building strengths...
nurturing growth

Philippine National Bank

2006 ANNUAL REPORT

About the Cover

building strengths... nurturing growth

As resilient and majestic as the bamboo, PNB has resolutely pursued its twin business strategies of building on strengths, while at the same time, nurturing growth. This twin strategy engendered a judicious balancing act between long-term results and short-term gains; between managing for the future and achieving immediate operational and financial gains.

The focus for 2007 is to build on established core competencies. However to ensure its steady growth through the implementation of set programs, the company is also firm in its resolve to shatter perceived limitations. The goal is not just to perform, but to excel.

Revered Chinese poets describe bamboo as firm and straight, relating these features to people's moral characteristics such as grittiness, uprightness, modesty and openness.

Eventually, scholars began comparing bamboo to men of moral integrity who are called junzi in Chinese. In Chinese culture, junzi is said to be the highest title any person could attain.

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Mission and Vision

We are a leading, dynamic Filipino financial services group with a global presence committed to delivering a whole range of quality products and services that will create value and enrich the lives of our customers, employees, shareholders and the communities we serve.

Vision for 2010 and Beyond

To be the most admired financial services organization in the country in terms of:

- Financial Performance – rank #1 or #2 in its businesses in terms of return on equity
- Innovativeness – in products, services, distribution and the use of cutting-edge technology
- Customer Perception – the preferred financial-services provider
  – customer-centered organization with a passion for service excellence
- Social Responsibility – the employer of choice, a good corporate citizen and partner in nation-building
- Long-Term Vision – developing competitive advantage on a sustained basis by anticipating changes in customer's preferences and in the manner of doing business

Consolidated Financial Highlights

(In Thousand Pesos, Except Per Share Amounts)

	December 31	
	2006	2005
Operating Results		
Gross Earnings	20,172,979	17,550,484
Total Expenses	19,352,950	6,922,946
Net Income	820,029	627,538
Financial Condition		
Total Resources	243,471,065	222,658,250
Loans and Receivables - net	83,592,219	80,072,004
Deposit Liabilities	181,667,692	167,826,777
Capital Funds	24,756,275	22,909,272
Per Share		
Earnings Per Share		
Basic	1.42	1.08
Diluted	1.42	1.08
Book Value Per Share		
With Revaluation Increment on Land and Buildings	43.01	39.80
Without Revaluation Increment on Land and Buildings	38.70	37.22

Report to the Shareholders

Report to the Shareholders

Sustaining a Four-year Profitability Streak

Your Bank's performance in the year 2006 can be summed up as a breakthrough in profitability and operational efficiency.

Consider these: We were able to achieve an unprecedented four years of sustained profitability. We posted a 16 percent increase in net income beginning in 2003 from P52 million to P820 million. We were able to reduce our non-performing assets by a hefty P20 billion. Our bank capital is stronger than ever at P24.8 billion by end-2006. This is translated to a 20 percent capital adequacy ratio.

We are proud to report that for 2006, your Bank continued to improve its performance way beyond expectations. The Bank took full advantage of the positive environment to solidify its path towards profitability and growth registering an annual net income of P820 million, more than 30 percent higher than the 2005 level. Without the provisions for impairment and credit losses, the Bank's actual net income for 2006 would have registered at P3.6 billion.

A P2.6 billion or 15 percent growth in revenue notably from lending activities, treasury and trust operations accounted for a major portion of the Bank's improved profitability in 2006. At the same time, your Bank successfully controlled costs and expenses without sacrificing operational efficiency. With the growth in revenue not being matched by a corresponding increase in operating expenses, the Bank's cost-to-income ratio notably improved from 74 percent in 2005 to a lower 66 percent in 2006.

Your Bank's success can be attributed to its faithful adherence to the three basic objectives of its business model–reducing non-performing assets, strengthening core businesses and increasing profitability.

Enhanced Asset Quality

With the successful sale of P20 billion of the Bank's non-performing assets under the Special Purpose Vehicle Facility consisting of P16 billion in non-performing loans, and P4 billion in acquired assets, your Bank's asset quality significantly improved.

We shall press on to further strengthen your Bank and leverage on what we do best, drawing much from the wealth of our experience and the lessons learned from the past.

Florencia G. Tarriela
Chairman

Your Bank's success can be attributed to its faithful adherence to the three basic objectives of its business model– reducing non-performing assets, strengthening core businesses and increasing profitability.

Omar Byron T. Mier
Vice Chairman, President and CEO

Non-performing loans were reduced to P12 billion, resulting in an NPL ratio of only 10.8 percent by end 2006. Simultaneously, acquired assets were trimmed down to P25 billion as of end-2006.

Solidifying Gains in Core Business

The Bank's deposit level increased by eight percent to P182 billion in 2006, mostly consisting of low-cost CASA deposits which went up by an aggregate of P14.6 billion. As a result, your Bank successfully maintained cost of funds at one of the lowest levels in the industry.

We are happy to report that the Bank maintained its stronghold in the overseas remittance business. Thus far, your Bank accounted for a substantial 19 percent of the country's OFW remittance business, reaffirming once again, its leadership in this core business.

Your Bank further strengthened its global imprint by establishing during the year two wholly-owned remittance subsidiaries in Austria and Spain, and two additional branches of PNB IFL in Shatin and in Yuen Long, both in Hong Kong, were opened.

Value-added service to our overseas remittance clients was provided by your Bank as it entered into remittance tie-ups with key partners. PNB Singapore fused strength with the United Overseas Bank (UOB) and the Development Bank of Singapore to make full use of UOB's bill payments services. Meanwhile, PNB Japan launched the Virtual Access Scheme in partnership with Mizuno (Misuho) Bank.

Moreover, PNB RCI in Los Angeles, California began offering web remittance service, allowing remitters to sign up online and send money from their US bank accounts via the Internet.

Your Bank relaunched the "Own a Philippine Home Loan Program," the only dollar-denominated currency financing facility available for overseas Filipinos who want to purchase residential properties in the Philippines.

On its lending activities, your Bank gained momentum in expanding the current loans portfolio of its Corporate Banking Sector with significant gains in the previously untapped growth area of Small and Medium Enterprise (SME). This expansion was achieved while the Bank

maintained its competitive edge in servicing the needs of local government unit market as well as big corporate accounts.

Priming for the Future

In preparation for your Bank's scheduled compliance with the global implementation of stricter capital rules under Basel II, PNB successfully completed its Tier 2 capital offering in 2006 where it raised P5.5 billion in new capital that added financial muscle to the Bank's capital base. The Tier 2 capital offering was two times oversubscribed indicating investors' overwhelming interest in the Bank.

PNB is also on its way to being one of the more technologically advanced banks in the country today by being the first bank in the Philippines to install the world-class core banking system called FLEXCUBE®. The system is the world's best-selling banking solution which helps run over 500 financial institutions in 105 countries.

The new core banking system is an end-to-end solution designed to automate the entire corporate and retail businesses of your Bank. PNB will leverage on the technological advances and global best practices of the new system in order to bring a world-class banking experience to all our customers.

With this new system, PNB will also be the first large Philipine bank to shift from an old and expensive mainframe based core banking system to a flexible open software platform that is cost-effective. Scalable, reliable, and secure, the new open system platform will significantly lower technology operating costs.

Thus, with this pioneering technology investment, we expect to post substantial savings and further enhance your Bank's operational capabilities.

Milestones and Recognition

For three years in a row, your Bank was awarded the highly-coveted Trusted Brand Award in the Gold Category by Readers' Digest, affirming the public's recognition of PNB as a trusted brand in the Philippine banking industry.

Also, for two years in succession, the BSP chose PNB for the Stakeholders Award for Outstanding Commercial Bank on OFW remittances. The citation recognized the integrity of PNB's data and the accuracy and timeliness of its reportage. Your Bank also received the Best Collecting Commercial Bank for OFW Remittances from the SSS Balikat ng Bayan Awards and Best Paying Commercial Bank for SSS pensioners.

Determined Drive to the Top

Looking forward to the future and guided by the corporate objectives to nurture growth and build on strength, we shall press on to further strengthen your Bank and leverage on what we do best, drawing much from the wealth of our experience and the lessons learned from the past.

President and CEO Omar Byron T. Mier receives the Stakeholders Award for Outstanding Commercial Bank on OFW remittances from BSP Governor and Monetary Board Chairman Amando M. Tetangco

These will fortify our capability to surmount the challenges we are sure to face in our determined drive to become bigger, stronger and among the top three most profitable banks of our country.

As part of our strategy in the next five years, we shall remain proactive in the areas of capital formation and operational efficiencies even as we continue to put premium on the professional growth of our own workforce.

We will proceed in pushing forward our strong brand name and corporate image through strategic advertising and promotions timed with our product launches and re-launches.

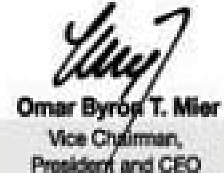
To better adapt to operational requirements in the future, your Bank invested in the latest banking technology, the Flexcube.

Equally important, we shall honor our commitment to empower our seasoned and highly effective management team.

Let us therefore express our most sincere appreciation to the members of the PNB family – our employees, the officers and members of the Board for each one's most valuable contribution in our continuing breakthrough in profitability and operational efficiency.

Together, we will soon realize a return to the premier position in the Philippine banking industry.

Florencia G. Tarriela
Chairman



Omar Byron T. Mier
Vice Chairman,
President and CEO

Operational Highlights

Operational Highlights

We succeed only as we identify in life...or in anything else, a single overriding objective, and make all other considerations bend to that one objective.

- Dwight D. Eisenhower (1890 - 1969)

With the success of its three-pronged strategy of reducing non-performing assets, strengthening core business and increasing profitability, your Bank was able to set the tone for building strategies and continually nurturing growth for the future.

RETAIL BANKING

In 2006, total deposits of the Retail Banking Sector greatly improved primarily as a result of an expansion in the lower-cost current and savings deposit accounts (CASA). This allowed the Bank to maintain its position as one of the industry's generator of low cost funds.

During the year, competitiveness was enhanced with the introduction of additional products designed for both corporate and retail customers. These included the Auto Debit Arrangement (ADA), using the Bank's e-Collect product. This facility provides a hassle-free settlement arrangement to pay recurring bills faster and with ease. Payment to billers, creditors, suppliers and other similar service providers are drawn automatically from a checking or savings account. Providing a safe, reliable, accurate and confidential mode of settlement, ADA simplifies the business cycles and positions the Bank as critical enabler between corporate customers and their trade partners.

Another product, Corporate e-Pay enables the Bank's corporate client to settle payments to multi-beneficiaries such as government, business partners, retail consumers and individuals.

The groundwork for branch expansion to better serve our clientele was laid out based on evolving regional business growth and ease of physical coverage.

The service shall be made available in various modes of electronic transmission to cater to varying comfort levels of a business or corporate entity ranging from file transfer protocol, portal or internet banking. With Corporate e-Pay, beneficiaries enjoy immediate access to payments due them via a direct credit to their PNB account.

Lastly, Interbank Fund Transfer is a payment gateway that allows movement of money from one deposit account to another deposit account maintained at two different banks. PNB account holders can conveniently transfer funds to and from other banks without the need to issue checks and perform over-the-counter transactions. Interbank Fund Transfer provides corporate customers an alternative option to manage disbursements to its suppliers or beneficiaries who are unable to maintain a deposit account with the Bank.

Meanwhile, the groundwork for branch expansion to better serve our clientele was laid out based on evolving regional business growth and ease of physical coverage. Branch sizing and re-classification were made to give emphasis on business potential and the appropriate business targets.

Relative to this, the scorecards of business managers and relationship officers were aligned with the distribution and volume goals of consumer loans (such as auto, housing personal loans and credit cards), on top of their deposit growth targets.

In the years ahead, we will continue to leverage on our low-cost deposit base advantage to further expand and accelerate loan growth in our consumer, small

and medium enterprise and government sectors. This will be done by enhancing our distribution capability for loans, trust and investment products, through our extensive branch network, two-thirds of which are deployed in key provincial cities.

Consistent with the new direction, the Bank relocated 11 branches last year to high-growth areas to fill the gap in the Bank's distribution network. Corollary to this, 48 new automated tellering machines were also installed to augment client servicing bringing PNB's total ATM network to 361 by end-2006.

INTERNATIONAL BANKING

Your Bank focused efforts on reaffirming its leadership in the remittance business as PNB garnered a 19 percent share in the total inward remittances to the country, representing US$ 2.4 billion being entrusted to and coursed through PNB in 2006.

In its quest to continually expand and enhance worldwide presence, the PNB Group opened four new offices abroad that raised the total number of overseas offices to 103 as of December 31, 2006. PNB International Finance Ltd. (PNB IFL) established two branches in Shatin and Yuen Long, both located in Hong Kong. The PNB Vienna Representative Office was upgraded with its replacement by PNB Austria Financial Services GmbH, a wholly-owned remittance subsidiary. The Bank also opened the PNB Global Filipino Remittance Spain, S.A. in Madrid to replace the PNB Madrid Representative Office and its Extension Office in Barcelona.

PNB Europe PLC, for its part, successfully secured approval from Banque de France for the establishment of a full-service PLC Paris Branch. Likewise, PNB Europe PLC was granted a license to offer cross-border transactions and establish tie-ups with other European banks in the 18 European Economic Area (EEA) member states. By end-2006, PNB Europe PLC's established tie-ups for cross-border transactions consisted of three EEA member states, namely: Ireland, Norway and Sweden.

PNB entered into synergistic remittance tie-ups with selected foreign and local institutions that allowed the Bank to introduce a number of alternative remittance pay-out and send-out channels to further enhance its appeal to our Overseas Filipino Workers. In Hong Kong, PNB Remittance Center Ltd (PNB RCL) entered into an agreement with Abenson Appliances where PNB remitters can make direct purchases from Abenson stores for delivery to their Philippine-based beneficiaries. PNB Singapore launched an Internet remittance service with the use of the bill payment services of United Overseas Bank and the Development Bank of Singapore/ POS Bank of Singapore. PNB Japan, on the other hand, partnered with Mizuno Bank to launch a "Virtual Access Scheme".

In North America, PNB Remittance Centers, Inc. (PNB RCI) in Los Angeles began offering its Web Remittance Service where remitters sign up online and send money

from their US bank accounts via the Internet. PNB Remittance Company Canada (PNB RCC) aside from similarly launching its own Internet and phone banking services, introduced a Bill Payment Scheme that allows remitters to use any Canadian bank ATM to fund their remittance. PNB RCC also launched a debit facility arrangement where remitters' Canadian bank accounts can be debited directly.

PNB New York started two additional modes on remitting funds using "Standing Payment Remittance Instructions" either through BillPay checks or fax. Furthermore, in line with a campaign of the Federal Reserve Board to motivate USA-based recipients of federal benefits to use the direct deposit system, PNB New York registered as a financial institution partner of GoDirect.

CORPORATE BANKING

The year 2006 provided the first real opportunity for the Bank to give more emphasis to targeting growth for its business loan portfolio by positioning its resources to embark on a more aggressive lending strategy. For better focus and control, business centers (initially those handling large corporate accounts) were reorganized in order to segregate the credit function from the marketing function for enhanced delivery systems.

In addition to big corporate accounts, the sector continued to nurture its long-established relationship with LGUs and GOCC accounts. However, it was in the relatively untapped small and medium enterprise (SME) sector where PNB's market penetration gained momentum. Significant growth prospects on the SME market started to be realized towards the end of the year. Also noteworthy are the various Commercial Lending Centers organized for both Metro Manila and provincial locations.

The Bank successfully acted as co-lead in a number of major loan syndications including, among other accounts, the P12.0 billion Meralco and US$65.0 million Luzon Hydro syndications. The Bank also participated in the Manila North Tollway term loan refinancing and the Petron Corporation term loan.

To ensure proper support for the newly-reorganized sector, the Bank's credit policies were amended making these more attuned to current market trends.

