATION**

....

5. Province, country or other jurisdiction of incorporation or organization - **Philippines**

6. Industry Classification Code: [ ] (SEC Use Only)

7. **Security Bank Centre, 6776 Ayala Avenue, Makati City** **0719**
   Address of issuer's principal office Postal Code

8. **(632) 867-67-88**
   Issuer's telephone number, including area code

9. **Not applicable**
   Former name, former address and former fiscal year, if changed since last report

10. Securities registered pursuant to Sections 8 and 12 of the Code, or Sections 4 and 8 of the RSA

Title of each Class	Number of shares of common stock outstanding and amount of debt outstanding
Common Shares (PhP 10 par)	**Total: 753,538,887 shares**
Preferred Shares (PhP 0.10 par) (Unregistered)	**Total: 1,000,000,000 shares**

....
....

11. Are any or all of the securities listed on a Stock Exchange?

    Yes [√] No [ ]

    Preferred Shares are not listed

    If yes, state the name of such Stock Exchange and the class/es of securities listed therein:

    Philippine Stock Exchange **Common Stock**

12. Check whether the registrant:

    (a) has filed all reports required to be filed by Section 17 of the Code and SRC Rule 17 thereunder or Sections 11 of the RSA and RSA Rule 11(a)-1 thereunder, and Sections 26 and 141 of the Corporation Code of the Philippines, during the preceding twelve (12) months (or for such shorter period the registrant was required to file such reports)

    Yes [√] No [ ]

    (b) has been subject to such filing requirements for the past ninety (90) days.

    Yes [√] No [ ]

PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements.

Attached are the following:

Unaudited Interim Statements of Financial Position	- Annex "1"
Unaudited Interim Statements of Income	- Annex "2"
Unaudited Interim Statements of Comprehensive Income	- Annex "3"
Unaudited Interim Statements of Changes in Equity	- Annex "4"
Unaudited Interim Statements of Cash Flows	- Annex "5"
Notes to Unaudited Interim Condensed Financial Statements	- Annex "6"
Aging of Loans and Receivables	- Annex "7"
Financial Soundness Indicators	- Annex "8"

Item 2. Management's Discussion and Analysis of Financial Position and Statement of Income - Annex "9"

PART 11 – OTHER INFORMATION

There are no material disclosures that have not been reported under SEC Form 17C during the period covered by this report.

SIGNATURES

Pursuant to the requirements of the Securities Regulation Code, the issuer has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

JOSELITO E. MAPE
Chief Financial Officer

Date: Nov. 5, 2018

Annex 1

SECURITY BANK CORPORATION AND SUBSIDIARIES
INTERIM CONDENSED STATEMENTS OF FINANCIAL POSITION

	September 30, 2018	December 31, 2017
	(Amounts in Thousands)	
ASSETS		
Cash and Other Cash Items	**₱8,334,461**	₱7,956,367
Due from Bangko Sentral ng Pilipinas	**62,042,701**	56,592,042
Due from Other Banks	**7,207,386**	6,822,992
Interbank Loans Receivable and Securities Purchased Under Resale Agreements with the Bangko Sentral ng Pilipinas	**2,269,620**	5,688,647
Financial Assets at Fair Value through Profit or Loss (Note 7)	**3,484,142**	4,592,495
Derivative Assets Designated as Hedges (Note 8)	**846,177**	–
Financial Assets at Fair Value through Other Comprehensive Income (Note 9)	**19,668,270**	200,271
Investment Securities at Amortized Cost (Note 10)	**214,542,426**	229,593,315
Loans and Receivables	**400,630,785**	370,189,758
Investment in a Joint Venture	**286,886**	266,855
Property and Equipment	**4,055,306**	4,104,073
Investment Properties	**793,599**	791,306
Deferred Tax Assets	**1,194,285**	1,763,432
Goodwill (Note 3)	**841,602**	841,602
Intangible Assets	**2,309,611**	2,019,039
Other Assets	**4,489,699**	2,604,444
TOTAL ASSETS	**₱732,996,956**	₱694,026,638
LIABILITIES AND EQUITY		
LIABILITIES		
Deposit Liabilities		
Demand	**₱122,953,174**	₱109,706,357
Savings	**188,321,117**	117,302,230
Time	**132,077,088**	167,568,814
Long-term Negotiable Certificates of Deposit (Note 12)	**24,273,415**	18,526,475
	467,624,794	413,103,876
Financial Liabilities at Fair Value through Profit or Loss	**2,116,056**	2,013,182
Bills Payable and Securities Sold Under Repurchase Agreements (Note 13)	**93,090,249**	131,179,238
Acceptances Payable	**555,637**	684,690
Margin Deposits and Cash Letters of Credit	**726,748**	650,277
Manager's and Certified Checks Outstanding	**3,733,713**	3,607,138
Income Tax Payable	**292,385**	681,080
Notes Payable (Note 14)	**32,266,669**	14,948,402
Subordinated Note (Note 15)	**9,955,592**	9,950,814
Accrued Interest, Taxes and Other Expenses	**4,937,228**	4,039,169
Other Liabilities	**8,376,563**	8,090,343
TOTAL LIABILITIES	**623,675,634**	588,948,209
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT COMPANY		
Capital stock (Note 16)	**7,635,389**	7,635,389
Additional paid-in capital (Note 16)	**38,524,323**	38,524,323
Surplus reserves (Note 16)	**2,498,859**	1,332,985
Surplus	**61,166,175**	57,520,438
Net unrealized gain (loss) on financial assets at fair value through other comprehensive income	**(577,578)**	90,968
Net unrealized gain on subsidiaries' financial assets at fair value through other comprehensive income	**9,568**	21,423
Cumulative foreign currency translation	**58,269**	(52,638)
	109,315,005	105,072,888
NON-CONTROLLING INTEREST	**6,317**	5,541
TOTAL EQUITY	**109,321,322**	105,078,429
TOTAL LIABILITIES AND EQUITY	**₱732,996,956**	₱694,026,638

See accompanying Notes to Interim Condensed Financial Statements.

SECURITY BANK CORPORATION AND SUBSIDIARIES
INTERIM CONDENSED STATEMENTS OF INCOME

	Quarter Ended September 30		Nine Months Ended September 30	
	2018	2017	**2018**	2017
	(Amounts in Thousands)			
INTEREST INCOME ON				
Loans and receivables	**₱6,155,162**	₱4,568,180	**₱16,818,928**	12,482,484
Financial investments	**2,479,219**	2,887,330	**7,276,278**	8,401,284
Interbank loans receivable and securities purchased under resale agreements with the Bangko Sentral ng Pilipinas	**37,756**	28,852	**107,442**	106,705
Deposits with banks and others	**19,410**	23,339	**76,360**	288,594
	8,691,547	7,507,701	**24,279,008**	21,279,067
INTEREST EXPENSE ON				
Deposit liabilities (Note 12)	**2,204,668**	1,350,521	**5,511,904**	3,758,290
Subordinated note, notes payable, bills payable and securities sold under repurchase agreements and other borrowings (Notes 13, 14 and 15)	**1,005,510**	997,076	**2,948,763**	2,708,823
Derivative instruments	**223,045**	121,620	**533,978**	470,230
Derivatives designated as hedges (Note 8)	**–**	819	**–**	4,156
	3,433,223	2,470,036	**8,994,645**	6,941,499
NET INTEREST INCOME	**5,258,324**	5,037,665	**15,284,363**	14,337,568
Service charges, fees and commissions	**707,682**	511,453	**1,981,649**	1,610,491
Profit from assets sold/exchanged	**150,080**	49,511	**171,019**	158,141
Rent	**104,945**	75,018	**304,987**	203,850
Trading and securities gain (loss) - net	**13,619**	(14,065)	**476,356**	24,612
Share in net income of a joint venture	**10,740**	7,740	**20,031**	18,349
Foreign exchange gain (loss) - net	**10,657**	(93,990)	**4,490**	70,137
Gain on disposal of investment securities at amortized cost (Note 10)	**–**	–	**–**	1,079,002
Miscellaneous	**240,206**	110,898	**534,392**	356,317
TOTAL OPERATING INCOME	**6,496,253**	5,684,230	**18,777,287**	17,858,467
OPERATING EXPENSES				
Compensation and fringe benefits	**1,165,167**	1,135,086	**3,464,433**	3,286,413
Taxes and licenses	**424,633**	373,462	**1,218,645**	1,082,935
Depreciation and amortization	**278,174**	231,723	**835,448**	663,537
Occupancy costs	**257,620**	238,073	**773,642**	656,403
Provision for credit losses	**137,385**	164,802	**227,346**	407,132
Amortization of software costs	**50,296**	32,422	**131,183**	90,329
Recovery of impairment losses	**–**	(1,183)	**(2,067)**	(20,060)
Miscellaneous	**1,299,405**	1,077,066	**3,762,052**	3,249,257
TOTAL OPERATING EXPENSES	**3,612,680**	3,251,451	**10,410,682**	9,415,946
INCOME BEFORE INCOME TAX	**2,883,573**	2,432,779	**8,366,605**	8,442,521
PROVISION FOR INCOME TAX	**637,033**	292,214	**1,827,412**	1,058,192
NET INCOME	**₱2,246,540**	₱2,140,565	**₱6,539,193**	₱7,384,329
ATTRIBUTABLE TO:				
Equity holders of the Parent Company	**₱2,246,304**	₱2,140,569	**₱6,538,494**	7,384,264
Non-controlling interest	**236**	(4)	**699**	65
NET INCOME	**₱2,246,540**	₱2,140,565	**₱6,539,193**	₱7,384,329
Weighted average number of outstanding common shares*	**753,538,887**	753,538,887	**753,538,887**	753,538,887
Basic/Diluted Earnings Per Share* (Note 19)	**₱2.98**	₱2.84	**₱8.67**	₱9.80

*In absolute amounts

See accompanying Notes to Interim Condensed Financial Statements.

SECURITY BANK CORPORATION AND SUBSIDIARIES
INTERIM CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

	Quarter Ended September 30		Nine Months Ended September 30	
	2018	2017	**2018**	2017
	(Amounts in Thousands)			
NET INCOME FOR THE PERIOD	**₱2,246,540**	₱2,140,565	**₱6,539,193**	₱7,384,329
OTHER COMPREHENSIVE INCOME (LOSS)				
Other Comprehensive Income (Loss) to be Reclassified to Profit or Loss in Subsequent Periods:				
Cumulative translation adjustments	**16,518**	18,499	**110,907**	(198,957)
Change in net unrealized gain (loss) on debt instruments at fair value through other comprehensive income	**87,100**	–	**(1,539,241)**	–
	103,618	18,499	**(1,428,334)**	(198,957)
Other Comprehensive Income Not to be Reclassified to Profit or Loss in Subsequent Periods:				
Revaluation gains on equity instruments at fair value through other comprehensive income	**2,058**	5,060	**46,208**	17,425
OTHER COMPREHENSIVE INCOME (LOSS) FOR THE PERIOD	**105,676**	23,559	**(1,382,126)**	(181,532)
TOTAL COMPREHENSIVE INCOME	**₱2,352,216**	₱2,164,124	**₱5,157,067**	₱7,202,797
ATTRIBUTABLE TO:				
Equity holders of the Parent Company	**₱2,351,980**	₱2,164,128	**₱5,156,368**	₱7,202,732
Non-controlling interest	**236**	(4)	**699**	65
	₱2,352,216	₱2,164,124	**₱5,157,067**	₱7,202,797

See accompanying Notes to Interim Condensed Financial Statements.

SECURITY BANK CORPORATION AND SUBSIDIARIES

INTERIM CONDENSED STATEMENTS OF CHANGES IN EQUITY

For the Periods Ended September 30, 2018 and 2017

	Equity Attributable to Equity Holders of the Parent Company									
	Capital Stock (Note 16)	**Additional Paid-In Capital** (Note 16)	**Surplus Reserves** (Note 16)	**Surplus**	**Net Unrealized Gain on Financial Assets at Fair Value through Other Comprehensive Income**	**Net Unrealized Gain on a Subsidiary's Financial Assets at Fair Value through Other Comprehensive Income**	**Cumulative Foreign Currency Translation**	**Total**	**Non-controlling Interest**	**Total Equity**
				(Amounts in Thousands)						
Balance at January 1, 2018, as previously reported	**₱7,635,389**	**₱38,524,323**	**₱1,332,985**	**₱57,520,438**	**₱90,968**	**₱21,423**	**(₱52,638)**	**₱105,072,888**	**₱5,541**	**₱105,078,429**
Effect of adopting the final version of Philippine Financial Reporting Standard (PFRS) 9 (Note 2)	**–**	**–**	**–**	**(601,818)**	**–**	**–**	**–**	**(601,818)**	**77**	**(601,741)**
Effect of adopting PFRS 15 (Note 2)	**–**	**–**	**–**	**9,503**	**–**	**–**	**–**	**9,503**	**–**	**9,503**
Balance at January 1, 2018, as restated	**7,635,389**	**38,524,323**	**1,332,985**	**56,928,123**	**90,968**	**21,423**	**(52,638)**	**104,480,573**	**5,618**	**104,486,191**
Total comprehensive income for the period	**–**	**–**	**–**	**6,538,494**	**(1,481,178)**	**(11,855)**	**110,907**	**5,156,368**	**699**	**5,157,067**
Effect of change in business model (Note 2)	**–**	**–**	**–**	**–**	**812,632**	**–**	**–**	**812,632**	**–**	**812,632**
Transfers from surplus reserves	**–**	**–**	**1,165,874**	**(1,165,874)**	**–**	**–**	**–**	**–**	**–**	**–**
Declaration of cash dividends	**–**	**–**	**–**	**(1,134,568)**	**–**	**–**	**–**	**(1,134,568)**	**–**	**(1,134,568)**
Balance at September 30, 2018	**₱7,635,389**	**₱38,524,323**	**₱2,498,859**	**₱61,166,175**	**(₱577,578)**	**₱9,568**	**₱58,269**	**₱109,315,005**	**₱6,317**	**₱109,321,322**
Balance at January 1, 2017	₱7,635,389	₱38,524,323	₱717,874	₱49,909,010	₱72,018	₱18,428	₱244,631	₱97,121,673	₱5,245	₱97,126,918
Total comprehensive income for the period	–		–	7,384,264	11,920	5,505	(198,957)	7,202,732	65	7,202,797
Transfers from surplus reserves	–	–	602,864	(602,864)	–	–	–	–	–	–
Declaration of cash dividends	–	–	–	(1,134,568)	–	–	–	(1,134,568)	–	(1,134,568)
Balance at September 30, 2017	₱7,635,389	₱38,524,323	₱1,320,738	₱55,555,842	₱83,938	₱23,933	₱45,674	₱103,189,837	₱5,310	₱103,195,147

See accompanying Notes to Interim Condensed Financial Statements.

SECURITY BANK CORPORATION AND SUBSIDIARIES

INTERIM CONDENSED STATEMENTS OF CASH FLOWS

	For the Periods Ended September 30	
	2018	2017
	(Amounts in Thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before income tax	**₱8,366,605**	₱8,442,521
Adjustments for:		
Depreciation and amortization	**835,448**	663,537
Amortization of software costs	**131,183**	90,329
Provision for credit losses	**227,346**	407,132
Amortization of transaction costs on long-term negotiable certificates of deposit (Note 12)	**19,446**	8,214
Amortization of transaction costs on notes payable (Note 14)	**11,653**	12,826
Amortization of transaction costs on subordinated note (Note 15)	**4,778**	4,523
Gain on disposal of investment securities at amortized cost (Note 10)	**–**	(1,079,002)
Share in net income of a joint venture	**(20,031)**	(18,349)
Recovery of impairment losses	**(2,067)**	(20,060)
Profit from assets sold/exchanged	**(171,019)**	(158,141)
Gain on disposal of financial assets at fair value through other comprehensive income (FVTOCI)	**(509,509)**	–
Unrealized market valuation gain on financial instruments at fair value through profit or loss (FVTPL)	**(635,142)**	(1,023,272)
Net unrealized market revaluation gain on derivatives designated as hedges	**(846,177)**	(3,826)
Changes in operating assets and liabilities:		
Decrease (increase) in the amounts of:		
Due from other banks (Note 20)	**(2,307)**	–
Interbank loans receivable (Note 20))	**(4,097)**	–
Loans and receivables	**(31,202,493)**	(81,031,279)
Financial assets at FVTPL	**1,846,369**	629,675
Other assets	**(1,874,530)**	78,088
Increase (decrease) in the amounts of:		
Deposit liabilities	**48,773,978**	84,271,285
Manager's and certified checks outstanding	**126,575**	374,184
Accrued interest, taxes and other expenses	**898,059**	1,027,238
Margin deposits and cash letters of credit	**76,471**	275,134
Acceptances payable	**(129,053)**	(347,647)
Other liabilities	**294,290**	(1,190,903)
Net cash generated from operations	**26,215,776**	11,412,207
Income taxes paid	**(1,769,811)**	(1,070,158)
Net cash provided by operating activities	**24,445,965**	10,342,049
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisitions of:		
Financial assets at FVTOCI	**(41,815,160)**	–
Investment securities at amortized cost	**(1,891,263)**	(62,217,932)
Property and equipment	**(884,260)**	(933,751)
Intangible assets	**(421,755)**	(157,097)
Proceeds from:		
Disposals/maturities of financial assets at FVTOCI	**51,828,969**	–
Disposal of property and equipment	**22,063**	21,223
Disposal of investment properties	**353,754**	240,515
Disposal/maturities of investment securities at amortized cost (Note 10)	**900,000**	27,846,302
Net cash provided by (used in) investing activities	**8,092,348**	(35,200,740)

(Forward)

	For the Periods Ended September 30	
	2018	2017
	(Amounts in Thousands)	
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from bills payable and securities sold under repurchase agreements	**₱1,919,235,407**	₱1,468,458,327
Settlements of bills payable and securities sold under repurchase agreements	**(1,966,813,253)**	(1,466,116,914)
Proceeds from issuance of notes payable	**16,144,347**	–
Proceeds from issuance of LTNCD	**5,727,494**	–
Cash dividends paid	**(1,135,600)**	(1,140,785)
Net cash provided by (used in) financing activities	**(26,841,605)**	1,200,628
Effect of change in foreign exchange rates	**(2,902,588)**	(740,457)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**2,794,120**	(24,398,520)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		
Cash and other cash items	**7,956,367**	7,692,810
Due from Bangko Sentral ng Pilipinas	**56,592,042**	71,662,840
Due from other banks	**6,822,992**	11,058,652
Interbank loans receivable and securities purchased under resale agreements with the Bangko Sentral ng Pilipinas	**5,688,647**	690,309
	77,060,048	91,104,611
CASH AND CASH EQUIVALENTS AT END OF PERIOD		
Cash and other cash items	**8,334,461**	6,300,704
Due from BSP	**62,042,701**	50,669,825
Due from other banks	**7,207,386**	8,610,309
Interbank loans receivable and securities purchased under resale agreements with the Bangko Sentral ng Pilipinas	**2,269,620**	1,125,253
	₱79,854,168	₱66,706,091
OPERATIONAL CASH FLOWS FROM INTEREST AND DIVIDENDS		
Interest received	**₱24,743,565**	₱21,640,658
Interest paid	**8,539,824**	6,726,270
Dividends received	**5,085**	3,786

See accompanying Notes to Interim Condensed Financial Statements.

SECURITY BANK CORPORATION AND SUBSIDIARIES
NOTES TO INTERIM CONDENSED FINANCIAL STATEMENTS

1. Corporate Information

Security Bank Corporation (the Parent Company) is a domestic corporation registered with the Securities and Exchange Commission (SEC) in 1951 and was listed in the Philippine Stock Exchange (PSE) in 1995. The Parent Company's head office is located at Security Bank Centre, 6776 Ayala Avenue, Makati City.

The Parent Company was incorporated on May 8, 1951 and started its operations as a commercial bank on June 18, 1951. On May 30, 2000, the Board of Directors (BOD) of the Parent Company approved its Amended Articles of Incorporation to extend the corporate term of the Parent Company, which expired on May 8, 2001, for another 50 years. On February 19, 2001, the SEC approved such amendment.

In 1994, it was approved by the Bangko Sentral ng Pilipinas (BSP) to operate as a universal bank, allowing it to expand its financial services and revenue sources.

The Parent Company provides expanded commercial banking services such as deposit products, loans and trade finance, domestic and foreign fund transfers, treasury, foreign exchange and trust services. In addition, the Parent Company is licensed to engage in financial derivatives to service the requirements of its customers and as a means of reducing and managing the Parent Company's foreign exchange and interest rate exposures.

The Parent Company's subsidiaries (collectively referred to as the "Group"), which are all incorporated in the Philippines, are engaged in the following businesses:

			Effective Percentage of Ownership	
Subsidiaries and Joint Venture	Principal place of business	Line of Business	**September 30, 2018**	December 31, 2017
SB Capital Investment Corporation (SBCIC)	18th floor, Security Bank Centre, 6776 Ayala Avenue, Makati City	Investment house	**100.00**	100.00
SB Equities, Inc. (SBEI)	18th floor, Security Bank Centre, 6776 Ayala Avenue, Makati City	Stock brokerage	**100.00**	100.00
SB International Services, Inc. (SISI) (pre-operating stage)	17th floor, Security Bank Centre, 6776 Ayala Avenue, Makati City	Marketing services	**100.00**	100.00
SB Rental Corporation (SBRC)	11th floor, Pacific Star Building, Sen. Gil Puyat Ave. corner Makati Ave. Makati City	Rental / leasing	**100.00**	100.00
SB Cards Corporation (SBCC)	Security Bank Centre, 6776 Ayala Avenue, Makati City	Credit card operations	**100.00**	100.00
Landlink Property Investments (SPV-AMC), Inc. (LPII) (pre-operating stage)	Security Bank Centre, 6776 Ayala Avenue, Makati City	Asset management	**100.00**	100.00
SB Forex, Incorporated (SBFI) (suspended operation)	Security Bank Centre, 6776 Ayala Avenue, Makati City	Foreign exchange services	**100.00**	100.00
SB Finance Company, Inc. (SBFCI) (formerly Security Bank Savings Corporation (SBS))	6797 Ayala Avenue corner Rufino St., Makati City	Financing	**99.54**	99.54
SBM Leasing, Inc. (SBML)	11th floor, Pacific Star Building, Sen. Gil Puyat Ave. corner Makati Ave. Makati City	Financing	**60.0**	60.0

The Parent Company is the Ultimate Parent Company of the Group.

In 2017, the SEC approved the conversion of SBS from a savings bank to a finance company under the name of SBFCI (see Note 11).

In 2016, the Bank of Tokyo-Mitsubishi UFJ, Ltd (BTMU) acquired a 20.0% voting interest in the Parent Company (see Note 16).

In 2016, SBCC sold a substantial portion of its existing Diners Club International credit card portfolio and its cardholder base (see Note 11).

2. Summary of Significant Accounting Policies

Basis of Preparation

The accompanying interim condensed financial statements include the financial statements of the Parent Company and its subsidiaries.

The accompanying interim condensed financial statements have been prepared on a historical cost basis except for financial assets and financial liabilities at fair value through profit or loss (FVTPL), financial assets at fair value through other comprehensive income (FVTOCI) and derivative liabilities designated as hedges that have been measured at fair value. The carrying values of recognized loans and receivables that are hedged items in fair value hedges, and otherwise carried at amortized cost, are adjusted to record changes in fair value attributable to the risks that are being hedged. The financial statements are presented in Philippine peso and all values are rounded to the nearest thousand peso (₱000) except when otherwise indicated.

The financial statements of the Parent Company 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 peso, which is the Parent Company's presentation currency. The financial statements individually prepared for these units are combined after eliminating inter-unit accounts. The interim condensed consolidated financial statements provide comparative information in respect of the previous period where certain balances of due from other banks and bills payable amounting to ₱62.8 billion were eliminated to correct the balances and to conform with the current year's presentation. The change in presentation is related to the cumulative effect of the transfers of funds and certain transactions between the Parent Company's FCDU and RBU books and did not have any impact on the Group's basic and diluted earnings per share.

The interim condensed financial statements provide comparative information in respect of the previous period.

Each entity in the Group determines its own functional currency and the items included in the financial statements of each entity are measured using that functional currency. The functional currency of each of the Parent Company's subsidiaries is the Philippine peso.

Explanatory Comments about the Seasonality or Cyclicality of Interim Operations

Seasonality or cyclicality of interim operations is not applicable to the Group's type of business.

Statement of Compliance

The accompanying interim condensed financial statements as of and for the nine months ended September 30, 2018 have been prepared in compliance with Philippine Accounting Standard (PAS) 34, *Interim Financial Reporting*. Accordingly, the interim condensed financial statements do not include all of the information and disclosures required in the annual financial statements, and should be read in conjunction with the Group's annual financial statements as of and for the year ended December 31, 2017.

Basis of Consolidation
The consolidated financial statements of the Group are prepared for the same reporting period as the subsidiaries, using consistent accounting policies.

Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if and only if the Group has:

- Power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee);
- Exposure, or rights, to variable returns from its involvement with the investee; and
- The ability to use its power over the investee to affect its returns.

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement with the other vote holders of the investee;
- Rights arising from other contractual arrangements; and
- The Group's voting rights and potential voting rights.

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the statement of comprehensive income from the date the Group gains control until the date the Group ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income (OCI) are attributed to the equity holders of the Parent Company and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies used in line with those used by the Group. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it:

- derecognizes the assets (including goodwill) and liabilities of the subsidiary;
- derecognizes the carrying amount of any non-controlling interests;
- derecognizes the cumulative translation differences recorded in equity;
- recognizes the fair value of the consideration received;
- recognizes the fair value of any investment retained;
- recognizes any surplus or deficit in profit or loss; and
- reclassifies the Parent Company's share of components previously recognized in OCI to profit or loss or surplus, as appropriate, as would be required if the Group had directly disposed of the related assets or liabilities.

Non-controlling Interest
Non-controlling interest represents the portion of profit or loss and net assets not owned, directly or indirectly, by the Parent Company.

Non-controlling interests are presented separately in the consolidated statement of income, consolidated statement of comprehensive income, and within equity in the consolidated statement of financial

position, separately from equity attributable to the Parent Company. Any losses applicable to the non-controlling interests are allocated against the interests of the non-controlling interest even if this results in the non-controlling interest having a deficit balance. Acquisitions of non-controlling interests that do not result in a loss of control are accounted for as equity transactions, whereby the difference between the consideration and the fair value of the share of the net assets acquired is recognized as an equity transaction and attributed to the owners of the Parent Company.

Changes in Accounting Policies

Except for the following standards and amended PFRS which were adopted as of January 1, 2018, the accounting policies and methods of computation adopted in the preparation of the financial statements are consistent with those followed in the previous financial year. These new and revised accounting standards have no impact to the Group, except for PFRS 9 and PFRS 15.

New Standards and Interpretations

- PFRS 9, *Financial Instruments*
- PFRS 15, *Revenue from Contracts with Customers*
- Philippine Interpretation IFRIC 22, *Foreign Currency Transaction and Advance Consideration*

Amendments to Standards

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

Final version of PFRS 9 Adoption

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

a. Classification and Measurement

   The Group early adopted the 2009 version of PFRS 9 in December 2010. The version adopted by the Group specified how an entity should classify and measure its financial assets. It requires 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 FVTOCI 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 of the change in the Parent Company's business models in the fourth quarter of 2017, on January 1, 2018, the Parent Company reclassified certain debt securities previously carried at amortized cost to FVTOCI (see Note 10). This resulted in increase in net unrealized gain reported in other comprehensive income amounting to ₱812.6 million.

b. Impairment

   The Group records expected credit losses (ECL) for all loans and other debt financial assets not classified as FVTPL, together with loan commitments and financial guarantee contracts.

   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.

Staging assessment
A three-stage approach for impairment of financial assets is used, based on whether there has been a significant deterioration in the credit risk of a financial asset. These three stages then determine the amount of impairment to be recognized.

For non-credit-impaired financial instruments:

- Stage 1 is comprised of all financial instruments which have not experienced a SICR since initial recognition or is considered of low credit risk as of the reporting date. The Group recognizes a 12-month ECL for Stage 1 financial instruments.
- Stage 2 is comprised of all financial instruments which have experienced a SICR since initial recognition. The Group 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 Group recognizes a lifetime ECL for Stage 3 financial instruments.

Definition of "default" and "restored"
The Group generally classifies a financial instrument as in default when it is credit impaired, or becomes past due on its contractual payments for more than 90 days. As part of a qualitative assessment of whether a customer is in default, the Group considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Group 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 at least six months.

Credit risk at initial recognition
The Group 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 Group'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 more than a specified days past due threshold, 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 Group 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 Group 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.

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.

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 Group 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 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	Re-measurement	ECLs under PFRS 9
Loans and receivables	₱3,851,108	₱443,876	₱4,294,984
Investment securities at amortized cost	–	21,975	21,975
Financial assets at fair value through other comprehensive income	–	11,012	11,012
Interbank loans receivable	–	9,975	9,975
Due from other banks	–	2,993	2,993
Other assets	–	247	247
	₱3,851,108	₱490,078	₱4,341,186

At January 1, 2018, the Group determined the amount of provision for credit losses under the ECL model. This resulted in net decrease in surplus amounting to ₱601.8 million.

c. Hedge Accounting
The Group aligns 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.

The Parent Company makes use of derivative instruments to manage exposures to interest rate risks, and applies hedge accounting for transactions which meet specified criteria.

At inception of the hedge relationship, the Parent Company formally designates and documents the relationship between the hedged item and the hedging instrument, including the nature of the risk being hedged, the objective and strategy for undertaking the hedge, and the method that will be used to assess the effectiveness of the hedging relationship. Also, a formal assessment is undertaken to ensure that the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. Hedges are formally assessed each quarter. Only prospective assessment shall be made on a cumulative basis and when circumstances affecting hedge effectiveness requirements change significantly.