To ensure proper support for the newly-reorganized sector, the Bank's credit policies were amended making these more attuned to current market trends. Approving authorities were decentralized, a risk-adjusted pricing was implemented, and desired industry target markets were more clearly identified. Loan products were improved and repackaged to make these more competitive in the industry. New corporate banking products were introduced to stimulate loan growth such as Suppliers' Financing, Structured Trade Financing/Guarantees and LGU Contractor Financing. Marketing efforts were intensified through branch referrals, product briefings and participation in trade fairs. Corporate Banking is also packaging loans for key manning agencies to support the Bank's thrust to regain the top position in the OFW remittance business.

By end-2006, Corporate Banking's current loan portfolio grew by 23.3% with well diversified loan mix among LGUs, big corporate accounts and SMEs. With an P8.0 billion growth in current loans, the group's loan portfolio more actively contributed to the Bank's increased profitability during the year despite a scenario of substantial reduction in interest rates.

TREASURY

Trading operations continued to generate substantial revenues for the Bank resulting from higher investment portfolio levels in both the domestic and foreign securities market. The significant drop in the yields

of Philippine fixed income instruments during 2006 enabled your Bank to strategize and realize trading gains in both markets that strengthened overall profitability performance.

Treasury continued to pursue its build-up of competent professional traders / officers for an expanded reach, not only in trading activities but in its distribution and sales capabilities as well. These are all in line with the objective of providing alternative investment products/ instruments not only to our customers nationwide but also to those overseas as may be allowed by the pertinent regulations in their country of work or residence.

CONSUMER FINANCE

This was another growth area for your Bank in 2006 as direct marketing efforts led to the Consumer Loans portfolio expanding by 22% during the year, mainly accounted for by a 26% growth in housing loans and a 38% increase in auto loans that were made more attractive with the implementation of incentive programs. The Bank also launched the Sure Home Flexi Loan program which allows housing loan borrowers to avail of additional loans for personal consumption purposes.

Consumer Finance further enhanced the features and expanded the coverage of the Contract to Sell Financing Scheme to include regional / provincial real estate developers.

As part of the Bank's thrust to provide the widest range of banking and financial services to overseas Filipinos, the Bank relaunched the Own a Philippine Home Loan

Program, the only dollar-denominated currency financing facility available for overseas Filipinos desiring to acquire residential properties in the Philippines. The Global Filipino Auto Loan program was launched to enable overseas Filipinos to purchase automotive vehicles for the use of their loved ones in the Philippines.

To further improve customer service and expand its portfolio, Consumer Finance's organizational structure was streamlined to achieve faster turn-around time, efficient loan account monitoring and speedy resolution of customer concerns.

TRUST

Trust Banking Group (TBG) posted a 16.8% growth in Net Income in 2006 versus 2005. To sustain business volume and profitability during the year, TBG relied substantially on transactions of its Special Government Escrow Accounts and the Trusteeship of the bond flotations of various Local Government Units (LGUs).

TBG continued to offer its Unit Investment Trust Funds (UITFs) both domestically and overseas to gain wide acceptance. By yearend 2006, OFWs abroad and investors through the PNB branches jointly accounted for more than half of the Bank's outstanding UITF investments.

For its support system, TBG completed implementation in 2006 of the second phase of the Total Accounting

2006 witnessed a shared awareness that each one has an important contribution in building strengths, both personal and as part of the PNB corporate family to nurture the Bank's successful growth in the years to come.

and Portfolio Management System (TAPS) to expand coverage to all Trust accounts thus enhancing monitoring of all trust transactions as well as delivery of various trust services.

REMEDIAL MANAGEMENT

An integral part of PNB's continuing efforts toward improved profitability is the disposal of non-performing loans (NPL) that place a heavy drag on the Bank's earning capabilities. In 2006, the Bank successfully reduced its inventory of Non-Performing Loans through a P15.3 billion sale under the Special Purpose Vehicle Law.

Together with other NPL accounts that were either collected, restructured or subjected to the final option of foreclosure, the Bank's total NPL level was brought down to a manageable P12.1 billion by end 2006 from a high of P45.0 billion in 2003. With NPL ratio substantially reduced to only 10.8%, Remedial Management is pursuing further significant improvements in the Bank's NPL ratio with prospects for additional sales under the Special Purpose Vehicle Law.

ASSET MANAGEMENT

Your Bank continues to address the aggressive disposal of acquired assets. A total of 1,461 acquired assets with an aggregate book value of P5.02 billion were sold in 2006. These included P4.0 billion, which were part of the successful P20 billion sale of the Bank's non-performing assets under the Special Purpose Vehicle (SPV) Law.

To improve focus on the disposal of the variety of acquired assets, Asset Management segregated them into four different asset pools. Account handling has thus been customized for: traditional channels (negotiated sales, auction, biddings and cross selling), small assets, joint ventures and SPV sales.

During the year, broker accreditation increased by 48%. This led to broker-related transactions registering new highs with a 67% increase from 2005.

To expedite the disposal of foreclosed assets, further innovations were introduced such as in outsourcing for title consolidation and writ-of-possession.

The year also saw the near-completion of the sector's information technology support comprised of centralized, automated data processing management system. This would expedite disposal of the acquired assets and ensure proper asset administration with accurate and updated information.

IN RETROSPECT

2006 witnessed a shared awareness that each one has an important contribution in building strengths, both personal and as part of the PNB corporate family to nurture the Bank's successful growth in the years to come. The return to its premiere position in the Philippine banking industry is not far from reality.

Corporate Social Responsibility

Corporate Social Responsibility

PNB signs MOA to help Gawad Kalinga build homes around the country. Seen in photo are, from left, Gawad Kalinga National Coordinator Luis Oquiñena, Gawad Kalinga Executive Director Antonio Meloto, PNB President and CEO Omar Byron T. Mier, PNB FSVP and Treasury Group Head Ramon Lim, and PNB SVP and Asset Management Sector Head Christian Jerome Dobles.

In line with its commitment to service, PNB also attended to its corporate social responsibility Programs. During the year, the Bank forged a partnership with Gawad Kalinga to provide property donations, financial assistance and human resources to help build Gawad Kalinga communities in select areas with PNB branch offices. In addition, PNB employees contributed in their own humble way to assist typhoon Reming victims through savings collected from the Bank's Christmas Party budget.

PNB employees spend a day in GK Sunshineville Las Piñas

Financial Statements

Statement of Management's Responsibility
Independent Auditor's Report
Statements of Condition
Statements of Income
Statements of Changes in Equity
Statements of Cash Flows
Notes to Financial Statements
Disclosure on Risk Management
Corporate Governance

Statement of Management's Responsibility for Financial Statements

The management of Philippine National Bank and Subsidiaries (the Group) and of Philippine National Bank (the Parent Company) is responsible for all information and representations contained in the consolidated financial statements of the Group and the Parent Company financial statements which comprise the statements of condition as at December 31, 2006 and 2005 and the statements of income, statements of changes in equity and statements of cash flows for each of the three years in the period ended December 31, 2006. These financial statements have been prepared in accordance with Philippine Financial Reporting Standards (PFRS), except for the deferral of losses on sale of nonperforming assets (NPAs) to special purpose vehicles (SPVs) in 2004, 2005 and 2006 and the non-consolidation of the SPV that acquired the NPAs sold in 2006 and reflect amounts that are based on the best estimates and informed judgment of management with an appropriate consideration to materiality.

In this regard, management maintains a system of accounting and reporting which provides for the necessary internal controls to ensure that transactions are properly authorized and recorded, assets are safeguarded against unauthorized use or disposition and liabilities are recognized. The management likewise discloses to the Group's and Parent Company's audit committee and to its external auditor: (i) all significant deficiencies in the design or operation of internal controls that could adversely affect its ability to record, process, and report financial data; (ii) material weaknesses in the internal controls; and (iii) any fraud that involves management or other employees who exercise significant roles in internal controls.

The Board of Directors reviews the aforementioned financial statements before such statements are approved and submitted to the stockholders.

SyCip, Gorres, Velayo and Co., the independent auditor appointed by the stockholders, has audited the financial statements of the Group and the Parent Company in accordance with Philippine Standards on Auditing and has expressed its opinion on the fairness of presentation upon completion of such audit, in its report to the Board of Directors and stockholders.

FLORENCIA G. TARRIELA
Chairman of the Board

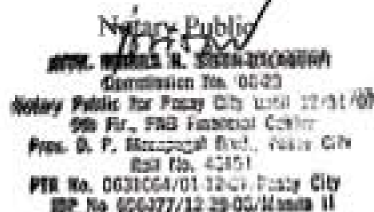
OMAR BYRON T. MIER
President & Chief Executive Officer

CARMEN G. HUANG
Executive Vice President & Chief Financial Officer

SUBSCRIBED AND SWORN to before me this APR 1 2 2007 day of April 2007 affiants exhibiting to me their Community Tax Certificates, as follows:

Names	CTC No.	Date of Issue	Place of Issue
Florencia G. Tarriela	07437377	January 10, 2007	Manila
Omar Byron T. Mier	15130241	January 17, 2007	Makati City
Carmen G. Huang	17662938	January 23, 2007	Makati City

Notary Public



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BOA/PRC Reg. No. 0001
SEC Accreditation No. 0012-FR-1

Independent Auditors' Report

The Stockholders and the Board of Directors
Philippine National Bank
PNB Financial Center
President Diosdado Macapagal Boulevard
Pasay City

We have audited the accompanying consolidated financial statements of Philippine National Bank and Subsidiaries (the Group) and the parent company financial statements of Philippine National Bank (the Parent Company), which comprise the statements of condition as at December 31, 2006 and 2005 and the statements of income, statements of changes in equity and statements of cash flows for each of the three years in the period ended December 31, 2006, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Philippine Financial Reporting Standards (PFRS). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Philippine Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Group's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

SGV & Co is a member practice of Ernst & Young Global

Opinion

As discussed in Notes 9 and 10 to the financial statements, to take advantage of incentives under Republic Act (RA) No. 9182, *The Special Purpose Vehicle Act of 2002*, and at the same time improve its chances of recovering from its non-performing assets (NPA), the Parent Company sold certain NPA to special purpose vehicle (SPV) companies. In accordance with regulatory accounting policies prescribed by the Bangko Sentral ng Pilipinas (BSP) for banks and financial institutions availing of the provisions of RA No. 9182, losses amounting to ₱1.9 billion in 2006, ₱4.3 billion in 2005 and ₱1.1 billion in 2004 from the sale of the NPA to the SPV companies, representing the allowance for impairment losses specifically provided for the NPA but released to cover other impairment losses of the Parent Company, were deferred and are being amortized over a ten-year period. As of January 1, 2005, upon adoption of Philippine Accounting Standards 39, the Parent Company did not set up the required allowance for impairment losses on the NPA sold in 2005.

Also, as discussed in Note 10, the required additional allowance as of December 31, 2006 on the NPA to be sold in 2007 amounting to ₱1.3 billion was not recognized by the Parent Company since it intends to defer the loss on such sale as allowed by BSP. Had the 2006 and 2004 impairment losses been charged against operations and the allowance for impairment losses on the sold NPA in 2005 been set up as of January 1, 2005 as required by PFRS, deferred charges and equity would have decreased by ₱6.9 billion and ₱8.2 billion, respectively, and allowance for credit losses would have increased by ₱1.3 billion as of December 31, 2006, deferred charges and equity would have decreased by ₱5.2 billion as of December 31, 2005, and the 2006 and 2004 net income would have decreased by ₱3.2 billion and ₱1.1 billion, respectively, and 2005 net income would have increased by ₱124.8 million.

The sale of the NPA to the SPV in 2006 is considered as a true sale under RA No. 9182 which qualified for derecognition under BSP regulatory reporting rules. However, PFRS requires that the accounts of the SPV that acquired the NPA of the Parent Company in 2006 should be consolidated into the Group's accounts. Had the accounts of the SPV been consolidated into the Group's accounts, total assets and minority interest in equity of consolidated entities would have increased by ₱30.0 million.

In 2004, the Parent Company received zero-coupon notes as part of the consideration for the non-performing loans sold. As of December 31, 2004, the loss of ₱1.9 billion representing the difference between the present value and the carrying value of these zero-coupon notes was deferred as allowed by BSP. PFRS requires that such difference be treated as loss and charged to current operations. Had such loss been recognized in 2004, equity as of December 31, 2004 would have decreased by ₱1.9 billion. Net income in 2004 would have decreased by ₱1.9 billion. On January 1, 2005, the Parent Company recognized the loss on the zero-coupon notes as a direct charge to deficit.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Group and of the Parent Company as of December 31, 2006 and 2005, and their financial performance and their cash flows for each of the three years in the period ended December 31, 2006 in accordance with PFRS, except for the effects on the 2006 and 2005 financial statements of not recognizing the losses on the NPA sold or to be sold to SPV companies as discussed in the sixth and seventh paragraphs, the effects in the 2006 consolidated financial statements of not consolidating the accounts of the SPV as discussed in the eighth paragraph, and the effects on the 2004 financial statements of not recognizing the loss on the zero-coupon notes received from the sale of NPL as discussed in the ninth paragraph.

SYCIP GORRES VELAYO & CO.

Wilson P. Tan

Wilson P. Tan
Partner
CPA Certificate No. 76737
SEC Accreditation No. 0100-AR-1
Tax Identification No. 102-098-469
PTR No. 0267394, January 2, 2007, Makati City

March 23, 2007

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

Statements of Condition

(In Thousand Pesos)

	Consolidated		Parent Company	
	December 31			
	2006	2005	2006	2005
ASSETS				
Cash and Other Cash Items (Note 17)	**₱4,820,155**	₱5,670,002	**₱4,753,539**	₱5,333,783
Due from Bangko Sentral ng Pilipinas (Note 17)	**12,566,759**	3,719,362	**12,566,759**	3,719,362
Due from Other Banks	**3,555,603**	5,494,793	**2,314,288**	4,897,004
Interbank Loans Receivable (Note 34)	**22,412,817**	16,914,045	**22,093,537**	16,881,081
Securities Held Under Agreements to Resell (Note 17)	**15,700,000**	12,300,000	**15,700,000**	12,300,000
Securities at Fair Value Through Profit or Loss (Note 8)	**1,137,835**	1,323,591	**1,109,137**	1,297,213
Loans and Receivables (Note 9)	**83,592,219**	80,072,004	**81,465,282**	77,895,771
Receivables from Special Purpose Vehicle (Note 10)	**1,361,074**	–	**1,361,074**	–
Available-for-Sale Investments (Notes 11 and 17)	**42,824,810**	40,242,135	**40,822,339**	38,084,187
Held-to-Maturity Investments (Note 11)	**1,554,368**	5,266,817	**1,420,044**	5,091,685
Property and Equipment				
At cost (Note 12)	**730,181**	788,877	**663,916**	700,345
At appraised value (Notes 12)	**15,846,819**	14,540,365	**15,846,819**	14,536,391
Investments in Subsidiaries and an Associate (Notes 2 and 13)	**801,838**	684,171	**5,439,520**	5,500,591
Investment Properties (Notes 2, 14 and 24)	**24,882,076**	26,847,767	**24,803,748**	26,765,021
Other Assets (Note 15)	**11,684,511**	8,794,321	**11,294,193**	8,442,814
TOTAL ASSETS	**₱243,471,065**	₱222,658,250	**₱241,654,195**	₱221,445,248
LIABILITIES AND EQUITY				
Liabilities				
Deposit Liabilities (Note 17)				
Demand	**₱17,867,651**	₱15,849,762	**₱17,823,367**	₱15,698,886
Savings	**140,233,120**	127,672,738	**140,085,759**	127,657,683
Time	**23,566,921**	24,304,277	**25,823,838**	26,739,311
	181,667,692	167,826,777	**183,732,964**	170,095,880
Bills and Acceptances Payable (Notes 2 and 18)	**10,955,948**	13,145,874	**10,361,715**	12,443,283
Accrued Taxes, Interest and Other Expenses (Note 19)	**4,899,427**	4,734,667	**4,823,811**	4,590,616
Subordinated Debt (Note 20)	**8,389,297**	2,958,437	**8,389,297**	2,958,437
Other Liabilities (Note 21)	**12,802,426**	11,083,223	**11,081,837**	10,062,154
TOTAL LIABILITIES	**218,714,790**	199,748,978	**218,389,624**	200,150,370

(Forward)

	Consolidated		Parent Company	
	December 31			
	2006	2005	**2006**	2005
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT COMPANY				
Capital stock (Notes 2 and 22)	**₱22,929,837**	₱22,929,837	**₱22,929,837**	₱22,929,837
Capital paid in excess of par value (Note 2)	**545,745**	545,745	**545,745**	545,745
Surplus reserves (Notes 2 and 27)	**512,204**	495,118	**512,204**	495,118
Deficit (Notes 2, 3 and 9)	**(2,603,474)**	(3,657,870)	**(3,980,989)**	(4,926,731)
Revaluation increment on land and buildings (Notes 2 and 12)	**2,471,113**	1,480,301	**2,471,113**	1,480,301
Accumulated translation adjustment (Notes 2 and 13)	**(114,869)**	217,479	**–**	–
Net unrealized gain on available-for-sale investments (Note 11)	**832,490**	810,619	**786,661**	770,608
Share in equity adjustments of an associate (Note 13)	**89,592**	–	**–**	–
Parent company shares held by a subsidiary	**(5,323)**	(5,323)	**–**	–
	24,657,315	22,815,906	**23,264,571**	21,294,878
MINORITY INTEREST	**98,960**	93,366	**–**	–
TOTAL EQUITY	**24,756,275**	22,909,272	**23,264,571**	21,294,878
TOTAL LIABILITIES AND EQUITY	**₱243,471,065**	₱222,658,250	**₱241,654,195**	₱221,445,248

See accompanying Notes to Financial Statements.

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

Statements of Income

(In Thousand Pesos, Except Earnings Per Share Amounts)

	Consolidated			Parent Company		
	Years Ended December 31					
	2006	2005	2004	**2006**	2005	2004
INTEREST INCOME ON						
Loans and receivables (Notes 9 and 28)	**₱7,147,512**	₱6,340,391	₱4,753,299	**₱6,962,022**	₱6,118,239	₱4,552,212
Investment securities (Note 11)	**4,148,546**	4,145,956	4,015,209	**4,053,146**	4,064,096	3,900,620
Deposits with banks and others	**761,144**	600,435	468,401	**640,566**	530,918	387,745
	12,057,202	11,086,782	9,236,909	**11,655,734**	10,713,253	8,840,577
INTEREST EXPENSE ON						
Deposit liabilities (Note 17)	**5,158,476**	4,728,664	4,845,233	**5,259,545**	4,789,760	4,863,293
Bills payable and other borrowings (Notes 18 and 20)	**1,554,215**	1,124,366	1,156,612	**1,505,089**	1,097,448	1,125,620
	6,712,691	5,853,030	6,001,845	**6,764,634**	5,887,208	5,988,913
NET INTEREST INCOME	**5,344,511**	5,233,752	3,235,064	**4,891,100**	4,826,045	2,851,664
Service fees and commission income	**2,767,462**	2,914,431	3,164,095	**1,796,203**	2,008,182	2,302,374
Service fees and commission expense	**102,479**	222,273	206,521	**92,280**	198,523	188,972
NET SERVICE FEES AND COMMISSION INCOME	**2,664,983**	2,692,158	2,957,574	**1,703,923**	1,809,659	2,113,402
Trading and investment securities gains - net (Note 8)	**2,071,623**	1,085,737	417,898	**2,047,021**	1,067,980	412,336
Foreign exchange gains - net	**1,076,607**	1,085,548	1,346,674	**630,806**	576,223	845,131
Miscellaneous (Notes 24 and 26)	**2,153,786**	1,328,321	1,711,392	**2,250,650**	1,148,531	1,582,377
TOTAL OPERATING INCOME	**13,311,510**	11,425,516	9,668,602	**11,523,500**	9,428,438	7,804,910
OTHER EXPENSES						
Compensation and fringe benefits (Notes 23 and 28)	**3,201,890**	3,150,009	3,333,362	**2,480,783**	2,485,397	2,701,819
Provision for impairment and credit losses (Note 16)	**2,802,283**	504,213	964,335	**2,734,736**	502,855	932,395
Taxes and licenses (Note 25)	**1,123,155**	1,001,462	868,844	**1,099,523**	973,867	841,498
Depreciation and amortization (Notes 12 and 14)	**1,111,364**	800,452	763,447	**1,066,999**	769,078	722,788
Occupancy and equipment-related costs (Note 24)	**832,172**	857,259	759,212	**672,435**	699,450	625,031
Miscellaneous (Notes 25 and 26)	**2,534,237**	2,642,531	2,032,943	**2,004,369**	2,015,035	1,463,837
TOTAL OPERATING EXPENSES	**11,605,101**	8,955,917	8,722,143	**10,058,845**	7,445,682	7,287,368
INCOME BEFORE SHARE IN NET INCOME OF AN ASSOCIATE AND INCOME TAX	**1,706,409**	2,469,599	946,459	**1,464,655**	1,982,756	517,542
SHARE IN NET INCOME OF AN ASSOCIATE (Note 13)	**46,299**	49,665	30,219	–	–	–
INCOME BEFORE INCOME TAX	**1,752,708**	2,519,264	976,678	**1,464,655**	1,982,756	517,542
PROVISION FOR INCOME TAX (Note 25)	**932,679**	1,891,726	618,142	**758,874**	1,731,778	478,793
NET INCOME	**₱820,029**	₱627,538	₱358,536	**₱705,781**	₱250,978	₱38,749
ATTRIBUTABLE TO:						
Equity Holders of the Parent Company (Note 31)	**₱814,435**	₱620,921	₱351,917			
Minority Interest	**5,594**	6,617	6,619			
	₱820,029	₱627,538	₱358,536			
Basic/Diluted Earnings Per Share Attributable to Equity Holders of the Parent Company (Note 31)	**₱1.42**	₱1.08	₱0.61			

See accompanying Notes to Financial Statements.

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

Statements of Changes in Equity

(In Thousand Pesos)

For the Year Ended December 31, 2006

	Consolidated											
	Attributable to Equity Holders of the Parent Company											
	Capital Stock (Notes 2 and 22)	Capital Paid in Excess of Par Value (Note 2)	Surplus Reserves (Notes 2 and 27)	Deficit (Notes 2, 3 and 9)	Revaluation Increment on Land and Buildings (Notes 2 and 12)	Accumulated Translation Adjustment (Notes 2 and 11)	Net Unrealized Gain on AFS Investments (Note 11)	Share in Equity Adjustments of an Associate (Note 13)	Parent Company Shares held by a Subsidiary	Total	Minority Interest	Total Equity
Balance at January 1, 2006	**₱22,329,837**	**₱545,745**	**₱495,118**	**(₱3,057,870)**	**₱1,480,301**	**₱217,479**	**₱810,619**	**₱–**	**(₱5,323)**	**₱22,815,906**	**₱93,366**	**₱22,909,272**
Net movement in unrealized gain on available-for-sale (AFS) investments	–	–	–	–	–	–	21,871	51,840	–	73,711	–	73,711
Net addition to revaluation increment	–	–	–	–	990,812	–	–	33,438	–	1,024,250	–	1,024,250
Amortization of deferred losses (Note 9)	–	–	–	(267,942)	–	–	–	–	–	(267,942)	–	(267,942)
Reversal of other deferred credits and unrealized profit on assets sold (Note 9)	–	–	–	524,989	–	–	–	–	–	524,989	–	524,989
Translation adjustment during the year	–	–	–	–	–	(332,348)	–	4,314	–	(328,034)	–	(328,034)
Total income and expenses recognized directly in equity	–	–	–	257,047	990,812	(332,348)	21,871	89,592	–	1,026,974	–	1,026,974
Net income for the year	–	–	–	814,435	–	–	–	–	–	814,435	5,594	820,029
Total income and expenses for the year	–	–		1,071,482	990,812	(332,348)	21,871	89,592	–	1,841,409	5,594	1,847,003
Transfer to surplus reserves (Note 27)	–	–	17,086	(17,086)	–	–	–	–	–	–	–	–
Balance at December 31, 2006	**₱22,329,837**	**₱545,745**	**₱512,204**	**(₱2,003,474)**	**₱2,471,113**	**(₱114,869)**	**₱832,490**	**₱89,592**	**(₱5,323)**	**₱24,657,315**	**₱98,960**	**₱24,756,275**

	Parent Company						
	Capital Stock (Notes 2 and 22)	Capital Paid in Excess of Par Value (Note 2)	Surplus Reserves (Notes 2 and 27)	Deficit (Notes 2, 3 and 9)	Revaluation Increment on Land and Buildings (Notes 2 and 12)	Net Unrealized Gain on AFS Investments (Note 11)	Total Equity
Balance at January 1, 2006	**₱22,329,837**	**₱545,745**	**₱495,118**	**(₱4,326,731)**	**₱1,480,301**	**₱769,808**	**₱21,294,878**
Net movement in unrealized gain on AFS investments	–	–	–	–	–	16,853	16,853
Amortization of deferred losses (Note 9)	–	–	–	(267,942)	–	–	(267,942)
Reversal of other deferred credits and unrealized profit on assets sold (Note 9)	–	–	–	524,989	–	–	524,989
Addition to revaluation increment	–	–	–	–	990,812	–	990,812
Total income and expenses recognized directly in equity	–	–	–	257,047	990,812	16,853	1,263,912
Net income for the year	–	–	–	705,781	–	–	705,781
Total income and expenses for the year	–	–	–	962,828	990,812	16,853	1,969,693
Transfer to surplus reserves (Note 27)	–	–	17,086	(17,086)	–	–	–
Balance at December 31, 2006	**₱22,329,837**	**₱545,745**	**₱512,204**	**(₱3,380,989)**	**₱2,471,113**	**₱786,661**	**₱23,264,571**

For the Year Ended December 31, 2005

	Consolidated										
	Attributable to Equity Holders of the Parent Company										
	Capital Stock (Notes 2 and 22)	Capital Paid in Excess of Par Value (Note 2)	Surplus Reserves (Notes 2 and 27)	Deficit (Notes 2, 3 and 9)	Revaluation Increment on Land and Buildings (Notes 2 and 12)	Accumulated Translation Adjustment (Notes 2 and 13)	Net Unrealized Gain (Loss) on AFS Investments (Note 11)	Parent Company Shares held by a Subsidiary	Total	Minority Interest	Total Equity
Balance at December 31, 2004	₱22,929,837	₱545,745	₱481,694	(₱267,142)	₱1,443,486	₱496,817	(₱142,456)	(₱5,323)	₱25,482,658	₱86,749	₱25,569,407
Cumulative effect of change in accounting for financial instruments - Philippine Accounting Standards (PAS) 39 (Note 3)	–	–	–	(2,075,890)	–	–	19,865	–	(2,056,025)	–	(2,056,025)
Balance at January 1, 2005	22,929,837	545,745	481,694	(2,343,032)	1,443,486	496,817	(122,591)	(5,323)	23,426,633	86,749	23,513,382
Net movement in unrealized gain on AFS investments	–	–	–	–	–	–	933,210	–	933,210	–	933,210
Net addition to revaluation increment	–	–	–	–	36,815	–	–	–	36,815	–	36,815
Translation adjustment during the year	–	–	–	–	–	(279,338)	–	–	(279,338)	–	(279,338)
Valuation loss on special purpose vehicle (SPV) subordinated notes (Note 9)	–	–	–	(1,868,299)	–	–	–	–	(1,868,299)	–	(1,868,299)
Amortization of deferred losses (Note 9)	–	–	–	(54,036)	–	–	–	–	(54,036)	–	(54,036)
Total income and expenses recognized directly in equity	–	–	–	(1,922,335)	36,815	(279,338)	933,210	–	(1,231,648)	–	(1,231,648)
Net income for the year	–	–	–	620,921	–	–	–	–	620,921	6,617	627,538
Total income and expenses for the year	–	–	–	(1,301,414)	36,815	(279,338)	933,210	–	(610,727)	6,617	(604,110)
Transfer to surplus reserves (Note 27)	–	–	13,424	(13,424)	–	–	–	–	–	–	–
Balance at December 31, 2005	₱22,929,837	₱545,745	₱495,118	(₱3,657,870)	₱1,480,301	₱217,479	₱810,619	(₱5,323)	₱22,815,906	₱93,366	₱22,909,272

	Parent Company						
	Capital Stock (Notes 2 and 22)	Capital Paid in Excess of Par Value (Note 2)	Surplus Reserves (Notes 2 and 27)	Deficit (Notes 2, 3 and 9)	Revaluation Increment on Land and Buildings (Notes 2 and 12)	Net Unrealized Gain on AFS Investments (Note 11)	Total Equity
Balance at December 31, 2004	₱22,929,837	₱545,745	₱481,694	(₱1,173,317)	₱1,439,328	(₱138,828)	₱24,084,459
Cumulative effect of change in accounting for financial instruments – PAS 39 (Note 3)	–	–	–	(2,068,633)	–	19,861	(2,048,772)
Balance at January 1, 2005	22,929,837	545,745	481,694	(3,241,950)	1,439,328	(118,967)	22,035,687
Net movement in unrealized gain on AFS investments	–	–	–	–	–	889,575	889,575
Net addition to revaluation increment	–	–	–	–	40,973	–	40,973
Valuation loss on SPV subordinated notes (Note 9)	–	–	–	(1,868,299)	–	–	(1,868,299)
Amortization of deferred losses (Note 9)	–	–	–	(54,036)	–	–	(54,036)
Total income and expenses recognized directly in equity	–	–	–	(1,922,335)	40,973	889,575	(991,787)
Net income for the year	–	–	–	250,978	–	–	250,978
Total income and expenses for the year	–	–	–	(1,671,357)	40,973	889,575	(740,809)
Transfer to surplus reserves (Note 27)	–	–	13,424	(13,424)	–	–	–
Balance at December 31, 2005	₱22,929,837	₱545,745	₱495,118	(₱4,926,731)	₱1,480,301	₱770,608	₱21,294,878

For the Year Ended December 31, 2004

	Consolidated										
	Attributable to Equity Holders of the Parent Company										
	Capital Stock (Notes 2 and 22)	Capital Paid in Excess of Par Value (Note 2)	Surplus Reserves (Notes 2 and 27)	Deficit (Notes 2, 3 and 9)	Revaluation Increment on Land and Buildings (Notes 2 and 12)	Accumulated Translation Adjustment (Notes 2 and 13)	Net Unrealized Gain (Loss) on AFS Investments (Note 11)	Parent Company Shares Held by a Subsidiary	Total	Minority Interest	Total Equity
Balance at January 1, 2004	₱22,929,837	₱545,745	₱445,146	(₱582,511)	₱1,446,862	₱433,702	₱128,058	(₱5,323)	₱25,341,516	₱80,130	₱25,421,646
Net deduction from revaluation increment	–	–	–	–	(3,376)	–	–	–	(3,376)	–	(3,376)
Net movement in unrealized loss on AFS investments	–	–	–	–	–	–	(270,514)	–	(270,514)	–	(270,514)
Translation adjustment during the year	–	–	–	–	–	63,115	–	–	63,115	–	63,115
Total income and expenses recognized directly in equity	–	–	–	–	(3,376)	63,115	(270,514)	–	(210,775)	–	(210,775)
Net income for the year	–	–	–	351,917	–	–	–	–	351,917	6,619	358,536
Total income and expenses for the year	–	–	–	351,917	(3,376)	63,115	(270,514)	–	141,142	6,619	147,761
Transfer to surplus reserves (Note 27)	–	–	36,548	(36,548)	–	–	–	–	–	–	–
Balance at December 31, 2004	₱22,929,837	₱545,745	₱481,694	(₱267,142)	₱1,443,486	₱496,817	(₱142,456)	(₱5,323)	₱25,482,658	₱86,749	₱25,569,407

	Parent Company						
	Capital Stock (Notes 2 and 22)	Capital Paid in Excess of Par Value (Note 2)	Surplus Reserves (Notes 2 and 27)	Deficit (Notes 2, 3 and 9)	Revaluation Increment on Land and Buildings (Notes 2 and 12)	Net Unrealized Gain (Loss) on AFS Investments (Note 11)	Total Equity
Balance at January 1, 2004	₱22,929,837	₱545,745	₱445,146	(₱1,175,518)	₱1,440,462	₱131,599	₱24,317,271
Net deduction from revaluation increment	–	–	–	–	(1,134)	–	(1,134)
Net movement in unrealized gain (loss) on AFS investments	–	–	–	–	–	(270,427)	(270,427)
Total income and expenses recognized directly in equity	–	–	–	–	(1,134)	(270,427)	(271,561)
Net income for the year	–	–	–	38,349	–	–	38,349
Total income and expenses for the year	–	–	–	38,349	(1,134)	(270,427)	(233,212)
Transfer to surplus reserves (Note 27)	–	–	36,548	(36,548)	–	–	–
Balance at December 31, 2004	₱22,929,837	₱545,745	₱481,694	(₱1,173,717)	₱1,439,328	(₱138,828)	₱24,084,059

See accompanying Notes to Financial Statements.