Fair value hedges
For designated and qualifying fair value hedges, the change in the fair value of a hedging derivative is recognized under 'Trading and securities gain (loss) - net' in the statement of income. Meanwhile, the change in the fair value of the hedged item attributable to the hedged risk is recorded as part of the carrying value of the hedged item and is also recognized in 'Trading and securities gain (loss) - net' in the statement of income.

Interest income is recognized in the statement of income when the "receive leg" is higher than the "pay leg" of interest-earning derivatives designated as effective hedging instruments. Interest expense is recognized in the statement of income when the "pay leg" is higher than the "receive leg" of interest-bearing derivatives designated as effective hedging instruments.

If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is terminated. For hedged items recorded at amortized cost, the difference between the carrying value of the hedged item on termination and the face value is amortized over the remaining term of the hedged item using the effective interest method. If the hedged item is derecognized, the unamortized fair value adjustment is recognized immediately in the statement of income.

The adoption of the new hedge accounting policies under PFRS 9 does not have an impact on the Group as there were no hedge relationships designated under hedge accounting as of December 31, 2017. As of September 30, 2018, the Parent Company has outstanding interest rate swaps designated as effective hedging instruments in a fair value hedge.

Derivative financial instruments held or issued for hedging purposes
As part of its asset and liability management, the Parent Company used derivatives for hedging purposes in order to reduce its exposure to market risks that is achieved by hedging portfolios of fixed rate financial instruments.

The accounting treatment varies according to the nature of the item hedged and compliance with the hedge criteria. Hedges entered into by the Parent Company which provide economic hedges but do not meet the hedge accounting criteria are treated as Derivatives Held or Issued for Trading Purposes.

The Group applied PFRS 9 retrospectively but not on comparative basis which is in compliance with the standards.

The Group has applied its existing governance framework to ensure that appropriate controls and validations are in place over key processes and judgments in implementing PFRS 9. The Group is continuously testing and refining the new accounting processes, internal controls and governance framework necessitated by the adoption of PFRS 9. Therefore, the estimation of expected credit losses and related impacts remain subject to change until finalization of the financial statements for the year ending December 31, 2018.

PFRS 15, *Revenue from Contracts with Customers*
PFRS 15 establishes a new five-step model that will apply to revenue arising from contracts with customers. Under PFRS 15, revenue is 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. The principles in PFRS 15 provide a more structured approach to measuring and recognizing revenue. The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under PFRSs.

PFRS 15 also requires an entity to recognize as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs. The asset is amortized on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates.

The Group recognize the incremental cost of obtaining contracts with customers and the costs incurred in fulfilling the contracts with customers that are directly associated with the contract as an asset if those costs are expected to be recoverable. Incremental costs of obtaining contracts are those costs that the Group incur to obtain a contract with a customer that would not have been incurred if the contract had not been obtained. As of January 1, 2018, the Group recognize these costs in the statement of financial position under 'Other assets' amounting to ₱9.5 million, net of deferred tax.

The Group applied PFRS 15 retrospectively but not on comparative basis which is in compliance with the standards.

The Group has applied its existing governance framework to ensure that appropriate controls and validations are in place over key processes and judgments in implementing PFRS 15.

3. Goodwill

Impairment testing of goodwill
In 2012, goodwill acquired through business combination has been allocated to SBS as the cash generating unit (CGU). In 2015, the entire goodwill was reallocated to the 23 branches of SBS which were transferred to the Parent Company as a single CGU. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. As of September 30, 2018 and December 31, 2017, the carrying amount of goodwill amounted to ₱841.6 million and there was no impairment loss recognized for the period ended September 30, 2018 and in 2017. The last impairment test was carried out as of December 31, 2017.

The recoverable amount of the CGU has been determined based on a VIU calculation using cash flow projections from financial budgets approved by senior management covering a four-year period. Key assumptions in VIU calculation of CGUs are most sensitive to discount rates and growth rates used to project cash flows. Future cash flows and growth rates were based on experiences and strategies developed and prospects. The discount rate used for the computation of the net present value is the cost of equity and was determined by reference to comparable entities. In 2017, the post-tax discount rate applied to cash flow projections is 9.15% and the growth rate used to extrapolate cash flows beyond the four-year period is 3.00%.

Management believes that no reasonably possible change in any of the above key assumptions would cause the carrying value of the goodwill to materially exceed its recoverable amount.

4. Significant Accounting Judgments and Estimates

Judgements

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

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.

Following is the additional critical judgment applied in 2018 that has a risk of material adjustment to the carrying amounts of assets and liabilities:

Business model test

The Group manages its financial assets based on a business model that maintains 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 Group's business model can be to hold financial assets to collect HTC 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 Group considers the circumstances surrounding the disposal as well as the requirements of BSP Circular No. 708, *Guidelines on the adoption of PFRS 9*.

As discussed in Note 10, the Parent Company participated in the cash tender offer executed by the Republic of the Philippines and sold certain investment securities under the HTC business model in January 2017. In April 2017, the Parent Company participated in the cash tender offer by another private entity and sold certain investment securities under the HTC business model. The Parent Company assessed that these disposals are consistent with the allowed disposals under its HTC business model.

Cash flow characteristics test

In determining the classification of financial assets under PFRS 9, the Group 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 (unless it is a variable interest rate that represents time value of money and credit risk) does not meet the amortized cost criteria.

Estimates

Measurement of the ECL allowance

The Group'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 used a combination of statistical techniques, expert judgment and estimates are the following:

1. The Group's credit risk rating models (corporate, financial institutions, etc.) which assign PDs to the rating scale;
2. The Group's criteria (account quality and payment behavior) for assessing if there has been a significant increase in credit risk;
3. The segmentation of financial assets when their ECL is assessed on a collective basis;
4. Development of ECL models, including the various formulas and the choice of inputs & assumptions;
5. Determination of associations between macroeconomic scenarios and economic inputs, such as interest rates and collateral values, and the effect on PDs, EADs and LGDs;
6. Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

5. Financial Risk Management

Compared with the December 31, 2017 financial statements, there have been no changes in the financial risk exposures that materially affect the financial statements of the Group as of September 30, 2018. The Group has exposures to the following risks from its use of financial instruments: (a) credit; (b) liquidity; and (c) market risks. Related discussions follow below, which should be read in conjunction with Note 5, *Financial Risk Management Objectives and Policies,* of the Group's 2017 financial statements.

Introduction

Integral to the Parent Company's value creation process is risk management. It therefore operates an integrated risk management system to address the risks it faces in its banking activities, including credit, market, liquidity and operational risks. Exposures across these risk areas are regularly identified, measured, controlled, monitored and reported to both Senior Management and the BOD.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. These risks are monitored through the Parent Company's strategic planning process.

Risk Management Structure

Board of Directors

The BOD directs the Parent Company's over-all risk management strategy. The risk management processes of the subsidiaries are the separate responsibilities of their respective BOD. The BOD performs an oversight function on the Parent Company's implementation of its risk policies through various committees that it has created, as follows:

Risk Oversight Committee

The Risk Oversight Committee (ROC) reviews, approves, and ensures effective implementation of the risk management framework. It approves risk-related policies, oversees limits to discretionary authority that the BOD delegates to management, and evaluates the magnitude, distribution and direction of risks in the Parent Company.

Corporate Governance Committee
The Corporate Governance Committee oversees the compliance function and assists the BOD in fulfilling its corporate governance responsibilities. It is responsible for ensuring the Board's effectiveness and due observance of corporate governance principles and guidelines.

Audit Committee
The Audit Committee through the Internal Audit Department provides the independent assessment of the overall effectiveness of, and compliance with the Parent Company's risk management policies and processes.

Executive Committee
The Executive Committee approves credit risk limit for large exposures except for directors, officers, stockholders and related interests (DOSRI) loans, which are approved by the BOD regardless of amount.

Restructuring Committee
The Loan Restructuring Committee focuses on substandard or non-performing loans (NPLs) and approves the remedial strategy and action plan for these exposures.

Related Party Transaction Committee
The Related Party Transaction Committee ensures that transactions with related parties are handled in a sound and prudent manner, with integrity, and in compliance with applicable laws and regulations to protect the interest of depositors, creditors and other stakeholders.

Nominations and Renumerations Committee
The Nominations and Renumerations Committee oversight over Board nominees and other appointments requiring Board approval, as well as their remuneration commensurate with corporate and individual performance.

Finance Committee
The Finance Committee oversight of the financial management of the group, including capital and liquidity management, reviewing financial performance ensuring that it is compliance with regulatory requirements.

Trust Committee
The Trust Committee ensures that funds and properties held in trust or in any fiduciary capacity shall be administered with the skill, care, prudence and diligence necessary under the circumstances then prevailing that a prudent man, acting in like capacity and familiar matters, would exercise in the conduct of an enterprise of like character and with similar aims.

Technology Steering Committee
The Technology Steering Committee oversees the development, implementation and performance of information technology systems in the Group.

The Parent Company's organizational structure includes the Risk Management Group (RMG), which is responsible for driving the following risk management processes of the Group:

- Independent assessment, measurement, monitoring and reporting of the Group's risk-taking activities; and
- Formulation, review and recommendation of risk related policies.

Nevertheless, the Group's risk management framework adopts the basic tenet that risks are owned by the respective business and process owners. Everyone in the organization is therefore expected to proactively manage the risks inherent to their respective area by complying with the Group's risk management framework, policies and standards.

The Parent Company and its subsidiaries manage their respective financial risks separately. The subsidiaries have their own risk management procedures but are structured similar to that of the Parent Company. To a certain extent, the respective risk management programs and objectives are the same across the Group.

Risk Measurement and Reporting
The Parent Company's risks are measured using various methods compliant with Basel III standards. The Parent Company also runs worst case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks are primarily performed based on limits established by the Parent Company. These limits reflect the business strategy and market environment of the Parent Company as well as the level of risk that the Parent Company is willing to accept. In addition, the Parent Company monitors and measures the overall risk-bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

For all levels throughout the Parent Company, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information. These reports include aggregate credit exposure, credit metric forecasts, limit exceptions, Value-at-Risk (VaR), liquidity ratios and risk profile changes.

Credit Risk Management prepares detailed reporting of risks per industry, customer risk rating and classification. Senior management assesses the appropriateness of allowance for credit losses on a yearly basis or as the need arises. The ROC and the heads of the concerned business units receive a comprehensive credit risk report monthly which is designed to provide all the necessary information to assess and conclude on the credit risks of the Parent Company.

In the case of market risk, a monthly report is presented to the ROC on the utilization of market limits and liquidity, plus any other risk developments.

Information compiled from all the businesses is examined and processed in order to analyze, control and identify early risks. This information is presented and explained to the BOD, the ROC, and the head of each business unit.

Risk Mitigation
As part of its market risk management, the Parent Company uses derivatives and other instruments to manage exposures resulting from changes in interest rates and foreign currencies. For interest rate risk from HTC securities (fair value hedge), the Bank entered into Interest Rate Swaps. The risk management objective is to protect the fair value of the HTC securities against adverse movements in interest rates, specifically due to an aggressive rate hike cycle in the identified hedge period. This objective also allows the Parent Company to safeguard its net interest margin and keep its pool of high-quality liquid assets.

In accordance with the Parent Company's policy, the risk profile of the Parent Company is assessed before entering into hedge transactions, which are authorized by the appropriate committees. The effectiveness of hedges is assessed by the RMG. The effectiveness of all the hedge relationships is monitored by the RMG monthly. In situations of ineffectiveness, the Parent Company will enter into a new hedge relationship to mitigate risk on a continuous basis.

The Parent Company actively uses collateral to reduce its credit risks.

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

conditions. Concentrations indicate the relative sensitivity of the Parent Company's performance to developments affecting a particular industry or geographic location.

The Parent Company manages concentration risks by setting exposure limits to borrowing groups, industries, and where appropriate, on products and facilities. These limits are reviewed as the need arises but at least annually.

In order to avoid excessive concentrations of risk, the Parent Company's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of risks are controlled and managed accordingly.

Credit Risk
Credit risk is the risk of loss resulting from the failure of a borrower or counterparty to perform its obligations during the life of the transaction. This includes risk of non-payment by borrowers or issuers, failed settlement of transactions and default on contracts.

The Parent Company drives credit risk management fundamentally via its Credit Policy Manual (CPM), the provisions of which are regularly reviewed and updated to reflect changing risk conditions. The CPM defines the principles and parameters governing credit activities, ensuring that each account's creditworthiness is thoroughly understood and regularly reviewed. Relationship Managers assume overall responsibility for the management of credit exposures while middle and back office functions are clearly defined to provide independent checks and balance to credit risk-taking activities. A system of approving and signing limits ensures adequate senior management involvement for bigger and more complex transactions. Large exposures of the Group are kept under rigorous review as these are subjected to stress testing and scenario analysis to assess the impact of changes in market conditions or key risk factors (examples are economic cycles, interest rate, liquidity conditions or other market movements) on its profile and earnings.

The risk management structure of policies, accountabilities and responsibilities, controls and senior management involvement is similarly in place for nonperforming assets.

Liquidity Risk
Liquidity risk is defined as the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

Liquidity risk arises because of the possibility that the Group might be unable to meet its payment obligations when they fall due under both normal and stress circumstances. Liquidity risk is monitored and managed using Maximum Cumulative Outflows (MCO) limits. A Contingency Funding Plan is likewise in place to ensure readiness for identified liquidity crisis situation.

The Parent Company's Asset and Liability Committee (ALCO) is directly responsible for market and liquidity risk exposures. ALCO regularly monitors the Parent Company's positions and sets the appropriate transfer pricing rate to effectively manage movements of funds across business activities.

Market Risk
Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates and equity prices. The Group classifies exposures to market risk into either trading or non-trading portfolios and manages those portfolios separately.

The Group manages its market risk exposures through various established structures, processes and measurement tools.

- Treasury Group, the unit in charge of managing customer flows, liquidity and interest rate risk in the banking book, and that which handles most of the proprietary trading of the Group, is assigned with risk limits by the ROC. Similarly, limits are assigned to the equities trading arm of the Group,

Equities Investment Unit.

- The Risk Management Group performs daily monitoring of compliance with policies, procedures and risk limits and accordingly makes recommendations, where appropriate.
- The ALCO is the senior decision making body for the management of all market risks related to asset and liability management, and the trading and accrual books.
- VaR is the statistical model used by the Group to measure the market risk of its trading portfolio, with the confidence level set at 99.0%. On top of VaR and to account for market liquidity, the Group applies various liquidity factors per product type as approved by the ROC.

The market risk measurement models are subjected to periodic back testing to ensure validity of market assumptions used.

Other risk management tools utilized by the Parent Company are as follows:

- Loss limits
- Position and duration limits, where appropriate
- Mark-to-market valuation
- VaR limits
- Earnings-at-Risk (EaR) limits

Additional risk monitoring tools were likewise adopted to better cope with the fluid market environment. This came mainly in the form of sensitivity analyses to pinpoint vulnerabilities in terms of profit or loss and capital erosion.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair value of financial instruments. The Parent Company follows a prudent policy on managing its assets and liabilities so as to ensure that exposure to fluctuations in interest rates are kept within acceptable limits.