PHILIPPINE NATIONAL BANK AND SUBSIDIARIES

Statements of Cash Flows

(In Thousand Pesos)

	Consolidated			Parent Company		
	Years Ended December 31					
	2006	2005	2004	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES						
Income before income tax	₱1,752,708	₱2,519,264	₱976,678	₱1,464,655	₱1,982,756	₱517,542
Adjustments for:						
Provision for impairment and credit losses (Note 16)	2,802,283	504,213	964,335	2,734,736	502,855	932,395
Depreciation and amortization (Notes 12 and 14)	1,111,364	800,452	763,447	1,066,999	769,078	722,788
Realized trading gain	(1,036,763)	–	–	(1,024,476)	–	–
Net gain on sale or exchange of investment properties (Note 26)	(1,317,083)	(372,542)	(638,612)	(1,317,083)	(372,542)	(635,130)
Amortization of premium (discount)	(13,205)	–	–	13,096	–	–
Share in net income of an associate (Note 13)	(46,299)	(49,665)	(30,219)	–	–	–
Changes in operating assets and liabilities:						
Decrease (increase) in amounts of:						
Securities at fair value through profit or loss (Note 8)	185,756	210,619	247,752	188,076	(584,984)	253,670
Loans and receivables	(9,400,615)	(5,594,019)	(1,172,583)	(9,295,614)	(5,770,616)	(826,079)
Other assets	(4,841,311)	4,652,339	2,017,794	(4,803,022)	5,422,119	2,466,412
Increase (decrease) in amounts of:						
Deposit liabilities (Note 17)	13,840,915	6,817,724	15,093,865	13,637,084	7,116,037	14,688,745
Accrued taxes, interest and other expenses (Note 19)	181,986	(1,404,823)	(2,496,435)	233,195	(1,490,972)	(2,449,613)
Other liabilities	1,138,920	2,088,545	2,393,571	785,851	2,396,976	2,228,541
Net cash generated from operations	4,358,656	10,172,107	18,119,593	3,683,497	9,970,707	17,899,271
Income taxes paid	(949,905)	(1,860,334)	(480,314)	(772,981)	(1,693,840)	(342,010)
Dividends received (Note 13)	9,012	9,212	7,210	7,147	9,212	7,210
Net cash provided by operating activities	3,417,763	8,320,985	17,646,489	2,917,663	8,286,079	17,564,471
CASH FLOWS FROM INVESTING ACTIVITIES						
Proceeds from sale of:						
Available-for-sale investments	147,467,060	–	851,109	145,161,445	–	851,022
Investment properties	6,316,502	2,123,987	2,139,734	6,315,196	2,022,742	2,136,251
Property and equipment	339,912	–	–	333,833	–	–
Collection of interbank loans receivables (Note 34)	420,276,297	2,346,334	–	420,276,297	2,346,334	–
Disposal of investments in subsidiaries	–	–	43,031	–	–	111,499
Proceeds from maturity of held-to-maturity investments	3,763,003	8,670,327	–	3,658,545	6,697,986	–
Acquisition of:						
Available-for-sale investments	(149,101,658)	(11,193,332)	–	(146,971,081)	(9,033,469)	–
Held-to-maturity investments	(37,350)	–	(16,605,981)	–	–	(16,830,998)
Property and equipment (Note 12)	(518,174)	(515,890)	(343,604)	(496,642)	(472,812)	(320,003)
Additional interbank loans receivables (Note 34)	(423,428,258)	–	(2,346,334)	(423,428,258)	–	(2,346,334)
Additional investments in subsidiaries	–	–	–	(40,498)	–	
Net cash provided by (used in) investing activities	5,077,334	1,431,426	(16,262,045)	4,808,837	1,560,781	(16,398,563)

(Forward)

	Consolidated			Parent Company		
	Years Ended December 31					
	2006	2005	2004	**2006**	2005	2004
CASH FLOWS FROM FINANCING ACTIVITIES						
Proceeds from:						
Bills and acceptances payable (Note 18)	**₱12,356,184**	₱–	₱984,730	**₱11,381,465**	₱–	₱965,359
Subordinated debt (Note 20)	**5,500,000**	–	3,000,000	**5,500,000**	–	3,000,000
Settlement of bills and acceptances payable	**(14,546,110)**	(388,784)	–	**(13,463,033)**	(452,190)	–
Net cash provided by (used in) financing activities	**3,310,074**	(388,784)	3,984,730	**3,418,432**	(452,190)	3,965,359
NET INCREASE IN CASH AND CASH EQUIVALENTS	**11,805,171**	9,363,627	5,369,174	**11,144,932**	9,394,670	5,131,267
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR						
Cash and other cash items	**5,670,002**	3,342,672	3,257,207	**5,333,783**	3,342,466	3,205,026
Due from Bangko Sentral ng Pilipinas	**3,719,362**	3,765,737	1,115,502	**3,719,362**	3,765,737	1,115,502
Due from other banks	**5,494,793**	7,051,470	5,807,556	**4,897,004**	6,092,449	5,142,524
Interbank loans receivable (Note 34)	**16,914,045**	16,574,696	13,785,136	**16,881,081**	16,535,908	13,742,241
Securities held under agreements to resell	**12,300,000**	4,000,000	5,400,000	**12,300,000**	4,000,000	5,400,000
	44,098,202	34,734,575	29,365,401	**43,131,230**	33,736,560	28,605,293
CASH AND CASH EQUIVALENTS AT END OF YEAR						
Cash and other cash items	**4,820,155**	5,670,002	3,342,672	**4,753,539**	5,333,783	3,342,466
Due from Bangko Sentral ng Pilipinas	**12,566,759**	3,719,362	3,765,737	**12,566,759**	3,719,362	3,765,737
Due from other banks	**3,555,603**	5,494,793	7,051,470	**2,314,288**	4,897,004	6,092,449
Interbank loans receivable (Note 34)	**19,260,856**	16,914,045	16,574,696	**18,941,576**	16,881,081	16,535,908
Securities held under agreements to resell	**15,700,000**	12,300,000	4,000,000	**15,700,000**	12,300,000	4,000,000
	55,903,373	₱44,098,202	₱34,734,575	**54,276,162**	₱43,131,230	₱33,736,560
OPERATIONAL CASH FLOWS FROM INTEREST AND DIVIDENDS						
Interest paid	**₱7,109,859**	₱7,116,769	₱8,777,495	**₱7,148,539**	₱7,159,482	₱8,761,868
Interest received	**12,118,812**	11,954,116	9,089,781	**11,705,491**	11,592,474	8,678,797
Dividends received	**9,012**	9,212	7,210	**191,949**	18,203	25,627

See accompanying Notes to Financial Statements.

1. Corporate Information

Philippine National Bank (the Parent Company) was incorporated in 1916 and started commercial operations that same year. Its principal place of business is at PNB Financial Center, President Diosdado Macapagal Boulevard, Pasay City. As of December 31, 2006 and 2005, the Parent Company is owned 77.43% by the Lucio Tan Group (LTG) and 12.53% by the National Government (NG). The remaining 10.04% is owned by the public.

The Parent Company provides a full range of banking and other financial services to corporate, middle-market and retail customers, the NG, local government units (LGUs) and government-owned and controlled corporations (GOCCs) and various government agencies. The Parent Company's principal commercial banking activities include deposit-taking, lending, bills discounting, foreign exchange dealing, investment banking, fund transfers/remittance servicing and a full range of retail banking and trust services through its 324 domestic and 30 overseas branches and offices in 2006 and 324 domestic and 33 overseas branches and offices in 2005. The Parent Company's international subsidiaries have a network of 73 and 69 offices in 2006 and 2005, respectively, in key cities of the United States of America (USA), Canada, Western Europe, Middle East and Asia.

The subsidiaries are engaged in a number of diversified financial and related businesses such as remittance servicing, non-life insurance, merchant banking, leasing, stock brokerage, foreign exchange trading and/or related services while an associate is engaged in the life-insurance business.

The accompanying financial statements of the Parent Company and its subsidiaries (the Group) and of the Parent Company were authorized for issue by the Parent Company's board of directors (BOD) on March 23, 2007.

2. Restructuring and Rehabilitation

The Parent Company is currently operating under a rehabilitation program pursuant to the Memorandum of Agreement (MOA) signed by the Republic of the Philippines, the Philippine Deposit Insurance Corporation (PDIC) and the LTG on May 3, 2002.

Pursuant to the MOA, the following measures have been implemented:

(1) Capital Restructuring

i. The Parent Company instituted a capital reduction exercise as of December 31, 2001, reducing the par value of its common shares from ₱60 per share to ₱40 per share, resulting in a total capital reduction of ₱7.6 billion. This resulted in a decrease in the authorized capital stock of the Parent Company from ₱50.0 billion divided into 833,333,334 common shares to ₱33.3 billion divided into 833,333,334 common shares. The reduction in par

value and the amendment to the articles of incorporation of the Parent Company were approved by the BOD of the Parent Company on May 17, 2002 and by the Philippine Securities and Exchange Commission (SEC) on July 23, 2002.

ii. On May 16, 2002, the Bangko Sentral ng Pilipinas (BSP) approved the following: (a) booking of an appraisal increment of ₱431.8 million for the year ended December 31, 2001 on properties and recognition of the same for the purpose of determining the Parent Company's capital adequacy ratio; and (b) booking of translation adjustment of ₱1.6 billion for the year ended December 31, 2001 representing the increase in peso value of the Parent Company's investment in foreign subsidiaries, for the purpose of the Rehabilitation Plan and as an exception to existing BSP regulations, provided that the same shall be excluded for dividend distribution purposes.

iii. The translation adjustment of ₱1.6 billion was applied to eliminate the Parent Company's remaining deficit of ₱1.3 billion as of December 31, 2001, after applying the total reduction in par value amounting to ₱7.6 billion as a result of the capital reduction exercise. This corporate act was approved by the SEC on November 7, 2002, subject to the following conditions: (a) the remaining translation adjustment of ₱310.7 million as of December 31, 2001 (shown in the statement of condition as part of Capital Paid in Excess of Par Value) will not, without the prior approval of the SEC, be used for or applied towards any provisions for losses that may be incurred in the future; and (b) for purposes of declaration of dividends, any future surplus account of the Parent Company shall be restricted to the extent of the deficit wiped out by the translation adjustment.

The foregoing capital restructuring measures were aimed at reducing the deficit in the equity of the Parent Company which amounted to ₱8.9 billion as of December 31, 2001.

The Parent Company's deficit before and after the quasi-reorganization follows (in thousand pesos):

Deficit before the quasi-reorganization (balance at December 31, 2001)	₱8,877,094
Reduction in par value during the year	(7,561,409)
Application of translation adjustment to deficit on quasi-reorganization	(1,626,430)
Deficit after the quasi-reorganization	(310,745)
Transfer to capital paid in excess of par value	₱310,745

(2) Debt-to-Equity Conversion

In 2002, convertible preferred shares were issued to the PDIC as payment for the ₱7.8 billion borrowed by the Parent Company from the PDIC. This increased (i) the authorized capital stock of the Parent Company to ₱50.0 billion consisting of 1,054,824,557 common shares with a par value of ₱40 each and 195,175,444 convertible preferred shares with a par value of ₱40 each and (ii) the issued capital stock of the Parent Company to ₱22.9 billion consisting of 378,070,472 common shares with a par value of ₱40 each and 195,175,444 convertible preferred shares with a par value of ₱40 each.

(3) Assignment of Certain Government Accounts to the PDIC

On July 30, 2002, the Parent Company and the PDIC signed an agreement whereby the Parent Company transferred and conveyed by way of "dacion en pago", or payment in kind, its rights and interests to the loans of the NG, certain LGUs, certain GOCCs and various government agencies and certain debt securities issued by various government entities (the Government accounts), to the PDIC. The "dacion en pago" arrangement reduced the Parent Company's outstanding obligations arising from the financial assistance given to the Parent Company by the BSP and the PDIC. The accrual of interest incurred by the Parent Company on the government accounts and on the ₱10.0 billion payable to the PDIC ceased on October 1, 2001.

After the completion of the corporate actions and rehabilitation set out above (especially, the conversion of debt to equity and the "dacion en pago" arrangement), the balance of the Parent Company's outstanding obligations to the PDIC was ₱6.1 billion as of December 31, 2002. This balance was restructured into a term loan of 10 years, with interest payable at 91-day treasury bill (T-bill) rate plus 1.00% (Note 18).

In line with the rehabilitation program of the Parent Company as approved under Monetary Board (MB) Resolution No. 626 dated April 30, 2003, the Parent Company and the BSP entered into a Memorandum of Understanding (MOU) on September 16, 2003. Pursuant to the MOU, the Parent Company shall comply to the full extent of its capability, with the following directives of MB Resolution No. 649, among others:

(1) Maintain a strong management team supported by competent staff;
(2) Improve the Parent Company's past due ratio;
(3) Sell the PNB Financial Center;
(4) Dispose real and other properties owned or acquired (included under investment properties); and
(5) Comply with certain prescribed limits.

3. Summary of Significant Accounting Policies

Basis of Preparation

The accompanying financial statements have been prepared on a historical cost basis except for securities at fair value through profit or loss (FVPL) including derivative financial instruments, available-for-sale (AFS) investments and land and building that have been measured at fair value. The financial statements are presented in Philippine pesos, the Parent Company's functional and presentation currency, and all values are rounded to the nearest thousand pesos (₱000) except when otherwise indicated.

The financial statements of the Parent Company reflect the accounts maintained in the Regular Banking Unit (RBU) and Foreign Currency Deposit Unit (FCDU). For financial reporting purposes, FCDU accounts and foreign currency-denominated accounts in the RBU are translated into their equivalents in Philippine pesos (see related policy on Foreign Currency Translation). The financial statements individually prepared for these units are combined and inter-unit accounts are eliminated.

Statement of Compliance

The financial statements of the Group and of the Parent Company have been prepared in compliance with Philippine Financial Reporting Standards (PFRS), except for the accounting for losses on sale of nonperforming loans (NPLS) to special purposes vehicles (SPVs) as discussed in Note 9 and the non-consolidation of the SPV as discussed in Note 10.

Basis of Consolidation

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

Subsidiary	Industry	Country of Incorporation	Effective Percentage of Ownership
PNB Capital and Investment Corporation (PNB Capital)	Financial Markets	Philippines	100.00
PNB Forex, Inc.	- do -	- do -	100.00
PNB Holdings Corporation (PNB Holdings)	- do -	- do -	100.00
PNB Securities, Inc.	Securities Brokerage	- do -	100.00
PNB Corporation - Guam	Financial Markets	Guam	100.00
PNB International Investments Corporation (PNBIIC)	- do -	USA	100.00
PNB Europe PLC	- do -	United Kingdom	100.00
PNB International Finance Limited (PNB IFL)	- do -	Hong Kong	100.00
PNB Global Filipino Remittance Spain (PNB GFRS)	- do -	Spain	100.00
PNB Austria Financial Services GmbH (PNB Austria)	- do -	Austria	100.00
PNB Italy SpA	- do -	Italy	100.00
PNB Remittance Center, Ltd.	Services	Hong Kong	100.00
Tanzanite Investments (SPV-AMC), Inc.	Others	Philippines	100.00
Tau Portfolio Investments (SPV-AMC), Inc.	- do -	- do -	100.00
Omicron Asset Portfolio (SPV-AMC), Inc.	- do -	- do -	100.00
Japan - PNB Leasing and Finance Corporation (Japan - PNB Leasing)	Financial Markets	- do -	60.00

The financial statements of the subsidiaries are prepared for the same reporting year as the Parent Company using consistent accounting policies. All significant intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated in full in the consolidation.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. Control is achieved where the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Consolidation of subsidiaries ceases when control is transferred out of the Group or Parent Company. The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate.

In 2006, the Parent Company sold Opal Portfolio Investments (SPV AMC), Inc. (OPII) and certain nonperforming assets (NPA) to Golden Dragon Star Equities, Inc. under a transaction that qualified, and was approved by the BSP, as a legal true sale (see Note 10). OPII will hold the NPA sold by the Parent Company. Under Standing Interpretations Committee (SIC) No. 12, *Consolidation of Special Purpose Entity*, the consolidated financial statements should include the accounts of OPII. However, no consolidation was made as of December 31, 2006.

The financial statements of OPII were included in the December 31, 2005 and 2004 consolidated financial statements.

Minority Interests
Minority interests represent the portion of profit or loss and the net assets not held by the Group and are presented separately in the consolidated statement of income and within equity in the consolidated statement of condition, separately from equity attributable to the Parent Company. Acquisitions of minority interests are accounted for using the entity concept method, whereby the difference between the consideration and the book value of the share of the net assets acquired is recognized as an equity transaction.

Changes in Accounting Policies
The accounting policies adopted are consistent with those of the previous financial years except as follows:

Amendments to PFRSs and Philippine Interpretation effective in 2006
The Group has adopted the following amendments to PFRS and Philippine Interpretation during the period. Adoption of these revised standards and interpretations did not have any significant effect on the Group except for the additional disclosures in the financial statements.

- Philippine Accounting Standards (PAS) 19 *Amendment - Employee Benefits*
- PAS 21 *Amendment - The Effects of Changes in Foreign Exchange Rates*
- PAS 39 *Amendments - Financial Instruments: Recognition and Measurement*
- Philippine Interpretation IFRIC - 4, *Determining Whether an Arrangement Contains a Lease*

Philippine Interpretation Early Adopted
The Group has also early adopted Philippine Interpretation IFRIC-9, *Reassessment of Embedded Derivatives.*

The principal effects of these changes, if any, are as follows:

PAS 19, *Employee Benefits*
Amendment for actuarial gains and losses, group plans and disclosures. As of January 1, 2006, the Group adopted the amendments to PAS 19. As a result, additional disclosures in the financial statements are made, starting in 2006, to provide information about trends in the assets and liabilities in the defined benefit plans and the assumptions underlying the components of the defined benefit cost. This amendment has no recognition or measurement impact, as the Group chose not to apply the new option to recognize actuarial gains and losses outside of the statement of income.

PAS 21, *The Effects of Changes in Foreign Exchange Rates*
Amendment for net investment in a foreign operation. As of January 1, 2006, the Group adopted the amendments to PAS 21. As a result, all exchange differences arising from a monetary item that forms part of the Group's net investment in a foreign operation are recognized in a separate component of equity in the financial statements regardless of the currency in which the monetary item is denominated. This amendment has no significant impact on the financial statements.

PAS 39, *Financial Instruments: Recognition and Measurement*
Amendment for financial guarantee contracts. This amended the scope of PAS 39 to require financial guarantee contracts that are not considered to be insurance contracts to be recognized initially at fair value and to be remeasured at the higher of the amount determined in accordance with PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, and the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with PAS 18, *Revenue*. This amendment has no significant impact on the financial statements.

Amendment for cash flow hedge accounting of forecast intra-group transactions. This amended PAS 39 to permit the foreign currency risk of a highly probable intra-group forecast transaction to qualify as the hedged item in a cash flow hedge, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and that the foreign currency risk will affect the consolidated statement of income. As the Group currently has no such transactions, the amendment did not have any significant effect on the financial statements.

Amendment for the fair value option. This amended PAS 39 to restrict the use of the option to designate any financial asset or any financial liability to be measured at FVPL. The Group has reassessed its existing FVPL, including documentation of the specific conditions allowing the continued FVPL classification of such investments. The Group has complied with the requirements of this amendment.

Philippine Interpretation IFRIC - 4, *Determining Whether an Arrangement Contains a Lease*
This Interpretation provides guidance in determining whether arrangements contain a lease to which lease accounting must be applied. This Interpretation has no significant impact on the financial statements.

Philippine Interpretation IFRIC - 9, *Reassessment of Embedded Derivatives*
This Interpretation becomes effective for financial years beginning on or after June 1, 2006. This Interpretation establishes that the date to assess the existence of an embedded derivative is the date an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. The Group assessed that adoption of this Interpretation has no significant impact on the financial statements.

On January 1, 2005, the Group adopted PAS 32, *Financial Instruments: Disclosure and Presentation* and PAS 39, *Financial Instruments: Recognition and Measurement*, for which the Philippine SEC has allowed to be applied from January 1, 2005. Accordingly, the comparative figures for the year ended December 31, 2004 were not restated to reflect the adjustments of the adoption of these standards. The total cumulative effect of adopting these standards amounting to ₱2.1 billion, however, was charged against deficit as of January 1, 2005. The net effect of the reclassification from other financial assets to 'AFS investments' and vice versa, on 'Net unrealized gain on AFS investments' amounted to ₱19.9 million as of January 1, 2005.

Foreign Currency Translation

Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

Transactions and balances

The books of accounts of the RBU are maintained in Philippine pesos, while those of the FCDU are maintained in United States (US) dollars. For financial reporting purposes, the monetary assets and liabilities of the FCDU and the foreign currency-denominated monetary assets and liabilities in the RBU are translated in Philippine pesos based on the Philippine Dealing System (PDS) closing rate prevailing at end of the year and for foreign currency-denominated income and expenses, at the PDS weighted average rate (PDSWAR) for the year. Foreign exchange differences arising from restatements of foreign currency-denominated assets and liabilities are credited to or charged against operations in the year in which the rates change. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Group companies

As at the reporting date, the assets and liabilities of overseas subsidiaries are translated into the Parent Company's presentation currency (the Philippine peso) at the rate of exchange ruling at the statement of condition date, and their income and expenses are translated at the weighted average exchange rates for the year. Exchange differences arising on translation are taken directly to a separate component of equity in the consolidated statement of condition. On disposal of a foreign entity, the deferred cumulative amount recognized in equity relating to the particular foreign operation is recognized in the consolidated statement of income.

Financial Instruments - Initial Recognition and Subsequent Measurement

Date of recognition

Purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace are recognized on settlement date. Derivatives are recognized on trade date basis (i.e., the date that the Group commits to purchase or sell). Deposits, amounts due to banks and customers and loans are recognized when cash is received by the Group or advanced to the borrowers. For PNB Securities, Inc., securities transactions are recorded on a trade date basis.

Initial recognition of financial instruments

All financial assets are initially recognized at fair value. Except for securities at FVPL, the initial measurement of financial assets and liabilities includes transaction costs. The Group classifies its financial assets in the following categories: securities at FVPL, held-to-maturity (HTM) investments, AFS investments, and loans and receivables. Financial liabilities are classified into securities at FVPL and other financial liabilities (at amortized cost). The classification depends on the purpose for which the investments were acquired and whether they are quoted in an active market. Management determines the classification of its investments at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

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

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

Day 1 profit
Where the transaction price in a non-active market is different to the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Group recognizes the difference between the transaction price and fair value (a Day 1 profit) in the statement of income in 'Trading and investment securities gains - net'. In cases where data is not observable, the difference between the transaction price and model value is only recognized in the statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Group determines the appropriate method of recognizing the 'Day 1' profit amount.

Derivatives recorded at FVPL
The Parent Company and some of its subsidiaries are counterparties to derivative contracts, such as currency forwards, currency swaps, and interest rate swaps. These derivatives are entered into as a service to customers and as a means of reducing or managing their respective foreign exchange and interest rate exposures, as well as for trading purposes. Such derivative financial instruments are initially recorded at fair value on the date at which the derivative contract is entered into and are subsequently remeasured at fair value. Any gains or losses arising from changes in fair values of derivatives (except those accounted for as accounting hedges) are taken directly to the statement of income and are included in 'Trading and investment securities gains - net'. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

For the purpose of hedge accounting, hedges are classified primarily as either: a) a hedge of the fair value of an asset, liability or a firm commitment (fair value hedge); or b) a hedge of the exposure to variability in cash flows attributable to an asset or liability or a forecasted transaction (cash flow hedge). For 2006 and 2005, the Group did not apply hedge accounting treatment for its derivatives transactions.

The Group has certain derivatives that are embedded in host financial (such as structured notes, debt investments, and loan receivables) and non-financial (such as purchase orders and service agreements) contracts.

These embedded derivatives include credit default swaps (which are linked either to a single reference entity or a basket of reference entities), and calls and puts in debt investments, which include structured notes and deposits; conversion options in loans receivable; call options in certain long-term debt, and foreign-currency derivatives in debt instruments, purchase orders and service agreements.

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

Other financial assets or financial liabilities held for trading
Other financial assets or financial liabilities held for trading (classified as 'Securities at FVPL') are recorded in the statement of condition at fair value. Changes in fair value relating to the held-for-trading positions are recognized in 'Trading and investment securities gains - net'. Interest earned or incurred is recorded in interest income or expense, respectively, while dividend income is recorded in 'Miscellaneous income' when the right to receive payment has been established.

Included in this classification are debt and equity securities which have been acquired principally for the purpose of selling or repurchasing in the near term.

Designated financial assets or financial liabilities at FVPL
Financial assets or financial liabilities classified in this category are designated by management on initial recognition when the following criteria are met:

- The designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognizing gains or losses on them on a different basis; or
- The assets and liabilities are part of a group of financial assets, financial liabilities or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- The financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

Financial assets and financial liabilities at FVPL are recorded in the statement of condition at fair value. Changes in fair value on financial assets and financial liabilities designated at FVPL are recorded in 'Trading and investment securities gains - net'. Interest earned or incurred is recorded in interest income or expense, respectively, while dividend income is recorded in 'Miscellaneous income' according to the terms of the contract, or when the right of payment has been established.

HTM investments
HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Group's management has the positive intention and ability to hold to maturity. Where the Group sells other than an insignificant amount of HTM investments, the entire category would be tainted and reclassified as AFS investments. After initial measurement, these HTM investments are subsequently measured at amortized cost using the effective interest rate method, less impairment in value. Amortized cost is calculated by taking

into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortization is included in Interest income in the statement of income. Gains and losses are recognized in income when the HTM investments are derecognized and impaired, as well as through the amortization process. The losses arising from impairment of such investments are recognized in the statement of income under 'Provision for impairment and credit losses'. The effects of restatement on foreign currency-denominated HTM investments are recognized in the statement of income.

Loans and receivables, amounts due from BSP and other banks, and interbank loans receivables
Classified as loans and receivables are 'Due from Bangko Sentral ng Pilipinas', 'Due from other banks', 'Interbank loans receivables', and 'Loans and receivables'. These are financial assets with fixed or determinable payments and fixed maturities and are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as Securities at FVPL or designated as AFS investments.

Loans and receivables also include receivables arising from transactions on credit cards issued directly by the Parent Company. Furthermore, 'Loans and receivables' also include the aggregate rental on finance lease transactions. Unearned income on finance lease transactions is shown as a deduction from 'Loans and receivables' (included in 'Unearned Discount').

After initial measurement, the 'Loans and receivables', 'Due from Bangko Sentral ng Pilipinas', 'Due from other banks' and 'Interbank loans receivables' are subsequently measured at amortized cost using the effective interest rate method, less allowance for credit losses. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortization is included in the 'Interest income' in the statement of income. The losses arising from impairment are recognized in 'Provision for impairment and credit losses' in the statement of income.

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

After initial measurement, AFS investments are subsequently measured at fair value. The effective yield component of AFS debt securities, as well as the impact of restatement on foreign currency-denominated AFS debt securities, is reported in earnings. The unrealized gains and losses arising from the fair valuation of AFS investments are excluded, net of tax, from reported earnings and are reported as 'Net unrealized gain on AFS investments' in the equity section of the statement of condition.

When the security is disposed of, the cumulative gain or loss previously recognized in equity is recognized as 'Trading and investment securities gains - net' in statement of income. Interest earned on holding AFS investments are reported as interest income using the effective interest rate. Dividends earned on holding AFS investments are recognized in the statement of income as 'Miscellaneous income' when the right of the payment has been established. The losses arising from impairment of such investments are recognized as 'Provision for impairment and credit losses' in the statement of income.

Bills payable and other borrowed funds
Issued financial instruments or their components, which are not designated at FVPL, are classified as bills payable or other appropriate account titles for such borrowed funds, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares. The components of issued financial instruments that contain both liability and equity elements are accounted for separately, with the equity component being assigned the residual amount after deducting from the instrument as a whole the amount separately determined as the fair value of the liability component on the date of issue.

After initial measurement, bills payable and other borrowings are subsequently measured at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into account any discount or premium on the issue and fees that are an integral part of the effective interest rate.

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

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

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

Repurchase and Reverse Repurchase Agreements
Securities sold under agreements to repurchase at a specified future date ('repos') are not derecognized from the statement of condition. The corresponding cash received, including accrued interest, is recognized on the statement of condition as a loan to the Group, reflecting the economic substance of such transaction.

Conversely, securities purchased under agreements to resell at a specified future date ('reverse repos') are not recognized on the statement of condition. The corresponding cash paid, including accrued interest, is recognized on the statement of condition as 'Securities held under agreements to resell,' and is considered a loan to the counterparty. The difference between the purchase price and resale price is treated as interest income and is accrued over the life of the agreement using the effective interest rate method.

Impairment of Financial Assets

The Group assesses at each statement of condition date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization, and where observable data indicate that there is measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Loans and receivables, due from BSP and other banks, and interbank loans receivables

For loans and receivables, due from BSP and other banks, and interbank loans receivables carried at amortized cost, the Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses for impairment. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment for impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred). The carrying amount of the asset is reduced through use of an allowance account and the amount of loss is charged to the statement of income. Interest income continues to be recognized based on the original effective interest rate of the asset. Loans, together with the associated allowance accounts, are written off when there is no realistic prospect of future recovery and all collateral has been realized. If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is reduced by adjusting the allowance account. If a future write-off is later recovered, any amounts formerly charged are credited to the 'Provision for impairment and credit losses' account.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate, adjusted for the original credit risk premium. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of such credit risk characteristics as industry, collateral type, past-due status and term. Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with changes in related observable data from period to period (such changes in property prices, payment status, or other factors that are indicative of incurred losses in the Group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

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

HTM investments
For HTM investments, the Group assesses whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through use of an allowance account and the amount of loss is charged to the statement of income. Interest income continues to be recognized based on the original effective interest rate of the asset.

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

AFS investments
For AFS investments, the Group assesses at each statement of condition date whether there is objective evidence that a financial asset or group of financial assets is impaired.

In case of equity investments classified as AFS investments, this would include a significant or prolonged decline in the fair value of the investments below its cost. Where there is evidence of impairment, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the statement of income - is removed from equity and recognized in the statement of income. Impairment losses on equity investments are not reversed through the statement of income. Increases in fair value after impairment are recognized directly in equity.