Interest rate risk exposures are reported via a repricing gap schedule. The repricing gap report highlights mismatches in the repricing tenors of assets and liabilities. Repricing gaps are calculated by distributing the statement of financial position accounts into time buckets based on the next repricing dates of individual items. The difference between the amount of the assets and the amount of the liabilities that will reprice within a particular time bucket constitutes a repricing gap.

<u>Market Risk in the Trading Book</u>

The Parent Company needs to measure VaR in order to have an idea on how the market value of an asset or of a portfolio of assets is likely to decrease over a certain time period as market factors randomly change.

VaR computation is actually a two-step process which involves calculation of the change in the Risk Factor then computing for the corresponding impact on profit or loss. The Risk Factor is defined as a variable that causes a change in the value of a financial instruments or a portfolio of financial instruments.

VaR Methodology

The Parent Company uses two different approaches - Variance-Covariance and Historical Model.

Variance-Covariance approach is based on the assumption that the market factors have a multivariate Normal distribution. Using this assumption, portfolio profits and losses follow a conditional normal distribution, i.e., the standardized return which is the return divided by the forecasted deviation follow the characteristic of the normal curve whilst the returns themselves do not necessarily follow a normal distribution. Due to this assumption, it is possible to have an explicit formula for the quantile, since a relationship exists between standard deviation and confidence level, which will be used for the VaR

computation.

Historical model assumes that asset returns in the future will have the same distribution that they had in the past. It estimates VaR by reliving history, which involves using historical changes in market factors to construct a distribution of potential profits and losses, and then reading off the loss that is exceeded at a specified confidence level and period. The Parent Company employs Historical model in two forms: one is a full revaluation while the other is a Taylor expansion composed of sensitivities ("Greeks") characterizing market behavior.

The Group uses the Historical model in calculating the VaR of most fixed income securities (except government securities), foreign exchange outrights, forwards and swaps, and other derivative instruments. For equities, the Variance-Covariance approach is used.

VaR Parameters
The Group uses a 99.0% confidence level which translates to 2.326 standard deviations. To give a better picture, a 99.0% VaR can be taken as the 10th lowest of 1,000 profit and loss observations.

Since VaR is computed based on the volatility of market factors irrespective of market liquidity, the Parent Company has assigned liquidity factors to account for the market's ability to absorb the bank's positions if it were to unload it the next day. The liquidity-adjusted 1-day VaR replaces the use of various defeasance assumption, meant to represent the length of time it takes to fully close positions on a specific product/portfolio. While the Parent Company uses a fixed 1 day defeasance assumption across all products, liquidity factors is subject to a periodic review.

The VaR figures are backtested against actual and hypothetical profit and loss to validate the robustness of the VaR model. Likewise, to complement the VaR measure, the Parent Company performs stress tests wherein the trading portfolios are valued under extreme market scenarios not covered by the confidence interval of the VaR model.

Since VaR is an integral part of the Parent Company's market risk management, VaR limits are set annually for all financial trading activities based on its risk appetite level. Exposures are then monitored daily against the established VaR limits.

Equity price risk
Equity price risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks.

Market Risk in the Non-Trading Book
The accrual book pertains to the assets and liabilities that make up the Parent Company's balance sheet. Such accrual positions are sensitive to changes in interest rates. The Parent Company monitors the exposure of non-trading assets and liabilities to fluctuations in interest rates by measuring the impact of interest rate movements on its interest income.

Earnings-at-Risk (EAR) or the sensitivity of the statement of income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at each statement of financial position date. This approach focuses on the impact in profit or loss of holding on to the gaps over a 1-year time frame.

To control the interest rate repricing risk in the banking books, the Parent Company sets a limit on the Earnings at Risk (EAR) measure.

The Parent Company recognizes, however, that this metric assumes a "business-as-usual" scenario and, therefore, do not show potential losses under a "stress" scenario. To address this limitation, the Parent Company performs regular stress testing to test its ability to cope with adverse changes in interest rates under different stress scenarios. This process involves applying one-time interest rate shocks of

different magnitudes to the current repricing gap positions in the balance sheet.

Currency risk
Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

Foreign currency-denominated deposits are generally used to fund the Parent Company's foreign currency-denominated loan and investment portfolio in the FCDU. Banks are required by the BSP to match the foreign currency-denominated liabilities with the foreign currency-denominated assets held under the FCDU books. As of December 31, 2017, BSP requires a 30.00% liquidity reserve on all foreign currency liabilities held under the FCDU.

Effective January 1, 2018, the liquid asset cover requirements for FCDU and Expanded FCDU (EFCDU) liabilities shall be as follows: (a) for universal and commercial banks, 0% liquid asset cover, and (b) for thrift, rural and cooperative banks, 30.0% liquid asset cover. Further, beginning on 1 January 2019, the liquid asset cover requirement for FCDU and EFCDU liabilities for all banks shall be 0%. FCDUs and EFCDUs of universal banks and commercial banks may maintain its foreign currency cover in any foreign currency acceptable with the BSP. However, FCDUs and EFCDUs of thrift banks and rural banks are required to maintain foreign currency cover in the same currency as that of the corresponding foreign currency deposit liability until 31 December 2018. Beginning 1 January 2019, FCDUs and EFCDUs of thrift banks and rural banks may maintain its foreign currency cover in any foreign currency acceptable with the BSP. FCDUs and EFCDUs of universal banks, commercial banks, and thrift banks have the option to maintain foreign currency deposits with the BSP equivalent to 15.0% of their foreign currency deposit liabilities as a form of foreign currency cover. The Parent Company adopts this regulation as prescribed by BSP and addresses this on an ongoing basis. As reported to the BSP, the Parent Company is in compliance with said regulation as of September 30, 2018.

The Group's policy is to maintain foreign currency exposure within acceptable limits and within existing regulatory guidelines.

6. Fair Value Measurement

The following show the fair values of the assets and liabilities of the Group:

	September 30, 2018				
		Fair Value			
	Carrying Value	Total	Quoted Prices in active market (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets Measured at Fair Value					
Financial assets at FVTPL:					
HFT investments:					
Government securities	**₱675,302**	**₱675,302**	**₱675,302**	**₱–**	**₱–**
Private bonds	**30,778**	**30,778**	**30,778**	**–**	**–**
Equity securities	**169**	**169**	**169**	**–**	**–**
Total HFT investments	**706,249**	**706,249**	**706,249**	**–**	**–**
Derivative assets:					
Currency forwards	**971,047**	**971,047**	**–**	**971,047**	**–**
Interest rate swaps	**1,277,607**	**1,277,607**	**–**	**1,277,607**	**–**
Cross-currency swaps	**513,749**	**513,749**	**–**	**513,749**	**–**
Bonds forward	**3**	**3**	**–**	**3**	**–**
Total derivative assets	**2,762,406**	**2,762,406**	**–**	**2,762,406**	**–**
Others	**15,487**	**15,487**	**15,487**	**–**	**–**
Total financial assets at FVTPL	**3,484,142**	**3,484,142**	**721,736**	**2,762,406**	**–**
Derivative assets designated as hedges	**846,177**	**846,177**	**–**	**846,177**	**–**

	September 30, 2018				
		Fair Value			
	Carrying Value	**Total**	**Quoted Prices in active market (Level 1)**	**Significant observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Financial assets at FVTOCI					
Treasury notes and bills	**₱2,699,460**	**₱2,699,460**	**₱2,699,460**	**₱–**	**₱–**
Treasury bonds	**11,819,609**	**11,819,609**	**11,819,609**	**–**	**–**
Private bonds	**4,905,253**	**4,905,253**	**4,905,253**	**–**	**–**
Equity securities	**243,948**	**243,948**	**–**	**243,948**	**–**
	19,668,270	**19,668,270**	**19,424,322**	**243,948**	**–**
	₱23,998,589	**₱23,998,589**	**₱20,146,058**	**₱3,852,531**	**₱–**
Assets for which Fair Values are Disclosed					
Financial Assets					
Financial assets at amortized cost					
Investment securities at amortized cost:					
Treasury bonds	**₱172,430,055**	**₱158,620,696**	**₱158,620,696**	**₱–**	**₱–**
Private bonds	**24,357,759**	**22,565,379**	**22,565,379**	**–**	**–**
Treasury notes and bills	**17,754,612**	**14,405,304**	**14,405,304**	**–**	**–**
Total investment securities at amortized cost	**214,542,426**	**195,591,379**	**195,591,379**	**–**	**–**
Loans and receivables - net	**400,630,785**	**406,346,307**	**–**	**–**	**406,346,307**
Other assets	**355,338**	**302,883**	**–**	**–**	**302,883**
Total financial assets at amortized cost	**615,528,549**	**602,240,569**	**195,591,379**	**–**	**406,649,190**
Non-financial Assets					
Investment properties	**793,599**	**1,055,686**	**–**	**–**	**1,055,686**
	₱616,322,148	**₱603,296,255**	**₱195,591,379**	**₱–**	**407,704,876**
Liabilities Measured at Fair Value					
Financial liabilities at FVTPL:					
Derivative liabilities:					
Currency forwards	**₱678,277**	**₱678,277**	**₱–**	**₱678,277**	**₱–**
Interest rate swaps	**1,284,557**	**1,284,557**	**–**	**1,284,557**	**–**
Cross-currency swaps	**149,811**	**149,811**	**–**	**149,811**	**–**
Warrants	**3,409**	**3,409**	**–**	**3,409**	**–**
Bonds forward	**2**	**2**	**–**	**2**	**–**
Total financial liabilities at FVTPL	**₱2,116,056**	**₱2,116,056**	**₱–**	**₱2,116,056**	**₱–**
Liabilities for which Fair Values are Disclosed					
Deposit liabilities excluding LTNCD	**₱443,351,379**	**₱443,412,926**	**₱–**	**₱–**	**443,412,926**
LTNCD	**24,273,415**	**23,251,077**	**–**	**–**	**23,251,077**
Subordinated note	**9,955,592**	**9,991,266**	**–**	**–**	**9,991,266**
Notes Payable	**32,266,669**	**32,474,555**	**32,474,555**	**–**	**–**
Bills payable and SSURA	**93,090,249**	**93,650,956**	**–**	**–**	**93,650,956**
	₱602,937,304	**₱602,780,780**	**₱32,474,555**	**₱–**	**570,306,225**

	December 31, 2017				
		Fair Value			
	Carrying Value	Total	Quoted Prices in active market (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets Measured at Fair Value					
Financial assets at FVTPL:					
HFT investments:					
Government securities	₱2,965,152	₱2,965,152	₱2,965,152	₱–	₱–
Private bonds	146,362	146,362	146,362	–	–
Equity securities	8	8	8	–	–
Total HFT investments	3,111,522	3,111,522	3,111,522	–	–
Derivative assets:					
Interest rate swaps	666,382	666,382	–	666,382	–
Currency forwards	607,271	607,271	–	607,271	–
Cross-currency swaps	191,571	191,571	–	191,571	–
Interest rate futures	262	262	–	262	–
Total derivative assets	1,465,486	1,465,486	–	1,465,486	–
Others	15,487	15,487	15,487	–	–
Total financial assets at FVTPL	4,592,495	4,592,495	3,127,009	1,465,486	–
Financial assets at FVTOCI	200,271	200,271	–	200,271	
	₱4,792,766	₱4,792,766	₱3,127,009	₱1,665,757	₱–

	December 31, 2017				
		Fair Value			
	Carrying Value	Total	Quoted Prices in active market (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets for which Fair Values are Disclosed					
Financial Assets					
Financial assets at amortized cost					
Investment securities at amortized cost:					
Treasury bonds	₱175,794,191	₱173,501,074	₱173,501,074	₱–	₱–
Private bonds	35,940,157	35,933,280	35,933,280	–	–
Treasury notes and bills	17,858,967	16,892,112	16,892,112	–	–
Total investment securities at amortized cost	229,593,315	226,326,466	226,326,466	–	–
Loans and receivables - net	370,189,758	374,035,841	–	–	374,035,841
Other assets	321,154	288,959	–	–	288,959
Total financial assets at amortized cost	600,104,227	600,651,266	226,326,466	–	374,324,800
Non-financial Assets					
Investment properties	791,306	1,223,667	–	–	1,223,667
	₱600,895,533	₱601,874,933	₱226,326,466	₱–	₱375,548,467
Liabilities Measured at Fair Value					
Financial liabilities at FVTPL:					
Derivative liabilities:					
Currency forwards	₱1,416,071	₱1,416,071	₱–	₱1,416,071	₱–
Interest rate swaps	593,305	593,305	–	593,305	–
Warrants	3,151	3,151	–	3,151	–
Interest rate futures	655	655	–	655	–
Total financial liabilities at FVTPL	₱2,013,182	₱2,013,182	₱–	₱2,013,182	₱–
Liabilities for which Fair Values are Disclosed					
Deposit liabilities excluding LTNCD	₱394,577,401	₱394,355,302	₱–	₱–	₱394,355,302
LTNCD	18,526,475	18,698,646	–	–	18,698,646
Subordinated note	9,950,814	9,991,168	–	–	9,991,168
Notes payable	14,948,402	15,522,407	15,522,407	–	–
Bills payable and SSURA	131,179,238	130,772,666	–	–	130,772,666
	₱569,182,330	₱569,340,189	₱15,522,407	₱–	₱553,817,782

During the periods ended September 30, 2018 and December 31, 2017, there were no transfers between level 1 and level 2 fair value measurements and no transfers into and out of level 3 fair value measurement.

The Group measures certain financial instruments at fair value at each reporting period. Also, fair values of financial instruments carried at amortized cost and investment properties carried at cost are measured for disclosure purposes.

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 by the Group.

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.

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 Group 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 on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing 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.

External appraisers are involved for valuation of significant nonfinancial assets, such as investment properties. Selection criteria include market knowledge, reputation, independence and whether professional standards are maintained.

For the purpose of fair value disclosures, the Group 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.

The methods and assumptions used by the Group in estimating the fair value of its assets and liabilities are:

COCI, due from BSP and other banks and interbank loans receivable and SPURA with the BSP
The carrying amounts approximate fair values considering that these accounts consist mostly of overnight deposits and floating rate placements.

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

Equity securities
Fair values of quoted equity securities are based on quoted market prices. The unquoted equity securities are carried at cost net of impairment since there is insufficient information available to determine its fair values.

Receivable from customers and sales contracts receivable (included under Other receivables)
Fair values of loans and receivables are estimated using the discounted cash flow methodology, using the Group's current incremental lending rates for similar types of loans and receivables.

Other receivables - Accounts receivable and accrued interest receivable
Carrying amounts approximate fair values given their short-term nature.

Investment properties
Fair value of investment properties are determined by independent or in-house appraisers using the market data approach. Valuations were derived on the basis of recent sales of similar properties in the

same area as the investment properties and taking into account the economic conditions prevailing at the time the valuations were made and comparability of similar properties sold with the property being valued. Significant unobservable inputs in determining fair values include the following:

Location	Location of comparative properties whether on a main road, or secondary road. Road width could also be a consideration if data is available. As a rule, properties located along a main road are superior to properties located along a secondary road.
Size	Size of lot in terms of area. Evaluate if the lot size of property or comparable conforms to the average cut of the lots in the area and estimate the impact of the lot size differences on land value.
Time element	An adjustment for market conditions is made if general property values have appreciated or depreciated since the transaction dates due to inflation or deflation or a change in investor's perceptions of the market over time, in which case, the current data is superior to historic data.
Discount	Generally, asking prices in advertisements posted for sale are negotiable. Discount is the amount the seller or developer is willing to deduct from the posted selling price if the transaction will be in cash or equivalent.

Other financial assets
The carrying amounts approximate fair values due to their short-term nature.

Derivative instruments
Fair values of quoted warrants are based on quoted market prices. Other derivative products are valued using valuation techniques using market observable inputs including foreign exchange rates and interest rate curves prevailing at the statement of financial position date. For interest rate swaps, cross-currency swaps and foreign exchange contracts, discounted cash flow model is applied. This valuation model discounts each cashflow of the derivatives at a rate that is dependent on the tenor of the cashflow.

Deposit liabilities (demand and savings deposits excluding long-term savings deposits)
The carrying amounts approximate fair values considering that these are due and demandable.

Long-term savings deposits and time deposits, and bills payable and SSURA
Fair values of long-term savings and time deposits, and bills payable and SSURA are estimated using the discounted cash flow methodology using the Group's current incremental borrowing rates for similar borrowings with maturities consistent with those remaining for the liability being valued.

Long-term negotiable certificates of deposit (LTNCD), subordinated note and notes payable
Fair values of LTNCD and subordinated note are estimated using adjusted quoted market prices of comparable investments. The adjustments on market quoted prices are unobservable inputs. Fair values of notes payable are based on quoted market prices.

Other financial liabilities
For accrued interest and other expenses and other financial liabilities, the carrying amounts approximate fair values due to their short-term nature.

7. Financial Assets and Liabilities at Fair Value through Profit or Loss

As of September 30, 2018 and December 31, 2017, financial assets at FVTPL include net unrealized gain of ₱2.8 billion and ₱1.5 billion, respectively, while financial liabilities at FVTPL include net unrealized loss of ₱2.1 billion and ₱2.0 billion, respectively.

Net unrealized gain or loss on financial assets at FVTPL (other than currency forwards) is included in Trading and securities gain - net in the statement of income. For the nine months ended September 30,

2018 and 2017, net unrealized gain of ₱1.1 billion and ₱67.2 million, respectively, on currency forwards is included in Foreign exchange gain (loss) - net in the statement of income.

8. Derivatives Designated as Hedges

The following table sets out the information about the Group's derivative financial instruments designated as hedges and the related fair values:

	September 30, 2018		
	Notional Amount	**Derivative Asset**	**Derivative Liability**
Interest rate swaps	**USD2,781,571**	**₱846,177**	**₱–**

For the nine months ended September 30, 2018 and 2017, net interest expense on derivative liabilities designated as hedges amounted to nil and ₱4.2 million, respectively.

9. Financial Assets at Fair Value through Other Comprehensive Income

This account consists of:

	September 30, 2018	December 31, 2017
Debt instruments		
Treasury notes and bills	**₱2,699,460**	₱–
Treasury bonds	**11,819,609**	–
Private bonds	**4,905,253**	–
	19,424,322	–
Equity instruments		
Golf shares	**210,339**	157,480
PSE shares	**33,609**	42,791
	243,948	200,271
	₱19,668,270	₱200,271

On January 19, 2018, the Parent Company participated in the Republic of the Philippines' cash tender program and submitted its holdings of eligible ROP bonds classified as FVTOCI securities with face value of USD128.6 million (₱6.6 billion) resulting in gain amounting to USD4.3 million (₱220.0 million) recorded under 'Trading and securities gain - net'.

As discussed in Note 10, the Parent Company reclassified certain HTC securities to financial assets at FVTOCI due to change in business model in managing its financial assets in accordance with the final version of PFRS 9.

As of September 30, 2018, financial assets at FVTOCI peso and dollar-denominated securities amounted to ₱1.7 billion and ₱17.7 billion, respectively.

As of September 30, 2018, certain treasury bond securities with a carrying amount of ₱9.3 billion were pledged with foreign and local banks as collateral for SSURA.

PSE shares were obtained by SBEI in 2001 as a result of the demutualization of its membership shares in the stock exchange. These investments were for long-term strategic purpose. SBEI designated these equity securities as financial assets at FVTOCI as management believes that this provides a more meaningful presentation for medium or long-term strategic investments, rather than reflecting changes in

fair value immediately in the statements of income. The Group also adopted the same classification for its investments in golf shares.

10. Investment Securities at Amortized Cost

This account consists of investments in:

	September 30, 2018	December 31, 2017
Treasury bonds	**₱172,430,055**	₱175,794,191
Private bonds	**24,357,759**	35,940,157
Treasury notes and bills	**17,754,612**	17,858,967
	₱214,542,426	₱229,593,315

During the fourth quarter of 2017, the Parent Company disposed certain USD-denominated government securities classified as HTC securities with a carrying amount of USD1.0 billion (₱52.2 billion). The disposals resulted in a gain of USD24.2 million (₱1.2 billion).

Management obtained the approval of its ROC and the BOD for the disposal of these securities, which proceeds would be used to fund the growth in its lending business.

As part of the approval, management expressed the need to change its business model for managing its HTC securities considering the reassessment of its funding strategy vis-à-vis the business requirements and funding sources. The change in business model was considered in relation to the adoption of the final version of PFRS 9.

Accordingly, in December 2017, the ROC and the BOD of the Parent Company approved the proposed business models in managing its financial assets in accordance with the final version of PFRS 9. The new business models included categories of financial assets as to amortized cost, FVTPL and FVTOCI.

On January 1, 2018, as a result of the change in business model, certain USD-denominated and Peso denominated HTC securities with a carrying amount of USD517.6 million (₱25.8 billion) and ₱1.7 billion, respectively, have been reclassified to the 'Financial assets at FVTOCI' category. The reclassification resulted in a valuation gain of ₱812.6 million recorded under 'Net unrealized gain (loss) on debt instruments at fair value through other comprehensive income'.

In November 2017, the Parent Company participated in the cash tender offer of a private entity of its USD-denominated 2019 bonds classified as HTC with a carrying amount of USD10.0 million (₱501.5 million). The issuer subsequently redeemed the bonds not tendered in the offer in December 2017 in accordance with the terms and conditions of the bonds. The participation in the cash tender offer resulted in a gain of USD0.7 million (₱37.6 million).

In April 2017, the Parent Company participated in the cash tender offer by another private entity of its USD-denominated 2021 bonds classified as HTC with a carrying amount of USD57.8 million (₱2.9 billion). The disposal resulted in a gain of USD5.5 million (₱275.3 million).

The Parent Company concluded that the participation in tender offers in April and November 2017 resulting in disposals of HTC securities was not inconsistent with the Parent Company's HTC business model as supported by the following:

- The main motivation of the Parent Company in participating was to protect itself from potential adverse effects of reduced liquidity of the bonds following the tender offers. In addition, for the

securities tendered in November, the issuer also had a program to redeem all securities not tendered. Hence, the Parent Company decided to participate in the tender offer that provided the higher price.
- The securities submitted were purchased by the Parent Company based on their yield and credit prior to the issuers' decision to make a tender offer.

In January 2017, as part of the general cash management program and broader program to manage its external liabilities, the Republic of the Philippines executed a cash tender offer. Under the cash tender offer, the government offered selected USD-denominated securities for buyback. The Parent Company submitted its holdings of eligible bonds that resulted in the derecognition of certain HTC securities. USD-denominated investment securities at amortized cost with carrying amount of USD455.6 million (₱22.7 billion) were tendered which resulted in a gain of USD16.1 million (₱803.7 million) recorded in the statements of income under 'Gain on disposal of investment securities at amortized cost'. The Parent Company concluded that the participation in the tender offer was not inconsistent with the Parent Company's HTC business model as supported by the following:

- The Parent Company participated in the tender offer to protect itself from the possible adverse impact on the liquidity of the eligible securities. There is a high likelihood that the securities will become illiquid after the offerings as it substantially reduces the outstanding issue size of the eligible securities.
- The government has no program explicitly set that requires it to undertake a debt swap activity regularly. There is no guarantee that it will announce such an undertaking at any point in time until the government makes the announcement on the actual offer date.
- The securities submitted for the offerings were purchased by the Parent Company prior to the announcement of the government of the securities eligible for the offerings.

BSP Circular No. 708 also provides that derecognition of financial assets attributable to changes in the payment structure as initiated by the creditor like bond swap or exchange is not considered inconsistent with an HTC business model.

As of September 30, 2018 and December 31, 2017, HTC dollar-denominated securities amounted to ₱168.7 billion and ₱181.2 billion, respectively.

As of September 30, 2018 and December 31, 2017, HTC Peso-denominated securities amounted to ₱46.6 billion and ₱48.4 billion, respectively.

As of September 30, 2018 and December 31, 2017, certain treasury bond securities with a carrying amount of ₱81.3 billion and ₱129.6 billion, respectively, and fair value of ₱75.3 billion and ₱127.6 billion, respectively, were pledged with foreign and local banks as collateral for SSURA.

As of September 30, 2018 and December 31, 2017, government securities included under 'Investment securities at amortized cost' with a total face value of ₱508.1 million and ₱550.0 million, respectively, were deposited with the BSP in compliance with the requirements of the General Banking Law relative to the Parent Company's trust functions.

11. Investments in Subsidiaries

Disposal of Diners Club International Credit Cards

On June 14, 2016, SBCC signed a Portfolio Sale and Purchase Agreement (PSPA) with BDO Unibank, Inc. (BDO), whereby BDO accepted SBCC's offer to sell its rights as the exclusive issuer and acquirer of Diners Club International credit cards in the Philippines effective September 30, 2016. The move is a strategic decision to focus on the existing MasterCard as the main credit card offering. The acquisition includes SBCC's existing Diners Club portfolio and its cardholder base. Pursuant to the PSPA, SBCC transferred a substantial portion of its credit card receivables with carrying values of ₱586.7 million to

BDO for a consideration of ₱751.7 million. SBCC recognized a gain of ₱165.0 million from this transaction included under 'Miscellaneous income' in 2016. As part of the PSPA, SBCC shall provide transition services, including operational and system support for automated teller machine transactions of the cardholders to facilitate the continued management and servicing of the sold portfolio. The transition fees received by SBCC amounted to nil and ₱73.9 million for the nine months ended September 30, 2018 and 2017, respectively, included under 'Service charges, fees and commissions' in the statement of income.

Integration of SBS to the Parent Company

The Parent Company's BOD approved the integration of SBS. On January 8, 2015, the BSP approved the purchase of all assets and assumption of all liabilities of SBS by the Parent Company. On January 14, 2015, the BSP clarified that SBS will not become a shell corporation after the integration because it will retain cash to meet its capital requirement as a thrift bank, and after one year of dormancy, shall go back to the BSP for consideration to resume its banking operations. On its letter dated January 29, 2015, the PDIC also granted the consent to the proposed sale of all assets and assumption of all liabilities of SBS to the Parent Company under the Resolution No. 2014-12-290 dated December 19, 2014.

Assets and liabilities with carrying values of ₱8.3 billion and ₱9.6 billion, respectively, in the books of SBS were sold/transferred to SBC at their fair values of ₱8.4 billion and ₱9.7 billion, respectively on transfer date. SBS paid the Parent Company for the difference between the fair value of the assets and liabilities transferred amounting to ₱1.3 billion.

On January 26, 2016, the BOD of SBS approved the extension of the existing thrift bank license under a dormant status for another year pending the firm up of its business model.

On May 26, 2016, the BSP approved the request of SBS to extend the license and retain the vehicle on a dormant status for another year or until January 25, 2017.

Conversion of SBS to SBFCI

On November 24, 2016 and December 15, 2016, the BOD and stockholders of SBS, respectively, approved the conversion of SBS from a savings bank to a finance company. On April 11, 2017, the Monetary Board (MB) of the BSP, in its resolution No. 616, approved the voluntary surrender of SBS of its thrift bank, trust and FCDU licenses, subject to submission of certain regulatory requirements.

On August 4, 2017, the SEC approved the conversion of SBS from a savings bank to a finance company. On the same date, SEC also approved the Amended Articles of Incorporation and By-Laws of SBS to operate as a financing company in accordance with the Financing Act of 1998 (Republic Act. No. 8556) under the name of SBFCI.

On September 28, 2017, the BOD of SBFCI approved the organizational structure of the Company.

12. Deposit Liabilities

On May 8, 2014, the BSP, through BSP Circular 832, approved the 1.0% increase in reserve requirements effective May 30, 2014, thereby further increasing the reserve requirements on non-FCDU deposit liabilities of the Parent Company and SBS from 19.0% to 20.0% and from 7.0% to 8.0%, respectively. On February 15, 2018, the BSP, through BSP Circular 997, approved the 1.0% reduction in reserve requirements effective March 2, 2018 thereby reducing the reserve requirements on non-FCDU deposit liabilities of the Parent Company from 20.0% to 19.0%.

As mandated by the Circular, only demand deposit accounts maintained by banks with the BSP are eligible for compliance with reserve requirements, thereby excluding government securities and cash in vault as eligible reserves. Further, deposits maintained with the BSP in compliance with the reserve requirement shall no longer be paid interest.

On May 24, 2018, the BSP, through BSP Circular 1004, approved the 100-basis-point reduction in the reserve requirement ratios of selected reservable liabilities of the Parent Company effective June 1, 2018.

As of September 30, 2018 and December 31, 2017, the Group was in compliance with such regulations.

As of September 30, 2018 and December 31, 2017, the Group has set aside 'Due from BSP' as reserves amounting to ₱60.4 billion and ₱56.3 billion, respectively.

Long Term Negotiable Certificate of Deposits maturing on February 17, 2019

On February 17, 2012, the Parent Company issued 5.50% fixed coupon rate (EIR of 5.62%) unsecured LTNCD at par value of ₱5.0 billion.

The issuance of the foregoing LTNCD under the terms approved by the BOD was approved by the BSP on November 24, 2011.

Long Term Negotiable Certificate of Deposits maturing on August 16, 2019

On August 15, 2012, the Parent Company issued 5.50% fixed coupon rate (EIR of 5.62%) unsecured LTNCD at par value of ₱5.0 billion.

The issuance of the foregoing LTNCD under the terms approved by the BOD was approved by the BSP on April 26, 2012.

Long Term Negotiable Certificate of Deposits maturing on May 8, 2023

On November 8, 2017, the Parent Company issued 3.875% fixed coupon rate (EIR of 4.01%) unsecured LTNCD at par value of ₱8.6 billion.

The issuance of the foregoing LTNCD under the terms approved by the BOD was approved by the BSP on October 5, 2017.

Long Term Negotiable Certificate of Deposits maturing on November 2, 2023

On May 2, 2018, the Parent Company issued 4.50% fixed coupon rate (EIR of 4.69%) unsecured LTNCD at par value of ₱5.78 billion.