In the case of debt instruments classified as AFS investments, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Interest continues to be accrued at the original effective interest rate on the reduced carrying amount of the asset and is recorded as part of Interest income in the statement of income. If subsequently, the fair value of a debt instrument increased and the increase can be objectively related to an event occurring after the impairment loss was recognized in the statement of income, the impairment loss is reversed through the statement of income.

Offsetting Financial Instruments
Financial assets and financial liabilities are offset and the net amount reported in the statement of condition if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the statement of condition.

Terminal Value of Leased Assets and Deposits on Finance Leases
The terminal value of leased assets, which approximates the amount of guaranty deposit paid by the lessee at the inception of the lease, is the estimated proceeds from the sale of the leased asset at the end of the lease term. At the end of the lease term, the terminal value of the leased asset is generally applied against the guaranty deposit of the lessee when the lessee decides to buy the leased asset.

Financial Guarantees
In the ordinary course of business, the Group gives financial guarantees consisting of letters of credit, letters of guarantees, and acceptances. Financial guarantees are initially recognized in the financial statements at fair value, in 'Other liabilities'. Subsequent to initial recognition, the Group's liabilities under such guarantees are each measured at the higher of the initial fair value less, when appropriate, cumulative amortization calculated to recognize the fee in the statement of income in 'Service fees and commission income', over the term of the guarantee, and the best estimate of the expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the statement of income in 'Provision for impairment and credit losses'. Any financial guarantee liability remaining is recognized in the statement of income in 'Service fees and commission income', when the guarantee is discharged, cancelled or expired.

Accounting Policies Prior to January 1, 2005

Prior to January 1, 2005, financial assets were accounted for as follows:

Trading account securities (TAS)

TAS, which consist of government and private debt and equity securities, are purchased and held principally with the intention of selling them in the near term. These securities are carried at fair value; realized and unrealized gains and losses on these instruments are recognized in 'Trading and investment securities gains - net' in the statement of income. Interest earned on debt instruments is reported as 'Interest Income'.

Available-for-sale securities (ASS)

Securities are classified as ASS when purchased and held indefinitely, i.e., neither held to maturity nor for trading purposes, where the Group anticipates to sell in response to liquidity requirements or in anticipation of changes in interest rates or other factors. ASS are carried at fair market value and any unrealized gains or losses are reported as a separate component of equity.

Investments in bonds and other debt instruments (IBODI)

IBODI are debt securities where the Group has the positive intent and ability to hold to maturity. These securities are carried at amortized cost on a straight-line basis; realized gains and losses are included in 'Trading and investment securities gains - net' in the statement of income.

Receivables from customers and allowance for probable losses

Receivables from customers are stated at the outstanding principal balance, reduced by unearned discounts, other deferred income, capitalized interest, and allowance for probable losses.

Receivables from customers are classified as nonaccruing or nonperforming in accordance with BSP regulations, or when, in the opinion of management, collection of interest or principal is doubtful. At the time the receivable is classified as nonaccruing, interest previously recorded but not collected is provided with an allowance for probable losses. Receivables from customers are not reclassified as accruing until interest and principal payments are brought current or the receivables are restructured in accordance with existing BSP regulations, and future payments appear assured.

The allowance for probable losses, which comprises both specific and general loss reserves, is the estimated amount of losses in the Group's loan portfolio based on management's evaluation of the collectibility of the loans, after consideration of prevailing and anticipated economic conditions, collection and credit experience with specific accounts, fair market value of collateral, financial capabilities of guarantors, present value of future cash collections and evaluations made by the BSP. The BSP observes certain criteria and guidelines based largely on the classification of loans in establishing specific loss reserves. To supplement the specific loan loss reserves, a general reserve on unclassified loan is set aside.

The allowance for probable losses is established through provisions for probable losses charged against current operations. Loans are written off against the allowance for probable losses when management believes that the collectibility of the principal is unlikely.

Receivables arising from transactions with credit cardholders are provided with allowance for probable losses based on the review and evaluation of the status of the receivables from cardholders and guidelines issued by the BSP. The MB through BSP Circular 398 issued on August 21, 2003 provides general guidelines governing credit card operations, including the minimum credit card receivable classification requirement as follows:

No. of Days Past Due	Classification	Percentage of Allowance
91 - 120	Substandard	25%
121 - 180	Doubtful	50%
181 or more	Loss	100%

Revenue Recognition

Revenue is recognized to the extent that it is probable that economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized:

Interest income

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

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

Fee and commission income

The Group earns fee and commission income from diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

a) Fee income earned from services that are provided over a certain period of time
   Fees earned for the provision of services over a period of time are accrued over that period. These fees include investment fund fees, custodian fees, fiduciary fees, commission income, credit related fees, asset management fees, portfolio and other management fees, and advisory fees. However, loan commitment fees for loans that are likely to be drawn down are deferred (together with any incremental costs) and recognized as an adjustment to the effective interest rate on the loan.

b) Fee income from providing transaction services
   Fees arising from negotiating or participating in the negotiation of a transaction for a third party - such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses - are recognized on completion of the underlying transaction. Fees or

components of fees that are linked to a certain performance are recognized after fulfilling the corresponding criteria. These fees include underwriting fees, corporate finance fees, and brokerage fees. Loan syndication fees are recognized in the statement of income when the syndication has been completed and the Group retains no part of the loans for itself or retains part at the same effective interest rate as for the other participants.

Dividends
Dividend income is recognized when the Group's right to receive payment is established.

Trading and investment securities gains - net
Results arising from trading activities including all gains and losses from changes in fair value for financial assets and financial liabilities at FVPL.

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

Commissions earned on credit cards
Commissions earned are taken up as income upon receipt from member establishments of charges arising from credit availments by credit cardholders. These commissions are computed based on certain agreed rates and are deducted from amounts remittable to member establishments.

Purchases by the credit cardholders, collectible on installments basis, are recorded at the cost of the items purchased plus certain percentage of cost. The excess over cost is credited to 'Unearned discount' account and is shown as a deduction from 'Loans and receivables' in the consolidated statement of condition. The unearned discount is taken up to income over the installment terms and is computed using the effective interest method.

Income on direct financing leases and receivables financed
Income of Japan-PNB Leasing on loans and receivables financed with short-term maturities is recognized using the effective interest method.

Interest and finance fees on finance leases and loans and receivables financed with long-term maturities and the excess of the aggregate lease rentals plus the estimated terminal value of the leased equipment over its cost are credited to unearned discount and amortized over the term of the note or lease using the effective interest rate method.

Cash and Cash Equivalents
For purposes of reporting cash flows, cash and cash equivalents include notes and coins on hand, amounts due from BSP and other banks and interbank loans receivable and securities held under agreements to resell that are convertible to known amounts of cash, with original maturities of three months or less from dates of placements and that are subject to an insignificant risk of changes in fair value.

Receivables from SPV
Receivables from SPV are stated at the face value of the related note reduced by an allowance for credit losses. The allowance for credit losses is determined based on the difference between the outstanding principal amount and the recoverable amount which is the present value of the future cash flow expected to be received in payment of the receivable.

Investments in Subsidiaries and Associates

Investments in subsidiaries

Subsidiaries pertain to entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. See Basis of Consolidation.

Investments in Associates

Associates pertain to entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. In the consolidated financial statements, investments in associates are accounted for under the equity method of accounting.

Under the equity method, an investment in an associate is carried in the statement of condition at cost plus post-acquisition changes in the Group's share of the net assets of the associate. The Group's share of its associates' post-acquisition profits or losses is recognized in the statement of income, and its share of post-acquisition movements in the associates' equity reserves is recognized directly in equity. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

In the parent company financial statements, investments in subsidiaries and associates are carried at cost, less any impairment in value. Cost represents the carrying value of the investments as at the quasi-reorganization date of the Parent Company as discussed in Note 2, reduced by dividends subsequently received from the investees.

Property and Equipment

Depreciable properties such as leasehold improvements, and furniture, fixture and equipment are stated at cost less accumulated depreciation and amortization, and any impairment in value.

Land is stated at appraised values less any impairment in value while buildings are stated at appraised value less accumulated depreciation and any impairment in value. The appraised values were determined by professionally qualified, independent appraisers in 2006. The revaluation increment resulting from revaluation is credited to the 'Revaluation increment on land and buildings' under equity, net of applicable deferred income tax.

The initial cost of property and equipment consists of its purchase price, including import duties, taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after items of property and equipment have been put into operation, such as repairs and maintenance are normally charged against operations in the year in which the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of property and equipment.

Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are amortized over the shorter of the terms of the covering leases and the estimated useful lives of the improvements.

The estimated useful lives follow:

	Useful Life in Years
Buildings	25 - 50
Furniture, fixtures and equipment	5
Leasehold improvements	3 - 10

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

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

Investment Properties

Investment properties are measured initially at cost, including transaction costs. An investment property acquired through an exchange transaction is measured at fair value of the asset acquired unless the fair value of such an asset cannot be measured in which case the investment property acquired is measured at the carrying amount of asset given up. Foreclosed properties are classified under investment properties from foreclosure date.

Subsequent to initial recognition, depreciable investment properties are carried at cost less accumulated depreciation and impairment in value.

Investment properties are derecognized when they have either been disposed of or when the investment property is permanently withdrawn from use and no future benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognized in the statement of income in 'Miscellaneous income' in the year of retirement or disposal.

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

Depreciation is calculated on a straight-line basis using the remaining useful lives from the time of acquisition of the depreciable investment properties ranging from 25 to 50 years.

Transfers are made to investment properties when, and only when, there is a change in use evidenced by ending of owner occupation, commencement of an operating lease to another party or ending of construction or development. Transfers are made from investment properties when, and only when, there is a change in use evidenced by commencement of owner occupation or commencement of development with a view to sale.

Intangible assets

Exchange trading right

The exchange trading right, included in 'Other assets', was acquired, together with Philippine Stock Exchange (PSE) shares, in exchange for the exchange membership seat under the conversion program of the PSE. The exchange trading right is carried at the amount allocated from the original cost of the exchange membership seat (after a corresponding allocation for the value of the PSE shares) less allowance for impairment loss. The Group does not intend to sell the exchange trading right in the near future.

The exchange trading right is deemed to have an indefinite useful life as there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the Group. It ceased to be amortized on January 1, 2004 but is tested annually for any impairment in realizable value. Any impairment loss is charged directly to the statement of income.

Software costs

Software costs are capitalized on the basis of the cost incurred to acquire and bring to use the specific software. These costs are amortized over five years on a straight-line basis.

Costs associated with maintaining the computer software programs are recognized as expense when incurred.

Impairment of Nonfinancial Assets

At each reporting date, the Group assesses whether there is any indication that its nonfinancial assets may be impaired. When an indicator of impairment exists or when an annual impairment testing for an asset is required, the Group makes a formal estimate of recoverable amount. Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case the recoverable amount is assessed as part of the cash generating unit to which it belongs. Where the carrying amount of an asset (or cash generating unit) exceeds its recoverable amount, the asset (or cash generating unit) is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset (or cash generating unit).

An impairment loss is charged to operations in the year in which it arises, unless the asset is carried at a revalued amount, in which case the impairment loss is charged to the revaluation increment of the said asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation and amortization, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the statement of income unless the asset is carried at a revalued amount, in which case the reversal is treated as a

revaluation increase. After such a reversal, the depreciation expense is adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining life.

Intangible assets
Intangible assets with indefinite useful lives are tested for impairment annually as of December 31 either individually or at the cash generating unit level, as appropriate.

Intangible assets with finite lives are assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Leases
The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

(a) There is a change in contractual terms, other than a renewal or extension of the arrangement;
(b) A renewal option is exercised or extension granted, unless that term of the renewal or extension was initially included in the lease term;
(c) There is a change in the determination of whether fulfillment is dependent on a specified asset; or
(d) There is a substantial change to the asset.

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

For arrangements entered into prior to January, 1, 2005, the date of inception is deemed to be January 1, 2005 in accordance with the transitional requirements of Philippine Interpretation IFRIC-4.

Group as Lessee
Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments and included in Property and equipment account with the corresponding liability to the lessor included in 'Other liabilities' account. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to 'Interest expense'.

Capitalized leased assets are depreciated over the shorter of the estimated useful lives of the assets or the respective lease terms, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term.

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

Group as Lessor
Finance leases, where the Group transfers substantially all the risk and benefits incidental to ownership of the leased item to the lessee, are included in the statement of condition under 'Loans and receivables' account. A lease receivable is recognized at an amount equivalent to the net investment (asset cost) in the lease. All income resulting from the receivable is included in 'Interest income' in the statement of income.

Leases where the Group does not transfer substantially all the risk and benefits of ownership of the assets are classified as operating leases. Lease payments received are recognized as an income in the statement of income on a straight-line basis over the lease term. Lease payments received are recognized as an income in the statement of income on a straight line basis over the lease term. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognized over the lease term on the same basis as the rental income. Contingent rents are recognized as revenue in the period in which they are earned.

Retirement Benefits
The Group has a noncontributory defined benefit retirement plan.

The retirement cost of the Parent Company and certain subsidiaries is determined using the projected unit credit method. Under this method, the current service cost is the present value of retirement benefits payable in the future with respect to services rendered in the current period. The liability recognized in the statement of condition in respect of defined benefit pension plans is the present value of the defined benefit obligation at the statement of condition date less the fair value of plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by an independent actuary using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rate on government bonds that have terms to maturity approximating the terms of the related retirement liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are credited to or charged against income when the net cumulative unrecognized actuarial gains and losses at the end of the previous period exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These excess gains or losses are recognized over the expected average remaining working lives of the employees participating in the plan.

Past-service costs, if any, are recognized immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortized on a straight-line basis over the vesting period.

The defined benefit asset or liability comprises the present value of the defined benefit obligation less past service costs not yet recognized and less the fair value of plan assets out of which the obligations are to be settled directly. The value of any asset is restricted to the sum of any past service cost not yet recognized and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

Provisions and Contingencies

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of assets embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Group expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of income, net of any reimbursement. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an interest expense.

Contingent liabilities and contingent assets

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

Income Taxes

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

Deferred tax liabilities are recognized for all taxable temporary differences, including asset revaluations. Deferred tax assets are recognized for all deductible temporary differences, carryforward of unused tax credits from the excess of minimum corporate income tax (MCIT) over the regular corporate income tax (RCIT), and unused net operating loss carryover (NOLCO), to the extent that it is probable that sufficient taxable profit will be available against which the deductible temporary differences and carryforward of unused tax credits from MCIT and unused NOLCO can be utilized. Deferred income tax, however, is not recognized on temporary differences that arise from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting income nor taxable income.

Deferred tax liabilities are not provided on non-taxable temporary differences associated with investments in domestic subsidiaries and associates. With respect to investments in foreign subsidiaries and associates, deferred tax liabilities are recognized except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each statement of condition date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each statement of condition date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

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

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

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

Treasury shares and contracts on own shares
Own equity instruments which are acquired (treasury shares) are deducted from equity and accounted for at weighted average cost. No gain or loss is recognized in the statement of income on the purchase, sale, issue or cancellation of the Parent Company's own equity instruments.

Earnings Per Share
Basic earnings per share (EPS) is computed by dividing net income for the year attributable to common shareholders by the weighted average number of common shares outstanding during the year after giving retroactive effect to stock dividends declared and stock rights exercised during the year, if any.

Diluted earnings per share is calculated by dividing the aggregate of net income attributable to common shareholders and convertible preferred shareholders by the weighted average number of common shares outstanding during the year adjusted for the effects of dilutive convertible preferred shares.

Dividends on common shares
Dividends on common shares are recognized as a liability and deducted from equity when approved by the respective shareholders' of the Parent Company and subsidiaries. Dividends for the year that are approved after the statement of condition date are dealt with as an event after the statement of condition date.