The issuance of the foregoing LTNCD under the terms approved by the BOD was approved by the BSP on October 5, 2017.

The movement of unamortized debt issue costs on LTNCD follows:

	September 30, 2018	December 31, 2017
Beginning balance	**₱73,525**	₱27,262
Addition	**53,506**	58,711
Amortization	**(19,446)**	(12,448)
Balance at end of year	**₱107,585**	₱73,525

Interest expense on deposit liabilities consists of:

	For the period ended September 30	
	2018	2017
Demand	**₱94,894**	₱121,957
Savings	**2,167,117**	1,355,986
Time	**2,460,986**	1,859,633
LTNCD	**788,907**	420,714
	₱5,511,904	₱3,758,290

13. Bills Payable and Securities Sold Under Repurchase Agreements

This account consists of borrowings from:

	September 30, 2018	December 31, 2017
SSURA	**69,934,943**	₱107,630,850
Local banks	**8,398,177**	12,294,580
Foreign banks	**14,559,253**	11,044,516
Local government banks with relending facilities	**197,876**	209,292
	₱93,090,249	₱131,179,238

Certain investment securities were pledged with foreign and local banks as collateral for SSURA (see Notes 9 and 10).

Interest expense on bills payable amounted to ₱2.0 billion and ₱1.8 billion for the nine months ended September 30, 2018 and 2017, respectively.

14. Notes Payable

Senior Unsecured Notes due 2020

In February 2015, the Parent Company issued $300.0 million senior unsecured notes (“Senior Notes”) due on February 3, 2020. The Senior Notes, which are listed in the Singapore Stock Exchange, were priced at par with a coupon rate of 3.95% (EIR of 4.04%) payable on a semi-annual basis commencing on August 3, 2015. The Parent Company incurred debt issue costs amounting to ₱61.0 million.

Senior Unsecured Notes due 2023

In September 2018, the Parent Company issued $300.0 million senior unsecured notes (“Senior Notes”) due on September 25, 2023. The Senior Notes, which are listed in the Singapore Stock Exchange, were priced at a discount, with a coupon rate of 4.50% fixed rate (EIR of 4.67%) payable on a semi-annual basis commencing on March 25, 2019. The Parent Company incurred debt issue costs amounting to ₱57.6 million.

The movements in unamortized discount follow:

	September 30, 2018	December 31, 2017
Discount on issuance of notes	**₱30,598**	₱46,603
Additions	**124,653**	–
Amortization	**(11,653)**	(16,382)
Translation adjustment	**1,733**	377
Balance at end of year	**₱145,331**	₱30,598

Interest expense on notes payable amounted to ₱493.7 million and ₱459.9 million for the nine months ended September 30, 2018 and 2017, respectively.

15. Subordinated Note

Tier 2 Unsecured Subordinated Notes due 2024

On July 11, 2014, the Parent Company issued ₱10.0 billion Unsecured Subordinated Notes (2024 Sub Notes) due on July 11, 2024 qualifying as Tier 2 Capital. The Notes will initially bear interest at the rate of 5.375% per annum (EIR of 5.464%) from and including July 11, 2014 to but excluding July 11, 2019. Unless the 2024 Sub Notes are redeemed on July 12, 2019, the initial interest rate will be reset at the

equivalent of the five-year PDST-R1 plus a spread of 1.575% per annum, and such interest will be payable commencing on July 12, 2019 up to and including July 11, 2024. The interest of the 2024 Sub Notes for the entire term will be payable quarterly in arrears on the 11th of January, April, July, and October of each year, commencing on October 11, 2014.

The issuance of the 2024 Sub Notes under the terms approved by the BOD was approved by the BSP on May 21, 2014, subject to the Parent Company's compliance with certain conditions.

The movements in unamortized discount follow:

	September 30, 2018	December 31, 2017
Beginning balance	**₱49,186**	₱55,276
Amortization	**(4,778)**	(6,090)
Balance at end of year	**₱44,408**	₱49,186

Interest expense for the subordinated notes amounted to ₱407.9 million and ₱407.6 million for the nine months ended September 30, 2018 and 2017, respectively.

16. Equity

As of September 30, 2018 and December 31, 2017, the Parent Company's capital stock consists of:

	Shares*	**Amount**
Common stock - ₱10 par value		
Authorized	1,000,000,000	₱10,000,000
Issued and outstanding		
Balance at the beginning and end of the period	753,538,887	7,535,389
Preferred stock- ₱0.10 par value		
Authorized	1,000,000,000	100,000
Issued and outstanding		
Balance at the beginning and end of the period	1,000,000,000	100,000
	1,753,538,887	₱7,635,389

**Absolute number of shares*

On November 26, 2013, the Parent Company's stockholders approved and authorized the following:

1. Creation of 1.0 billion non-cumulative, non-participating, non-convertible voting Preferred Stock with par value of ₱0.1 each and issuance of approximately 602.8 million of such Preferred Stock; and
2. Increase in authorized capital stock from ₱10.0 billion to ₱10.1 billion broken down into ₱10.0 billion Common Stock and ₱100.0 million Preferred Stock.

The Preferred Stock was offered to eligible common stockholders, with each eligible stockholder entitled to subscribe to one voting preferred share for every one common stock held as of the record date, June 16, 2014.

On July 10, 2014, the Parent Company issued 602,831,109 non-cumulative, non-participating, non-convertible Preferred Stock with ₱0.1 par value. The dividend rate is 3.9% repricing every 10 years. The Preferred Stock is redeemable at the sole option of the Parent Company at its issue price. Redemption shall at all times be subject to regulation of the BSP and shall require (i) prior approval of the BSP; (ii) replacement with at least an equivalent amount of newly paid-in-shares; (iii) a lapse of at least five (5) years from the date of issuance; and (iv) solvency of the Parent Company. Redemption shall not be allowed when the Parent Company is insolvent or if such redemption will cause insolvency, impairment of capital or inability of the Parent Company to meet its debts as they mature.

A sinking fund for the redemption of Preferred Shares amounting ₱100.0 million is created upon their issuance, to be effected by the transfer of free surplus to a restricted surplus account and shall not be available for dividend distribution.

On January 14, 2016, the Parent Company's BOD approved the following in its special meeting:

1. The acceptance of the Offer from BTMU to invest in a 20.0% voting interest in the Parent Company;
2. The issuance of 150,707,778 common shares to BTMU from the unissued authorized shares of the Parent Company at a price of ₱245.0 per common share, or a total of ₱36,923,405,610;
3. The listing of these newly issued common shares in the Philippine Stock Exchange, subject to the approval of shareholders (if needed); and
4. The issuance of all unissued authorized voting preferred shares totaling to 397,168,891 at par value of ₱0.1 per share.

The application for investment has been approved by the Monetary Board of the BSP on February 24, 2016. The shares were issued to BTMU on April 1, 2016. Upon ratification of the stockholders of the investment by BTMU on April 26, 2016, shares issued to BTMU were listed with the Philippine Stock Exchange on June 28, 2016. The attributable costs of the issuance of common and preferred shares amounting to ₱102.2 million have been charged directly to equity as a reduction from 'Additional paid-in capital', while costs amounting to ₱41.6 million were charged directly to expense.

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 including capital adequacy requirements and other considerations such as general loan loss reserves. The amount declared as dividends is the amount approved by the BSP. However, in September 17, 2015, the BSP through MB Resolution No. 1516, allowed banks to declare and pay dividends without prior BSP verification provided that pre-qualification criteria including capital adequacy requirements are met.

Surplus reserves of the Group consist of:

	September 30, 2018	December 31, 2017
Reserve for trust business	**₱255,600**	₱255,600
Reserve for self-insurance	**2,111,200**	945,200
Reserve for redemption of preferred stock	**100,000**	100,000
Reserve for contingencies	**–**	–
Others	**32,059**	32,185
	₱2,498,859	₱1,332,985

To comply with Securities Regulation Code Rule 49.1 (B), *Reserve Fund,* requiring broker dealers to annually appropriate a certain minimum percentage of its audited profit after tax as reserve fund, a portion of the Group's surplus corresponding to the net earnings of SBEI amounting to ₱32.2 million as of September 30, 2018 and December 31, 2017 has been appropriated in the consolidated financial statements and is not available for dividend declaration.

Capital Management

The Group considers the equity attributable to the equity holders of the Parent Company as the capital base of the Group. The primary objectives of the Group's capital management are to ensure that it complies with externally imposed capital requirements and that it maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders value.

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities and assessment of prospective business requirements or directions. In order to maintain or adjust the capital structure, the Group may adjust the

amount and mode of dividend payment to shareholders, issue capital securities or undertake a share buy-back. The processes and policies guiding the determination of the sufficiency of capital for the Group relative to its business risks are the very same methodology that have been incorporated into the Group's ICAAP in compliance with the requirements of BSP Circular No. 639 for its adoption. Under this framework, the assessment of risks extends beyond the Pillar 1 set of credit, market and operational risks and onto other risks deemed material by the Group. The level and structure of capital are assessed and determined in light of the Group's business environment, plans, performance, risks and budget; as well as regulatory edicts. BSP requires submission of an ICAAP document every January 31. In 2015 and 2014, while the Group has revised and created additional triggers for its CET I capital, respectively, on top of it 2013 ICAAP to its original capital management process, no changes were made in the objectives and policies from previous years. In 2015, the Group has established the Finance Committee to oversee the Group's ICAAP. It recommends measures to safeguard the capital of the Group.

In March 2016, the BSP issued Circular 904, mandating the development of a recovery plan for Domestic Systemically Important Banks, with the initial submission in June 2016. The Group was able to enhance the 2016 ICAAP document to extend its analysis on capital to cover the guidelines mandated by the BSP.

Regulatory Qualifying Capital

Under existing BSP regulations, the determination of the Parent Company's compliance with regulatory requirements and ratios is based on the amount of the Parent Company's 'unimpaired capital' (regulatory net worth) reported to the BSP, which is determined on the basis of regulatory policies. In addition, the risk-based capital ratio of a bank, expressed as a percentage of qualifying capital to risk-weighted assets, should not be less than 10.0% for both solo basis (head office and branches) and consolidated basis (parent company and subsidiaries engaged in financial allied undertakings). Qualifying capital and risk-weighted assets are computed based on BSP regulations.

The regulatory Gross Qualifying Capital of the Parent Company consists of Tier 1 (core) and Tier 2 (supplementary) capital. Tier 1 capital comprises share capital, retained earnings (including current year profit) and non-controlling interest less required deductions such as deferred tax, intangible assets and unsecured credit accommodations to DOSRI. Tier 2 capital includes unsecured subordinated note, revaluation reserves and general loan loss provision. Certain items are deducted from the regulatory Gross Qualifying Capital, such as but not limited to equity investments in unconsolidated subsidiary banks and other financial allied undertakings, but excluding investments in debt capital instruments of unconsolidated subsidiary banks (for solo basis) and equity investments in subsidiary nonfinancial allied undertakings.

Risk-weighted assets are determined by assigning defined risk weights to statement of financial position exposures and to the credit equivalent amounts of off-balance sheet exposures. Certain items are deducted from risk-weighted assets, such as the excess of general loan loss provision over the amount permitted to be included in Tier 2 capital. The risk weights vary from 0.0% to 150.0% depending on the type of exposure, with the risk weights of off-balance sheet exposures being subjected further to credit conversion factors. For the purpose of determining the relevant risk weight, third party credit assessments provided by Standard & Poor's, Moody's, Fitch and PhilRatings were used.

Following is a summary of risk weights and selected exposure types:

Risk weight	Exposure/Asset type*
0%	Cash on hand; claims collateralized by securities issued by the non-government, BSP; loans covered by the Trade and Investment Development Corporation of the Philippines; real estate mortgages covered by the Home Guarantee Corporation
20%	COCI, claims guaranteed by Philippine incorporated banks/quasi-banks with the highest credit quality; claims guaranteed by foreign incorporated banks with the highest credit quality; loans to exporters to the extent guaranteed by Small Business Guarantee and Finance Corporation
50%	Housing loans fully secured by first mortgage on residential property; Local Government Unit (LGU) bonds which are covered by Deed of Assignment of Internal Revenue allotment of the LGU and guaranteed by the LGU Guarantee Corporation
75%	Direct loans of defined Small Medium Enterprise and microfinance loans portfolio; nonperforming housing loans fully secured by first mortgage
100%	All other assets (e.g., real estate assets) excluding those deducted from capital (e.g., deferred tax)
150%	All NPLs (except nonperforming housing loans fully secured by first mortgage) and all nonperforming debt securities

** Not all inclusive*

With respect to off-balance sheet exposures, the exposure amount is multiplied by a credit conversion factor (CCF), ranging from 0.0% to 100.0%, to arrive at the credit equivalent amount, before the risk weight factor is multiplied to arrive at the risk-weighted exposure. Direct credit substitutes (e.g., guarantees) have a CCF of 100.0%, while items not involving credit risk has a CCF of 0.0%.

In the case of derivatives, the credit equivalent amount (against which the risk weight factor is multiplied to arrive at the risk-weighted exposure) is generally the sum of the current credit exposure or replacement cost (the positive fair value or zero if the fair value is negative or zero) and an estimate of the potential future credit exposure or add-on. The add-on ranges from 0.0% to 1.5% (interest rate-related) and from 1.0% to 7.5% (exchange rate-related), depending on the residual maturity of the contract. For CLNs and similar instruments, the risk-weighted exposure is the higher of the exposure based on the risk weight of the issuer’s collateral or the reference entity or entities.

As of September 30, 2018 and December 31, 2017, the Group was in compliance with the required capital adequacy ratio (CAR), as follows:

	September 30, 2018	December 31, 2017
Tier 1 capital	**₱106,610,966**	₱103,223,871
Less Required deductions	**6,124,391**	6,366,321
	100,486,575	96,857,550
Excess from Tier 2 deducted to Tier 1 Capital*	**–**	–
Net Tier 1 Capital	**100,486,575**	96,857,550
Tier 2 capital	**13,817,132**	13,672,970
Less: Required deductions	**–**	–
	13,817,132	13,672,970
Excess of Tier 2 deducted to Tier 1 Capital*	**–**	–
Net Tier 2 Capital	**13,817,132**	13,672,970
Total Qualifying Capital	**₱114,303,707**	₱110,530,520
Risk Weighted Assets	**₱615,248,286**	₱592,182,696
Tier 1 CAR	**16.33%**	16.36%
Total CAR	**18.58%**	18.66%

**Deductions to Tier 2 Capital are capped at its total gross amount and any excess shall be deducted from Tier 1 Capital.*

On January 15, 2013, the BSP issued Circular No. 781, *Basel III Implementing Guidelines on Minimum Capital Requirements*, which provides the implementing guidelines on the revised risk-based capital adequacy framework particularly on the minimum capital and disclosure requirements for universal banks and commercial banks, as well as their subsidiary banks and quasi-banks, in accordance with the Basel III standards. The circular is effective on January 1, 2014.

The Circular sets out a minimum Common Equity Tier 1 (CET1) ratio of 6.0% and Tier 1 capital ratio of 7.5%. It also introduces a capital conservation buffer of 2.5% comprised of CET1 capital. The BSP's existing requirement for Total CAR remains unchanged at 10% and these ratios shall be maintained at all times.

Further, existing capital instruments as of December 31, 2010 which do not meet the eligibility criteria for capital instruments under the revised capital framework shall no longer be recognized as capital upon the effectivity of Basel III. Capital instruments issued under BSP Circular Nos. 709 and 716 (the circulars amending the definition of qualifying capital particularly on Hybrid Tier 1 and Lower Tier 2 capitals), starting January 1, 2011 and before the effectivity of BSP Circular No. 781, shall be recognized as qualifying capital until December 31, 2015. In addition to changes in minimum capital requirements, this Circular also requires various regulatory adjustments in the calculation of qualifying capital.

On June 27, 2014, the BSP issued Circular No. 839, *REST Limit for Real Estate Exposures*, which provides the implementing guidelines on the prudential REST limit for universal, commercial, and thrift banks on their aggregate real estate exposures. The Circular sets out a minimum REST limit of 6.0% CET1 capital ratio and 10.0% risk-based capital adequacy ratio, on a solo and consolidated basis, under a prescribed write-off rate of 25.0% on the Group's real estate exposure. These limits shall be complied with at all times.

On June 9, 2015, the BSP issued Circular No. 881, *Implementing Guidelines on the Basel III Leverage Ratio Framework*, which provides implementing guidelines for universal, commercial, and their subsidiary banks/quasi banks. The circular sets out a minimum leverage ratio of 5.0% on a solo and consolidated basis and shall be complied with at all times.

The Group has taken into consideration the impact of the foregoing requirements to ensure that the appropriate level and quality of capital are maintained on an ongoing basis.

17. Related Party Transactions

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. The Group'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,
- subsidiaries, joint ventures and associates and their respective subsidiaries, and
- post-employment benefit plans for the benefit of the Group's employees.

The Group has several business relationships with related parties. Transactions with such parties are made in the ordinary course of business and on substantially same terms, including interest and collateral, as those prevailing at the time for comparable transactions with other parties. These transactions also did not involve more than the normal risk of collectability or present other unfavorable conditions.

In the ordinary course of business, the Parent Company has loan transactions with subsidiaries and with certain DOSRI. Under the Parent Company's policies, these loans are made substantially on the same terms as loans to other individuals and businesses of comparable risks.

On January 31, 2007, BSP Circular No. 560 was issued providing the rules and regulations that shall govern loans, other credit accommodations and guarantees granted to subsidiaries and affiliates of banks and quasi-banks. Under the said circular, the total outstanding loans, credit accommodations and guarantees to each of the bank's subsidiaries and affiliates shall not exceed 10.00% of the bank's net worth, the unsecured portion shall not exceed 5.00% of such net worth. Further, the total outstanding exposures shall not exceed 20.00% of the net worth of the lending bank. The said Circular became effective on February 15, 2007.

BSP Circular No. 423, dated March 15, 2004 amended the definition of DOSRI accounts. Further, BSP issued Circular No. 464 dated January 4, 2005 clarifying the definition of DOSRI accounts.

Other related party transactions conducted in the normal course of business includes the following, as detailed in the Memorandum of Agreement (MOA) between the Parent Company and its subsidiaries (except for SBCC):

- Human resource-related services
- Finance/accounting functions including audit
- Collection services (for legal action)
- Preparation of reports
- Processing of credit application (for property appraisal and credit information)
- General services
- Legal documentation
- Information technology related service

The Parent Company has lease agreements with some of its subsidiaries for periods ranging from 1 to 10 years. The lease agreements include the share of the subsidiaries in the maintenance of the building. Transactions of the Parent Company with its subsidiaries were eliminated in the consolidated financial statements of the Group.

For the period ended September 30, 2018 and 2017, SBML sold various loans and lease receivables to the Parent Company. The Parent Company's proportionate share in the gain on sale of loans and lease receivables was eliminated in the consolidated financial statements of the Group.

The Group has transactions with its key management personnel or those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly. The Group considers senior officers to constitute key management personnel.

Under PFRS, certain post-employment benefit plans are considered as related parties. The Group has business relationships with a number of its retirement plans pursuant to which it provides trust and management services to these plans. The Group's retirement funds may hold or trade the Parent Company's shares or securities. Significant transactions of the retirement fund, particularly with related parties, are approved by the Trust Investment Committee. Voting rights over the Parent Company's shares are exercised by an authorized trust officer.

18. Commitments and Contingent Liabilities

In the normal course of operations of the Group, there are outstanding commitments and contingent liabilities and bank guarantees that are not reflected in the financial statements. The Group does not anticipate losses that will materially affect its financial position and financial performance as a result of these transactions.

There are several suits and claims that remain unsettled. Management believes, based on the opinion of its legal counsels, that the ultimate outcome of such cases and claims will not have a material effect on the Group's financial position and financial performance.

Regulatory Reporting

The following is a summary of the Group's commitments and contingent liabilities at their equivalent peso contractual amounts:

	September 30, 2018	December 31, 2017
Committed loan line	**₱52,107,359**	₱83,859,911
Trust department accounts	**46,075,679**	50,193,693
Unused commercial letters of credit	**28,969,470**	24,836,816
Unutilized credit limit of credit cardholders	**17,823,006**	13,214,507
Outstanding guarantees	**2,215,345**	1,220,768
Inward bills for collection	**659,835**	500,300
Late deposit/payment received	**534,384**	5,539
Outward bills for collection	**450,234**	294,738
Others	**112,517**	86,477

19. Financial Performance

The following basic ratios measure the financial performance of the Group and the Parent Company:

	For the Period Ended September 30	
	2018	2017
Return on average equity	**8.14%**	9.80%
Return on average assets	**1.23**	1.42
Net interest margin	**3.23**	3.18

Basic earnings per share amounts were computed as follows:

	For the Period Ended September 30	
	2018	2017
a. Net income attributable to the equity holders of the Parent Company	**₱6,538,494**	₱7,384,264
b. Weighted average number of outstanding common shares*	**753,538,887**	753,538,887
c. Earnings per share	**₱8.67**	₱9.80

**in absolute amounts*

As of September 30, 2018 and 2017, the Parent Company has no potentially dilutive common shares.

20. Notes to the Statement of Cash Flows

The amounts of interbank loans receivables and securities purchased under agreements to resell considered as cash and cash equivalents as of September 30, 2018 and December 31, 2017 follow:

	2018	2017
Interbank loans receivable and SPURA	**₱2,269,620**	₱5,578,217
Interbank loans receivable and SPURA not considered as cash and cash equivalents	–	110,430
	₱2,269,620	₱5,688,647

As of September 30, 2018 and December 31, 2017, the Bank recognized an allowance for credit losses from 'Due from other banks' and 'Interbank loans receivable and securities purchased under agreements to resell' as follows:

	2018	2017
Due from other banks	**₱2,307**	₱–
Interbank loans receivable and SPURA	**4,097**	–
	₱6,404	₱–

As discussed in Note 10, the Parent Company reclassified certain HTC securities to financial assets at FVTOCI due to change in business model in managing its financial assets in accordance with the final version of PFRS 9.

Significant non-cash transactions of the Group include foreclosures of investment properties and chattels.

Reconciliation of liabilities arising from financing activities follows:

	Consolidated					
		Cashflows		**Non-cash changes**		
	Beginning Balance	**Proceeds/ Availments**	**Payments**	**Foreign exchange movement**	**Amortization of transaction costs**	**Ending Balance**
September 30, 2018						
Bills payable and SSURA	**₱131,179,238**	**₱1,919,235,407**	**₱1,966,813,253**	**₱9,488,857**	**₱–**	**₱93,090,249**
Notes payable	**14,948,402**	**16,144,347.00**	**–**	**1,162,267**	**11,653**	**32,266,669**
LTNCD	**18,526,475**	**5,727,494**	**–**	**–**	**19,446**	**24,273,415**
Subordinated note	**9,950,814**	**–**	**–**	**–**	**4,778**	**9,955,592**
	₱174,604,929	**₱1,941,107,248**	**₱1,966,813,253**	**₱10,651,124**	**₱35,877**	**₱159,585,925**

	Consolidated					
		Cashflows		Non-cash changes		
	Beginning Balance	Proceeds/ Availments	Payments	Foreign exchange movement	Amortization of transaction costs	Ending Balance
September 30, 2017						
Bills payable and SSURA	₱157,992,642	₱1,468,458,327	₱1,466,116,914	₱3,752,798	₱–	₱164,086,853
Notes payable	14,869,397	–	–	327,566	12,826	15,209,789
LTNCD	9,972,738	–	–	–	8,214	9,980,952
Subordinated note	9,944,724	–	–	–	4,523	9,949,247
	₱192,779,501	₱1,468,458,327	₱1,466,116,914	₱4,080,364	₱25,563	₱199,226,841

21. Segment Information

The Group’s operating businesses are recognized and managed separately according to the nature of services provided and the different markets served with each segment representing a strategic business unit.

The Group derives revenues from the following main operating business segments:

Financial Markets Segment - this segment focuses on providing money market, foreign exchange, financial derivatives, securities distribution, asset management, trust and fiduciary services, as well as the management of the funding operations for the Group.

Wholesale Banking Segment - this segment addresses the top 1,000 corporate, institutional, and public sector markets. Services include relationship management, lending and other credit facilities, trade, cash management, deposit-taking and leasing services provided by the Group. It also provides structured financing and advisory services relating to debt and equity capital raising, project financing, and mergers

and acquisitions. The Group's equity brokerage operations are also part of this segment.

Retail Banking Segment - this segment addresses the individual, retail, small-and-medium enterprise and middle markets. It covers deposit-taking and servicing, commercial and consumer loans, credit card facilities and bancassurance. The Group includes SBFCI as part of this segment.

All Other Segments - this segment includes but not limited to branch banking and other support services. Other operations of the Group comprise the operations and financial control groups.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on net income after taxes, which is measured in a manner consistent with PFRS as shown in the statements of income. This is regularly reported to the Group's Chief Operating Decision Maker. The Group's Chief Operating Decision Maker is the Parent Company's President and Chief Executive Officer.

Segment assets are those operating assets that are employed by a segment in its operating activities and that either directly attributable to the segment or can be allocated to the segment on a reasonable basis.

Segment liabilities are those operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

The Group's revenue-producing assets are located in the Philippines (i.e., one geographical location), therefore, geographical segment information is no longer presented.

The Group has no significant customers which contribute 10.0% or more of the consolidated revenue, net of interest expense.

The segment results include internal transfer pricing adjustments across business units as deemed appropriate by management. Transactions between segments are conducted at estimated market rates on an arm's length basis. Interest is charged/credited to the business units based on a pool rate which approximates the marginal cost of funds.

Segment information follows (amounts in millions):

	For the Period Ended September 30, 2018				
	Financial Markets	**Wholesale Banking**	**Retail Banking**	**All Other Segments**	**Total**
Statement of Income					
Net interest income:					
Third party	**₱3,980**	**₱8,625**	**₱3,025**	**(₱346)**	**₱15,284**
Intersegment	**(1,605)**	**(3,102)**	**1,739**	**2,968**	**–**
	2,375	**5,523**	**4,764**	**2,622**	**15,284**
Noninterest income	**606**	**1,178**	**1,893**	**(185)**	**3,492**
Revenue - net of interest expense	**2,981**	**6,701**	**6,657**	**2,437**	**18,776**
Noninterest expense	**1,799**	**4,483**	**3,150**	**979**	**10,411**
Income before income tax	**1,182**	**2,218**	**3,507**	**1,458**	**8,365**
Provision for income tax	**513**	**133**	**366**	**815**	**1,827**
Non-controlling interest in net income of subsidiaries	**–**	**–**	**–**	**–**	**–**
Net income for the period attributable to the Parent Company	**₱669**	**₱2,085**	**₱3,141**	**₱643**	**₱6,538**
Other Segment Information					
Capital expenditures	**₱4**	**₱286**	**₱344**	**₱250**	**₱884**

	For the Period Ended September 30, 2018				
	Financial Markets	**Wholesale Banking**	**Retail Banking**	**All Other Segments**	**Total**
Depreciation and amortization	**₱4**	**₱270**	**₱325**	**₱236**	**₱835**
Provision for (recovery of) credit and impairment losses	**₱–**	**₱394**	**₱468**	**(₱637)**	**₱225**

	For the Period Ended September 30, 2017				
	Financial Markets	Wholesale Banking	Retail Banking	All Other Segments	Total
Statement of Income					
Net interest income:					
Third party	₱5,503	₱7,446	₱1,738	(₱350)	₱14,337
Intersegment	(633)	(2,901)	1,210	2,324	–
	4,870	4,545	2,948	1,974	14,337
Noninterest income	1,187	1,032	1,131	171	3,521
Revenue - net of interest expense	6,057	5,577	4,079	2,145	17,858
Noninterest expense	1,029	3,890	2,670	1,827	9,416
Income before income tax	5,028	1,687	1,409	318	8,442
Provision for income tax	254	333	181	290	1,058
Non-controlling interest in net income of subsidiaries	–	–	–	–	–
Net income for the period attributable to the Parent Company	₱4,774	₱1,354	₱1,228	₱28	₱7,384
Other Segment Information					
Capital expenditures	₱9	₱222	₱443	₱260	₱934
Depreciation and amortization	₱6	₱158	₱315	₱185	₱664
Provision for (recovery of) credit and impairment losses	₱–	₱398	₱444	(₱455)	₱387

	For the Quarter Ended September 30, 2018				
	Financial Markets	**Wholesale Banking**	**Retail Banking**	**All Other Segments**	**Total**
Statement of Income					
Net interest income:					
Third party	**₱1,244**	**₱2,973**	**₱1,144**	**(₱103)**	**₱5,258**
Intersegment	**(601)**	**(950)**	**679**	**872**	**–**
	643	**2,023**	**1,823**	**769**	**5,258**
Noninterest income	**188**	**437**	**680**	**(67)**	**1,238**
Revenue - net of interest expense	**831**	**2,460**	**2,503**	**702**	**6,496**
Noninterest expense	**602**	**1,545**	**1,049**	**417**	**3,613**
Income before income tax	**229**	**915**	**1,454**	**285**	**2,883**
Provision for income tax	**183**	**55**	**152**	**247**	**637**
Non-controlling interest in net income of subsidiaries	**–**	**–**	**–**	**–**	**–**
Net income for the period attributable to the Parent Company	**₱46**	**₱860**	**₱1,302**	**₱38**	**₱2,246**
Other Segment Information					
Capital expenditures	**₱–**	**₱62**	**₱61**	**₱43**	**₱166**
Depreciation and amortization	**₱1**	**₱96**	**₱105**	**₱76**	**₱278**
Provision for (recovery of) credit and impairment losses	**₱–**	**₱132**	**₱158**	**(₱153)**	**₱137**

	For the Quarter Ended September 30, 2017				
	Financial Markets	Wholesale Banking	Retail Banking	All Other Segments	Total
Statement of Income					
Net interest income:					
Third party	₱1,770	₱2,723	₱648	(₱104)	₱5,037
Intersegment	(127)	(1,129)	434	822	–
	1,643	1,594	1,082	718	5,037
Noninterest income	(53)	243	356	101	647
Revenue - net of interest expense	1,590	1,837	1,438	819	5,684
Noninterest expense	277	1,022	1,049	903	3,251
Income before income tax	1,313	815	389	(84)	2,433
Provision for income tax	109	114	78	(9)	292
Non-controlling interest in net income of subsidiaries	–	–	–	–	–
Net income for the period attributable to the Parent Company	₱1,204	₱701	₱311	(₱75)	₱2,141
Other Segment Information					
Capital expenditures	₱2	₱82	₱144	₱96	₱324
Depreciation and amortization	₱1	₱59	₱103	₱69	₱232
Provision for (recovery of) credit and impairment losses	₱–	₱133	₱143	(₱112)	₱164

Statement of Financial Position as of September 30, 2018

	Financial Markets	**Wholesale Banking**	**Retail Banking**	**All Other Segments**	**Total**
Total assets	**₱291,673**	**₱338,033**	**₱93,066**	**₱10,225**	**₱732,997**
Total liabilities	**₱154,702**	**₱291,540**	**₱159,237**	**₱18,197**	**₱623,676**

Statement of Financial Position as of September 30, 2017

	Financial Markets	Wholesale Banking	Retail Banking	All Other Segments	Total
Total assets	₱350,233	₱324,369	₱52,452	₱12,263	₱739,317
Total liabilities	₱203,179	₱296,026	₱128,722	₱8,195	₱636,122

The Group’s share in net income (loss) of a joint venture is included under All Other Segments.