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

Segment Reporting
The Group's operating businesses are organized and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets.

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

Future Changes in Accounting Policies

The Group has not applied the following PFRS and Philippine Interpretations which are not yet effective for the year ended December 31, 2006:

PFRS 7, *Financial Instruments: Disclosures and complementary amendment to PAS 1, Presentation of Financial Statements (effective for annual periods beginning on or after January 1, 2007).*

PFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, as well as sensitivity analysis to market risk. It replaces PAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, and the disclosure requirements in PAS 32, *Financial Instruments: Disclosure and Presentation*. It is applicable to all entities that report under PFRS. The amendment to PAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Group is currently assessing the impact of PFRS 7 and the amendment to PAS 1 and expects that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by PFRS 7 and the amendment to PAS 1. The Group will apply PFRS 7 and the amendment to PAS 1 in 2007.

PFRS 8, *Operating Segments (effective for annual periods beginning on or after January 1, 2009)*

This PFRS adopts a management approach to reporting segment information. The information reported would be that which management uses internally for evaluating the performance of operating segments and allocating resources to those segments. Such information may be different from that reported in the statement of condition and statement of income and companies will need to provide explanations and reconciliations of the differences. PFRS 8 will replace PAS 14, *Segment Reporting*. The Group will assess the impact of the standard on its current manner of reporting segment information.

Philippine Interpretation IFRIC-7, *Applying the Restatement Approach under PAS 29, Financial Reporting in Hyperinflationary Economies (effective for annual periods beginning on or after March 1, 2006)*

This Interpretation provides guidance on how to apply PAS 29 when an economy first becomes hyperinflationary, in particular the accounting for deferred income tax. The Interpretation has no significant impact on the financial statements of the Group.

Philippine Interpretation IFRIC-8, *Scope PFRS 2 (effective for annual periods beginning on or after May 1, 2006)*

This Interpretation requires PFRS 2 to be applied to any arrangements where equity instruments are issued for consideration which appears to be less than fair value. The Interpretation has no impact on the financial statements of the Group.

Philippine Interpretation IFRIC-10, *Interim Financial Reporting and Impairment (effective for annual periods beginning on or after November 1, 2006)*

This Interpretation prohibits the reversal of impairment losses on goodwill and AFS equity investments recognized in the interim financial reports even if impairment is no longer present at the annual balance sheet date. This Interpretation has no significant impact on the financial statements of the Group.

Philippine Interpretation IFRIC-11, *PFRS 2 Group and Treasury Share Transactions (effective for annual periods beginning on or after March 1, 2007)*
This Interpretation requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme by the entity even if (a) the entity chooses or is required to buy those equity instruments (e.g., treasury shares) from another party, or (b) the shareholder(s) of the entity provide the equity instruments needed. It also provides guidance on how subsidiaries, in their separate financial statements, account for such schemes when their employees receive rights to the equity instruments of the parent. The Group currently does not have any stock option plan and therefore, does not expect this Interpretation to have significant impact on its financial statements.

Philippine Interpretation IFRIC-12, *Service Concession Arrangements (effective for annual periods beginning on or after January 1, 2008)*
This Interpretation covers contractual arrangements arising from private entities providing public services and is not relevant to the Group's current operations.

4. **Significant Accounting Judgments and Estimates**

The preparation of the financial statements in accordance with PFRS requires the Group to make estimates and assumptions 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.

Judgments

(a) Operating leases
The Group has entered into commercial property leases on its investment property portfolio. The Group has determined that it retains all the significant risks and rewards of ownership of these properties which are leased out on operating lease basis.

(b) Fair value of financial instruments
Where the fair values of financial assets and financial liabilities recorded on the statement of condition cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of liquidity and model inputs such as correlation and volatility for longer dated derivatives.

(c) HTM investments
The classification to HTM investment requires significant judgment. In making this judgment, the Group evaluates its intention and ability to hold such investments to maturity. If the Group fails to hold these investments to maturity other than in certain specific circumstances -

for example, selling an insignificant amount close to maturity - it will be required to reclassify the entire portfolio as AFS investments. The investments would therefore be measured at fair value and not at amortized cost.

(d) *Financial assets not quoted in an active market*
The Group classifies financial assets by evaluating, among others, whether the asset is quoted or not in an active market. Included in the evaluation on whether a financial asset is quoted in an active market is the determination on whether quoted prices are readily and regularly available, and whether those prices represent actual and regularly occurring market transactions on an arm's length basis.

Estimates

(a) *Impairment losses on loans and receivables*
The Group reviews its impaired loans and receivables at each reporting date to assess whether an allowance for impairment should be recorded in the statement of income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of required allowance. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

In addition to specific allowance against individually significant loans and receivables, the Group also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This collective allowance takes into consideration any deterioration in the loan or investment rating from the time the account was granted or amended, and such other factors as any deterioration in country risk, industry, and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows and underlying property prices, among others.

As of December 31, 2006 and 2005, allowance for credit losses on loans and receivables amounted to ₱13.5 billion and ₱24.1 billion, respectively, for the Group and ₱13.3 billion and ₱23.9 billion, respectively, for the Parent Company. As of December 31, 2006 and 2005, loans and receivables are carried at ₱83.6 billion and ₱80.1 billion for the Group and ₱81.5 billion and ₱77.9 billion for the Parent Company, respectively (see Note 9).

(b) *Fair values of structured debt instruments and derivatives*
The fair values of structured debt instruments and derivatives that are not quoted in active markets are determined using valuation techniques. Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are reviewed before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practicable, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments. Refer to Notes 6 and 30 for information on the carrying values of these instruments.

(c) *Valuation of unquoted equity investments*
Valuation of unquoted equity investments is normally based on one of the following:
- recent arm's length market transactions;
- current fair value of another instrument that is substantially the same;
- the expected cash flows discounted at current rates applicable for terms with similar terms and risk characteristics; or
- other valuation models.

The determination of the cash flows and discount factors for unquoted equity investments requires significant estimation. The Parent Company reviews the valuation techniques periodically and tests them for validity using either prices from observable current market transactions in the same instrument or from other available observable market data. As of December 31, 2006 and 2005, unquoted equity instruments amounted to ₱358.0 million and ₱364.6 million for the Group and Parent Company, respectively (see Note 11).

(d) *Impairment of AFS equity investments*
The Group treats AFS equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is 'significant' or 'prolonged' requires judgment. The Group treats 'significant' generally as 20% or more and 'prolonged' greater than 6 months. In addition, the Group evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for unquoted equities.

Refer to Note 11 for the information on the carrying amounts of these investments.

(e) *Recognition of deferred income taxes*
Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning strategies.

The Group's estimates of future taxable income indicate that certain temporary differences will be realized in the future. As discussed in Note 25, recognized net deferred tax assets as of December 31, 2006 and 2005 amounted to ₱1.8 billion and ₱2.6 billion, respectively, for the Group and Parent Company. Deferred tax assets on the temporary differences amounting to ₱9.3 billion and ₱7.9 billion for Group and ₱9.3 billion and ₱7.8 billion for the Parent Company as of December 31, 2006 and 2005, respectively, were not recognized.

(f) *Present value of retirement obligation*
The cost of defined benefit pension plan and other post employment benefits is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty.

The expected rate of return on plan assets of 10% was based on the market prices prevailing on the date applicable to the period over which the obligation is to be settled. The assumed discount rates were determined using the market yields on Philippine government bonds with terms consistent with the expected employee benefit payout as of statement of condition dates. Refer to Note 23 for the details of assumption used in the calculation.

As of December 31, 2006 and 2005, the present value of the retirement obligation of the Parent Company amounted to ₱2.0 billion and ₱775.7 million, respectively (see Note 23).

(g) *Impairment of non-financial assets*
The Group assesses impairment on assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The factors that the Group considers important which could trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of use of the acquired assets or the strategy for overall business; and
- significant negative industry or economic trends.

The Group recognizes an impairment loss whenever the carrying amount of an asset exceeds its recoverable amount. The recoverable amount is computed using the value in use approach. Recoverable amounts are estimated for individual assets or, if it is not possible, for the cash-generating unit to which the asset belongs.

As of December 31, 2006, the carrying value of the property and equipment and investment properties amounted to ₱16.6 billion and ₱24.9 billion, respectively, for the Group and ₱16.5 billion and ₱24.8 billion, respectively, for the Parent Company. As of December 31, 2005, the carrying value of the property and equipment and investment properties amounted to ₱15.3 billion and ₱26.8 billion, respectively, for the Group and ₱15.2 billion and ₱26.8 billion, respectively, for the Parent Company (see Notes 12 and 14).

(h) *Estimated useful lives of property and equipment and investment properties*
The Group estimates the useful lives of its property and equipment and investment properties. This estimate is reviewed periodically to ensure that the period of depreciation and amortization are consistent with the expected pattern of economic benefits from the items of property and equipment and investment properties.

As of December 31, 2006, the carrying value of depreciable property and equipment and investment properties amounted to ₱5.6 billion and ₱6.6 billion, respectively, for the Group and ₱5.5 billion and ₱6.5 billion, respectively, for the Parent Company. As of December 31, 2005, the carrying value of depreciable property and equipment and investment properties amounted to ₱5.3 billion and ₱5.0 billion, respectively, for the Group and ₱5.2 billion and ₱4.9 billion, respectively, for the Parent Company (see Notes 12 and 14).

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

The Group's activities are principally related to the use of financial instruments. The Group accepts deposits from customers at fixed rates, and for various periods, and seeks to earn above-average interest margins by investing these funds in high-quality assets. The Group seeks to increase these margins by consolidating short-term funds and lending for longer periods at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due.

The Group also seeks to raise its interest margins by obtaining above-average margins, net of allowances, through lending to commercial and retail borrowers with a range of credit standing. Such exposures involve not just on-balance sheet loans and advances. The Group also enters into guarantees and other commitments such as letters of credit and performance and other bonds.

The Group trades in financial instruments where it takes positions in traded and over-the-counter instruments, including derivatives, to take advantage of short-term market movements in equities and bonds and in currency and interest rate. The Group places trading limits on the level of exposure that can be taken in relation to both overnight and intra-day market positions.

Credit Risk

The Parent Company faces potential credit risks every time it extends funds to borrowers, commits funds to counterparties, guarantees the paying performance of its clients or invests funds to issuer either through implied or actual contractual agreements (i.e. on- or off-balance sheet exposures). It manages its credit risk at various levels (i.e. strategic level, portfolio level down to individual credit or transaction) by adopting a credit risk management environment that has the following components:

- Credit risk policies, systems and procedures that are subject to periodic review to consider internal and external developments.

- Regulatory and internal limits that are BOD-approved and reviewed at least annually; among the limit measures include single borrower's limit, directors, officers, stockholders and related interests (DOSRI), group of borrowers, concentration by security, segment, location, market type, etc.

- Systems, data and technology support for the credit management function which includes a newly-acquired core banking system and a centralized management information system (MIS) capable of capturing and monitoring credit exposures;

- Credit Risk Rating System (CRRS) for risk profiling of its loan portfolio and in evaluating the adequacy of impairment provision;

- Credit controls that include:

  a. portfolio analysis and management
  b. independent pre-review and post review of individual loans
  c. quarterly review of loan loss reserves
  d. credit evaluation to determine the payment capacity of borrowers and securing credit risk mitigants by obtaining collateral and guarantees

Credit-related commitments
The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties carry the same credit risk as loans. Documentary and commercial letters of credit which are written undertakings by the Group on behalf of a customer authorizing a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions are collateralized by the underlying shipments of goods to which they relate.

Commitments to extend credit represent unused portions of authorizations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit commitments because long-term commitments generally have a greater degree of credit risk than short-term commitments.

Market Risk
The Parent Company is exposed to the potential loss in its trading portfolio because the values of its trading positions are sensitive to changes in the market prices and rates. Similarly, it is also exposed to market risk in its investment portfolio. Market risk is dimensioned and controlled in both the trading book and in the balance sheet. In the trading book, market risk is controlled by a daily analysis of the Value-At-Risk (VaR) of trading instruments under normal market conditions. The volatilities used for this regular analysis are those for a rolling one-year period, updated quarterly. The risk amounts computed are for a 99% confidence level.

Foreign Currency Risk
The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

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

Foreign currency 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 liabilities with the foreign currency assets held through FCDUs. In addition, the BSP requires a 30% liquidity reserve on all foreign currency liabilities held through FCDUs. Outside the FCDU, the Parent Company has additional foreign currency assets and liabilities in its foreign branch network.

The Group's policy is to maintain foreign currency exposure within acceptable limits and within existing regulatory guidelines. The Group believes that its profile of foreign currency exposure on its assets and liabilities is within conservative limits for a financial institution engaged in the type of business in which the Group is involved.

The table below summarizes the Group's exposure to foreign currency exchange rate risk as of December 31, 2006 and 2005. Included in the table are the Group's assets and liabilities at carrying amounts (in thousand pesos), categorized by currency.

	2006			2005		
	USD	Others	Total	USD	Others	Total
Assets						
Cash and Due from BSP	₱980,932	₱104,990	₱1,085,922	₱1,407,663	₱133,072	₱1,540,735
Due from other banks	1,778,688	687,262	2,465,950	894,331	1,237,476	2,131,807
Interbank loans receivable and securities held under agreements to resell	18,506,373	409,626	18,915,999	15,269,943	404,332	15,674,275
Loans and receivables	10,009,918	33,822	10,043,740	10,311,463	1,320,334	11,631,797
AFS investments	24,953,318	181,761	25,135,079	21,041,109	184,350	21,225,459
HTM investments	1,483,545	–	1,483,545	5,017,574	–	5,017,574
Other assets	3,936,788	3,628	3,940,416	3,692,028	170,574	3,862,602
Total assets	61,649,562	1,421,089	63,070,651	57,634,111	5,450,138	61,084,249
Liabilities						
Deposit liabilities	42,737,240	782,669	43,519,909	41,390,246	633,420	42,023,666
Bills and acceptances payable	3,059,217	5	3,059,222	2,720,514	1,384,243	4,104,757
Accrued taxes, interest and other expenses	105,031	1,324	106,355	73,669	3,309	76,978
Other liabilities	5,727,288	580,652	6,307,940	5,471,267	538,465	6,009,732
Total liabilities	51,628,776	1,364,650	52,993,426	49,655,696	2,559,437	52,215,133
Net Exposure	₱10,020,786	₱56,439	₱10,077,225	₱7,978,415	₱2,890,701	₱8,869,116

Information relating to the Parent Company's currency derivatives is contained in Note 30. The Parent Company has outstanding foreign currency spot transactions (in equivalent peso amounts) of ₱1.3 billion (sold) and ₱0.9 billion (bought) as of December 31, 2006 and ₱0.4 billion (sold) and ₱0.4 billion (bought) as of December 31, 2005, respectively.

Maturity (Liquidity Risk)

The Group's liquidity management involves maintaining funding capacity to accommodate fluctuations in asset and liability levels due to changes in the Group's business operations or unanticipated events created by customer behavior or capital market conditions. The Group seeks to ensure liquidity through a combination of active management of liabilities, a liquid asset portfolio composed substantially of deposits in primary and secondary reserves, the securing of money market lines and the maintenance of repurchase facilities to address any unexpected liquidity situations.

Liquidity risk is monitored and controlled primarily by a gap analysis of maturities of relevant assets and liabilities reflected in the maximum cumulative outflow (MCO) report, as well as an analysis of liquid assets, which provides guidance as to the Group's ability to generate sufficient liquidity. The MCO focuses on a 12-month period wherein the 12-month cumulative outflow is compared to the acceptable MCO limit set by the BOD. Furthermore, an internal liquidity ratio has been set to determine sufficiency of liquid assets over deposit liabilities.

Liquidity is monitored on a daily basis and under stressed situations. Refer to Note 33 for the maturity profile of the Group's assets and liabilities.

Interest Rate Risk

The Parent Company seeks to ensure that exposure to fluctuations in interest rates are kept within acceptable limits. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise.