22. Events after the Reporting Period

On October 30, 2018, the Parent Company’s BOD approved cash dividends of ₱1.50 per common share, representing regular semestral cash dividend of ₱1.00 per share and a special cash dividend of ₱0.50 per share, with record date on November 19, 2018 and payment date on November 29, 2018.

Annex 7

SECURITY BANK CORPORATION AND SUBSIDIARIES
AGING OF LOANS AND RECEIVABLES
AS OF SEPTEMBER 30, 2018
(In thousands)

Type of Loan	Current	90 days or less	91 to 180 days	181 days to 1 year	More than1 year	Total
Loans and Receivables	₱400,372,215	₱1,989,633	₱884,883	₱539,505	₱917,890	₱404,704,126
Less: Allowance for Probable Losses						4,073,341
TOTAL						**₱400,630,785**

Annex 8

SECURITY BANK CORPORATION AND SUBSIDIARIES

FINANCIAL SOUNDNESS INDICATORS

	September 30, 2018	December 31, 2017
Liquid to total assets	**43.44**	44.88
Loans (net) to Deposit Ratio	**85.67**	89.61
Non-performing loans ratio	**0.36****	0.02*
Non-performing loan (NPL) cover	**120.42****	239.37*
Debt-to-equity ratio	**5.71**	5.61
Asset-to-equity ratio	**6.71**	6.61

	September 30, 2018	September 30, 2017
Return on assets	**1.23**	1.42
Return on equity	**8.14**	9.80
Net interest margin	**3.23**	3.18
Cost to income ratio	**54.24**	50.56
Interest rate coverage ratio	**1.93**	2.22

** Computed based on BSP Circular 941.*

*** Computed based on BSP Circular 941 and 1011.*

Item 2. Management's Discussion and Detailed Analysis of Financial Condition and Results of Operations

Key Performance Indicators

The Bank monitors its performance and benchmarks itself with the other players in the banking industry in terms of the following indicators:

Key Performance Indicators:	**September 30, 2018**	December 31, 2017
Capital Adequacy		
Capital to Risk Assets Ratio	**18.58%**	18.66%
Asset Quality		
Non-performing Loan (NPL) Ratio	**0.36**	0.02
Non-performing Loan (NPL) Cover	**120.42**	239.37
Liquidity		
Liquid Assets to Total Assets	**43.44**	44.88
	For the Period Ended September 30	
	2018	2017
Profitability		
Return on Average Equity	**8.14**	9.80
Net Interest Margin	**3.23**	3.18

The manner by which the Bank calculates the above indicators is as follows:

Key Performance Indicator	Formula
Capital to Risk Assets Ratio	BSP prescribed formula: Total Qualifying Capital Market, Credit and Operational Risk Weighted Exposures
Non-performing Loan (NPL) Ratio	Non-performing Loans (net of specific allowance) Gross Loans
Non-performing Loan (NPL) Cover	Allowance for Probable Losses Loans Non-performing Loans (gross of specific allowance)
Liquid Assets to Total Assets	Total Liquid Assets Total Assets
Return on Average Equity	Annualized Net Income Attributable to Parent Company Average Total Equity Attributable to Parent Company for the Period
Net Interest Margin	Annualized Net Interest Income Average Interest Earning Assets for the Period

Analysis of Consolidated Statements of Financial Position as of September 30, 2018 and December 31, 2017

Total Assets increased by 5.6% to ₱733.0 billion on account of increases in Cash and Other Cash Items, Due from Bangko Sentral ng Pilipinas, Due from Other Banks, Derivative Assets Designated as Hedges, Financial Assets at Fair Value through Other Comprehensive Income, Loans and Receivables, Investment in a Joint Venture, Investment Properties, Intangible Assets and Other Assets tempered by decreases in Interbank Loans Receivable and Securities Purchased Under Resale Agreements (SPURA) with the Bangko Sentral ng Pilipinas (BSP), Financial Assets at Fair Value through Profit or Loss, Investment Securities at Amortized Cost, Property and Equipment and Deferred Tax Assets.

Increase in **Cash and Other Cash Items** by ₱378.1 million or 4.8% can be attributed to the Bank's daily operations and increase in **Due from BSP** by ₱5.5 billion or 9.6% is due to asset-liability management. **Due from Other Banks** increased by 5.6% or P384.4 million due to increased level of working balances with counterparty banks. **Interbank Loans Receivable and SPURA with the BSP** decreased by 60.1% or ₱3.4 billion due to decreased level of placements.

Financial Assets at Fair Value Through Profit or Loss decreased by ₱1.1 billion or 24.1% to ₱3.5 billion due to trading related activities of the Bank. **Derivative Assets Designated as Hedges** increased to ₱846.2 million from nil in 2017**. Financial Assets at Fair Value through Other Comprehensive Income** increased by ₱19.5 billion to ₱19.7 billion due to reclassifications from HTC to FVTOCI category due to updated business model in managing financial assets.

Investment Securities at Amortized Cost decreased by 6.6% or ₱15.1 billion due to reclassifications from HTC to FVTOCI category due to updated business model in managing financial assets of the Parent Company.

Loans and Receivables increased by 8.2% to ₱400.6 billion from ₱370.2 billion in 2017.

Property and Equipment decreased by 1.2% to ₱4.1 billion, while **Investment Properties** increased by 0.3% to ₱793.6 million due to real and other properties foreclosed during the period.

Deferred Tax Assets decreased by 32.3% from ₱1.8 billion as of year-end 2017. **Intangible Assets** grew by 14.4% to ₱2.3 billion with the acquisition of additional software costs during the period.

Other Assets increased by 72.4 % to ₱4.5 billion due to increase in cash collaterals related to Bank's trading activities.

Total Liabilities increased by 5.9% or ₱34.7 billion to ₱623.7 billion on account of increases in Deposit Liabilities, Financial Liabilities at Fair Value through Profit or Loss, Margin Deposits and Cash Letters of Credit, Manager's and Certified Checks Outstanding, Notes Payable, Subordinated Note and Accrued Interest, Taxes and Other Expenses and Other Liabilities, tempered by decreases in Bills Payable and Securities Sold Under Repurchase Agreements, Acceptances Payable, and Income Tax Payable.

Deposit Liabilities grew by 13.2% from ₱413.1 billion as of year-end 2017 to ₱467.6 billion contributed by increases in Demand, Savings Deposit and Long-term Negotiable Certificates of Deposit partly offset by decrease in Time Deposits.

Financial Liabilities at Fair Value through Profit or Loss increased by 5.1% to ₱2.1 billion attributable to higher valuation of the Bank's derivative liabilities. **Bills Payable and Securities Sold Under Repurchase Agreements** dropped by 29.0% to ₱93.1 billion due to decrease in the Bank's repo transactions.

Acceptances Payable decreased by 18.8% to ₱555.6 million. **Margin Deposits and Cash Letters of Credit** increased by 11.8% to ₱726.7 million. **Manager's and Certified Checks Outstanding** at ₱3.7 billion went down by ₱126.6 million.

Income Tax Payable decreased to ₱292.4 million from year-end 2017's ₱681.1 million due to lower income tax liability for the third quarter of 2018 versus the last quarter of 2017. **Notes Payable** increased by 115.9% or ₱17.3 billion due to additional issuance amounting to ₱16.1 billion (USD297.7 million), amortization and foreign currency translation adjustment. **Subordinated Note** increased slightly by ₱4.8 million due to amortization of debt issue costs. **Accrued Interest, Taxes and Other Expenses** increased by 22.2% to ₱4.9 billion. **Other Liabilities** went up by 3.5% to ₱8.4 billion due to lower payable to brokers.

Total Equity grew by 4.0% to ₱109.3 billion on account of net income during the period. **Surplus Reserves** went up by ₱1.2 billion. **Surplus** was up by 6.3% due to the net income during the period. **Net Unrealized Gain on Financial Assets at Fair Value through Other Comprehensive Income of the Parent** decreased by 734.9% while that **of the Subsidiaries** also decreased by 55.3% due to decrease in market valuation of outstanding debt securities purchased and transferred from HTC to financial assets at FVTOCI. **Cumulative Foreign Currency Translation** grew to ₱58.3 million.

The **Capital Adequacy Ratio (CAR)** is 18.6% in September 2018. This is well above BSP minimum requirement of 10% and international standard of 8%, indicative of the sufficiency of the Bank's capital to support the current level of its risk assets.

Analysis of Consolidated Statements of Income for the Periods Ended September 30, 2018 and 2017

Net income attributable to the Bank's equity holders amounted to ₱6.5 billion for the period ended September 30, 2018 from a year ago level of ₱7.4 billion. This translates to earnings per share of ₱8.67 from ₱9.80 for the period ended September 30, 2017.

Interest Income
Interest Income ended higher than prior period by 14.1% or ₱3.0 billion mainly on account of increase in loan-related activities during the period. **Interest Income on Loans and Receivables** grew by 34.7% or ₱4.3 billion due to expansion in Loans & Receivables on a period-on-period basis. **Interest Income on Financial Investments** decreased by ₱1.1 billion or 13.4%, on account of lower securities portfolio. Increase in **Interest Income on Interbank Loans Receivables and Securities Purchased under Resale Agreements with the Bangko Sentral ng Pilipinas** by 0.7% or ₱0.7 million was due to the increase in volume of placements during the period**. Interest Income on Deposits with Banks and Others** dropped by 73.5% to ₱76.4 million due to decrease in transactions.

Interest Expense
Interest Expenses went up by 29.6% or ₱2.1 billion from prior period. **Interest Expense on Deposits** increased by 46.7% or ₱1.8 billion due to increase in deposit volume on a period-on-period basis. **Interest Expense on Derivative Instruments** went up by 13.6%. **Interest Expense on Subordinated Note, Bills Payable and Securities Sold under Repurchase Agreements and Other Borrowings** grew by 8.9% or ₱239.9 million due to increase in volume of transactions.

Net Interest Income increased to ₱15.3 billion, a 6.6% or ₱946.8 million growth compared to 2017 on a period-on-period basis.

Other Income
Other Income went down to ₱3.5 billion due to lower **Gain on Disposal of Investments at Amortized Cost** and **Trading and Securities Gains**, which declined by ₱627.3 million to ₱476.4 million. **Service Charges, Fees and Commissions** grew by ₱371.2 million or 23.0% due to higher transaction volumes, **Foreign Exchange Gains** reflected a decline of ₱65.6 million, and **Profit**

from Assets Sold/Exchanged increased by ₱12.9 million during the period on account of higher gains on acquisition and sale of foreclosed properties. **Rent Income** increased by 49.6% due to rental of Bank properties. **Miscellaneous Income** increased by ₱178.1 million or 50.0%. **Share in Net Income of a Joint Venture** of ₱20.0 million is attributable to the Bank's share in the net income of SBM Leasing, Inc. during the period.

Operating Expenses
Operating expenses (excluding provisions for credit and impairment losses) were higher by 12.8% or ₱1.2 billion. **Taxes and Licenses** and **Occupancy Costs** increased by 12.5% and 17.9%, respectively. **Compensation and Fringe Benefits** increased by 5.4% while **Provision for Credit Losses** decreased by ₱179.8 million. **Depreciation and Amortization, Amortization of Software Costs** and **Miscellaneous Expenses** increased by 25.9%, 45.2% and 15.8%, respectively. **Recovery of impairment losses** decreased to ₱2.1 million from ₱20.1 million in 2017.

Provision for Income Tax
Provision for Income Tax amounted to ₱1.8 billion for the period ended September 30, 2018 or 72.7% higher than ₱769.2 million reported in 2017 on a period-on-period basis.

Comprehensive Income
Total Comprehensive Income for the period ended September 30, 2018 amounted to ₱5.2 billion decreased by 28.4% compared to ₱7.2 billion in 2017 on a period-on-period basis on account of lower net income and net unrealized gain on financial assets at fair value through other comprehensive income.

Liquidity

The Group's liquidity is more than adequate with liquid assets to total assets ratio of 43.4% as of September 30, 2018. The Group does not anticipate any cash flow or liquidity problems within the next twelve (12) months, and is not in default or breach of any note, loan, lease or other indebtedness or financing arrangement requiring it to make payments. All payables have been paid by the Group within the stated terms. There are no known trends, demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the Group's liquidity increasing or decreasing in any material way.

Commitments and Contingent Liabilities

The Group has outstanding commitments, contingent liabilities, bank guarantees and tax assessments that arose from the normal course of operations. The Group does not anticipate losses that will materially affect its financial position and results of operations as a result of these transactions.

Material Commitments for Capital Expenditures

The Bank's commitments for capital expenditures will be funded out of cash flows from operations. This covers investments in electronic systems to comply with regulatory requirements (e.g. electronic money laundering monitoring system), investments in other systems (e.g. credit evaluation system), upgrades of existing systems (e.g. telecommunications system), expansion of the Bank's electronic banking channels, ATM installations, renovation or relocation or branch premises, and investments for new branches.

Material Impact on Income from Continuing Operations

In the normal course of operations, the Bank's activities are affected by changes in interest rates, foreign currency exchange rates and other market changes. The Bank follows a prudent policy on managing its assets and liabilities so as to ensure that exposure to fluctuations in interest rates and foreign currency exchange rates are kept within acceptable limits and within regulatory guidelines.

Significant Elements of Income or Loss that did not arise from Continuing Operations

There are no significant elements of income or loss that did not arise from continuing operations of the Group.

Seasonal aspects that have a material effect on the financial condition or results of operations.

The Group's financial position or results of operations are not affected by seasonal aspects.