Repricing mismatches will expose the Bank to interest rate risk. The Parent Company measures the sensitivity of its assets and liabilities to interest rate fluctuations by way of a "repricing gap" analysis using the repricing characteristics of its balance sheet positions tempered with approved assumptions. To evaluate earnings exposure, interest rate sensitive liabilities in each time band are subtracted from the corresponding interest rate assets to produce a "repricing gap" for that time band. The difference in the amount of assets and liabilities maturing or being repriced over a one year period would then give the Parent Company an indication of the extent to which it is exposed to the risk of potential changes in net interest income. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. Accordingly, during a period of rising interest rates, a company with a positive gap would be better positioned than one with a negative gap to invest in higher yielding assets more quickly than it would need to refinance its interest-bearing liabilities. During a period of falling interest rates, a company with a positive gap would tend to see its assets repricing at a faster rate than one with a negative gap, which may restrain the growth of its net income or result in a decline in net interest income.

For risk management purposes, the repricing gap covering the one year period is multiplied by an assumed change in interest rates to yield an approximation of the change in net interest income that would result from such an interest rate movement. The Parent Company's BOD sets a limit on the level of earnings at risk (EAR) exposure tolerable to the Parent Company. Compliance to the EAR limit is monitored monthly by the Risk Management Group.

The following table sets forth the repricing gap position of the Parent Company as of December 31, 2006 and 2005 (in million pesos):

	2006					
	Up to 1 month	1 to 3 months	3 to 6 Months	6 to 12 months	Greater than 1 year	Total
Financial Assets						
Placements with other banks	₱14,591	₱–	₱–	₱–	₱290	₱14,881
Interbank loans receivable	22,094	–	–	–	–	22,094
Securities held under agreements to resell	15,700	–	–	–	–	15,700
Securities at FVPL	1,109	–	–	–	–	1,109
Loans receivables and unquoted debt instruments	27,664	24,217	3,591	2,946	23,180	81,598
AFS investments	7,232	10,991	1,536	2,892	17,387	40,038
HTM investments	–	269	–	–	1,151	1,420
Total Financial Assets	₱88,390	₱35,477	₱5,127	₱5,838	₱42,008	₱176,840
Financial Liabilities						
Deposit liabilities	₱55,466	₱16,130	₱10,888	₱14,752	₱86,497	₱183,733
Bills and acceptances payable	7,502	–	–	–	2,860	10,362
Subordinated debt	–	–	–	–	8,389	8,389
Other liabilities	4,801	771	104	1,091	2,751	9,518
Total Financial Liabilities	₱67,769	₱16,901	₱10,992	₱15,843	₱100,497	₱212,002
Repricing Gap	₱20,621	₱18,576	(₱5,865)	(₱10,005)	(₱58,489)	(₱35,162)
Cumulative Gap	20,621	39,197	33,332	23,327	(35,162)	–

	2005					
	Up to 1 month	1 to 3 months	3 to 6 Months	6 to 12 months	Greater than 1 year	Total
Financial Assets						
Placements with other banks	₱8,616	₱–	₱–	₱–	₱–	₱8,616
Interbank loans receivable	11,759	5,122	–	–	–	16,881
Securities held under agreements to resell	12,300	–	–	–	–	12,300
Securities at FVPL	1,297	–	–	–	–	1,297
Loans receivables and unquoted debt instruments	23,920	15,180	1,418	1,159	48,729	90,406
AFS investments	9,949	6,203	4,826	3,351	12,658	36,987
HTM investments	–	–	310	760	4,022	5,092
Total Financial Assets	₱67,841	₱26,505	₱6,554	₱5,270	₱65,409	₱171,579
Financial Liabilities						
Deposit liabilities	₱45,217	₱22,096	₱10,961	₱13,258	₱78,564	₱170,096
Bills and acceptances payable	7,246	–	–	–	5,197	12,443
Subordinated debt	–	–	–	–	2,958	2,958
Other liabilities	3,190	412	213	1,725	2,422	7,962
Total Financial Liabilities	₱55,653	₱22,508	₱11,174	₱14,983	₱89,141	₱193,459
Repricing Gap	₱12,188	₱3,997	(₱4,620)	(₱9,713)	(₱23,732)	(₱21,880)
Cumulative Gap	12,188	16,185	11,565	1,852	(21,880)	–

6. Fair Value Measurement

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

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

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

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

Unquoted equity securities - Fair values could not be reliably determined due to the unpredictable nature of future cash flows and the lack of suitable methods of arriving at a reliable fair value.

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

Liabilities - The fair value of quoted debt instruments are based on quotes obtained from an independent pricing service. For unquoted instruments, fair values 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. Except for bills and acceptances payable and subordinated notes, the carrying values approximate fair values due to either the presence of a demand feature or the relatively short-term maturities of these liabilities.

Derivative instruments - Fair values are estimated based on quoted market prices, prices provided by independent parties or acceptable valuation models.

The following table summarizes the carrying amounts and fair values of the financial assets and liabilities as of December 31, 2006 and 2005:

	2006			
	Consolidated		**Parent Company**	
	Carrying Value	**Fair value**	**Carrying Value**	**Fair value**
	(In Thousand Pesos)			
Financial Assets				
Cash and Due from BSP	**₱17,386,914**	**₱17,386,914**	**₱17,320,298**	**₱17,320,298**
Due from other banks	**3,555,603**	**3,555,603**	**2,314,288**	**2,314,288**
Interbank loans receivable	**22,412,817**	**22,412,817**	**22,093,537**	**22,093,537**
Securities held under agreements to resell	**15,700,000**	**15,700,000**	**15,700,000**	**15,700,000**
Securities at FVPL	**1,137,835**	**1,137,835**	**1,109,137**	**1,109,137**
Loans and receivables	**83,592,219**	**83,348,602**	**81,465,282**	**81,051,369**
Receivables from SPV	**1,361,074**	**1,361,074**	**1,361,074**	**1,361,074**
AFS investments	**42,824,810**	**42,824,810**	**40,822,339**	**40,822,339**
HTM investments	**1,554,368**	**1,719,244**	**1,420,044**	**1,584,920**
Financial Liabilities				
Deposit liabilities	**181,667,692**	**181,667,692**	**183,732,964**	**183,732,964**
Bills and acceptances payable	**10,955,948**	**10,955,949**	**10,361,715**	**10,361,715**
Subordinated debt	**8,389,297**	**9,588,439**	**8,389,297**	**9,588,439**
Other liabilities	**10,167,060**	**10,167,060**	**9,517,601**	**9,517,601**

	2005			
	Consolidated		Parent Company	
	Carrying Value	Fair value	Carrying Value	Fair value
	(In Thousand Pesos)			
Financial Assets				
Cash and due from BSP	₱9,389,364	₱9,389,364	₱9,053,145	₱9,053,145
Due from other banks	5,494,793	5,494,793	4,897,004	4,897,004
Interbank loans receivable	16,914,045	16,914,045	16,881,081	16,881,081
Securities held under agreement to resell	12,300,000	12,300,000	12,300,000	12,300,000
Securities at FVPL	1,323,591	1,323,591	1,297,213	1,297,213
Loans and receivables	80,072,004	80,053,498	77,895,771	77,756,696
AFS investments	40,242,135	40,242,135	38,084,187	38,084,187
HTM investments	5,266,817	5,365,103	5,091,685	5,189,971
Financial Liabilities				
Deposit liabilities	167,826,777	167,826,777	170,095,880	170,095,880
Bills and acceptances payable	13,145,874	13,145,874	12,443,283	12,443,283
Subordinated debt	2,958,437	3,117,041	2,958,437	3,117,041
Other liabilities	8,555,552	8,555,552	7,962,301	7,962,301

7. Segment Information

Business Segments

The Group's operating businesses are determined 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's business segments follow:

Retail Banking - principally handling individual customer's deposits, and providing consumer type loans, overdrafts, credit card facilities and fund transfer facilities

Corporate Banking - principally handling loans and other credit facilities and deposit accounts for corporate and institutional customers

Treasury - principally providing money market, trading and treasury services, as well as the management of the Group's funding operations by use of T-bills, government securities and placements and acceptances with other banks, through treasury and wholesale banking.

These segments are the bases on which the Group reports its primary segment information. Other operations of the Group comprise of the operations and financial control groups. Transactions between segments are conducted at estimated market rates on an arm's length basis. Interest is credited to or charged against business segments based on a pool rate which approximates the marginal cost of funds.

Business segment information of the Group follows (in thousand pesos):

	2006				
	Retail Banking	Corporate Banking	Treasury	Others	Total
Gross income	₱3,153,057	₱5,964,411	₱9,272,896	₱1,782,615	₱20,172,979
Segment result	₱744,233	₱1,524,341	₱3,008,677	₱356,997	₱5,634,248
Unallocated expenses					3,881,540
Income from operations before tax					1,752,708
Provision for income tax					(932,679)
Minority interest					(5,594)
Net income for the year attributable to equity holders of the Parent Company					₱814,435
Other Information					
Segment assets	₱29,588,781	₱70,393,516	₱80,011,081	₱31,342,309	₱211,335,687
Unallocated assets					32,135,378
Total assets					₱243,471,065
Segment liabilities	₱26,305,449	₱62,582,268	₱71,132,617	₱27,864,396	₱187,884,730
Unallocated liabilities					30,830,060
Total liabilities					₱218,714,790
Other Segment Information					
Capital expenditures	₱272,729	₱6,144	₱380	₱24,370	₱303,623
Unallocated capital expenditures					214,551
Total capital expenditures					₱518,174
Depreciation and amortization	₱273,198	₱373,412	₱14,876	₱47,700	₱709,186
Unallocated depreciation and amortization					402,178
Total depreciation and amortization					₱1,111,364
Provision for impairment and credit losses					₱2,802,283

	2005				
	Retail Banking	Corporate Banking	Treasury	Others	Total
Gross income	₱3,253,014	₱5,700,770	₱6,593,889	₱2,002,811	₱17,550,484
Segment result	₱1,895,821	₱824,659	₱2,264,326	₱805,175	₱5,790,181
Unallocated expenses					3,270,917
Income from operations before tax					2,519,264
Provision for income tax					(1,891,726)
Minority interest					(6,617)
Net income for the year attributable to equity holders of the Parent Company					₱620,921
Other Information					
Segment assets	₱31,222,190	₱78,238,539	₱67,164,137	₱26,468,019	₱203,092,885
Unallocated assets					19,565,365
Total assets					₱222,658,250
Segment liabilities	₱27,783,779	₱69,622,352	₱59,767,542	₱23,553,171	₱180,726,844
Unallocated liabilities					19,022,134
Total liabilities					₱199,748,978
Other Segment Information					
Capital expenditures	₱259,386	₱8,519	₱2,044	₱30,743	₱300,692
Unallocated capital expenditures					215,198
Total capital expenditures					₱515,890
Depreciation and amortization	₱181,717	₱9,997	₱41,540	₱10,664	₱243,918
Unallocated depreciation and amortization					556,534
Total depreciation and amortization					₱800,452
Provision for impairment and credit losses					₱504,213

	2004				
	Retail Banking	Corporate Banking	Treasury	Others	Total
Gross income	₱2,665,170	₱5,347,414	₱6,452,622	₱1,441,981	₱15,907,187
Segment result	₱1,299,763	₱315,801	₱1,349,744	₱313,827	₱3,279,135
Unallocated expenses					2,302,457
Income from operations before tax					976,678
Provision for income tax					(618,142)
Minority interest					(6,619)
Net income for the year attributable to equity holders of the Parent Company					₱351,917
Other Information					
Segment assets	₱35,152,132	₱76,767,000	₱94,917,336	₱5,417,254	₱212,253,722
Unallocated assets					7,487,302
Total assets					₱219,741,024
Segment liabilities	₱32,109,282	₱67,080,807	₱86,828,027	₱5,021,365	₱191,039,481
Unallocated liabilities					3,127,905
Total liabilities					₱194,167,386
Other Segment Information					
Capital expenditures	₱177,622	₱1,624	₱13,401	₱143,415	₱336,062
Unallocated capital expenditures					7,542
Total capital expenditures					₱343,604
Depreciation and amortization	₱177,747	₱13,563	₱32,932	₱244,847	₱469,089
Unallocated depreciation and amortization					294,358
Total depreciation and amortization					₱763,447
Provision for impairment and credit losses					₱964,335

Geographical Segments

Although the Group's businesses are managed on a worldwide basis, the Group operates in five principal geographical areas of the world. The distribution of assets, liabilities, off-balance sheet items and revenues by geographic region of the Group as of December 31, 2006 and 2005 follows (in thousand pesos):

	Assets		Liabilities		Credit Commitments		Revenues	
	2006	2005	**2006**	2005	**2006**	2005	**2006**	2005
Philippines	**₱230,693,390**	₱207,405,509	**₱ 208,345,788**	₱189,001,156	**₱ 57,091,916**	₱65,840,050	**₱17,767,691**	₱14,983,968
Asia (excluding Philippines)	**4,572,540**	8,200,346	**6,373,945**	7,122,249	**1,786,160**	754,369	**895,672**	982,928
United States and Canada	**4,093,909**	4,841,563	**2,406,088**	2,204,031	**37,640**	43,121	**1,248,935**	1,308,100
United Kingdom	**1,257,561**	1,448,746	**712,116**	501,802	**5,021**	60,698	**172,822**	171,281
Other European Union Countries	**853,657**	762,066	**796,933**	759,540	**–**	–	**87,859**	104,207
	₱243,473,065	₱222,658,230	**₱218,714,790**	₱199,748,978	**₱58,840,745**	₱66,698,178	**₱20,172,979**	₱17,550,484

The Philippines is the home country of the Parent Company, which is also the main operating company. The Group offers a wide range of financial services as discussed in Note 1. Additionally, most of the remittance services are managed and conducted in Asia, Canada, USA and United Kingdom.

The areas of operation include all the primary business segments.

8. Securities at Fair Value Through Profit or Loss

This account consists of:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
	(In Thousand Pesos)			
Derivative assets (Note 30)	**₱961,067**	₱785,122	**₱961,067**	₱785,122
Government securities	**148,070**	507,140	**148,070**	512,091
Equity securities	**28,698**	31,329	**–**	–
	₱1,137,835	₱1,323,591	**₱1,109,137**	₱1,297,213

Government securities include unrealized gain of ₱1.1 million and ₱0.8 million as of December 31, 2006 and 2005, respectively, for the Group and the Parent Company.

Equity securities include unrealized gain of ₱1.0 million and ₱2.8 million as of December 31, 2006 and 2005, respectively, for the Group.

In 2006 and 2005, the effective interest rates of government securities range from 4.10% to 9.65% and 5.83% to 12.09%, respectively.

9. Loans and Receivables

This account consists of:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
	(In Thousand Pesos)			
Loans receivables:				
Loans and discounts	**₱55,533,021**	₱65,481,792	**₱54,643,968**	₱64,613,174
Bills purchased	**3,003,647**	2,994,513	**3,003,647**	2,994,513
Customers' liabilities on acceptances, letters of credit and trust receipts	**2,078,947**	1,744,153	**2,078,947**	1,744,153
Lease contracts receivable	**1,002,423**	968,530	**–**	–
Credit card accounts	**569,915**	558,896	**569,915**	558,896
	62,187,953	71,747,884	**60,296,477**	69,910,736
Less unearned and other deferred income	**543,861**	1,234,570	**431,438**	1,134,741
	61,644,092	70,513,314	**59,865,039**	68,775,995
Unquoted debt instruments	**21,301,724**	20,495,265	**21,301,724**	20,495,265
Other receivables:				
Accrued interest receivable	**5,952,681**	6,014,291	**5,914,611**	5,964,368
Accounts receivable	**5,233,271**	3,983,271	**4,926,892**	3,431,571
Sales contract receivables	**2,110,298**	2,175,412	**2,110,298**	2,175,412
Miscellaneous	**847,376**	1,021,531	**617,521**	989,942
	14,143,626	13,194,505	**13,569,322**	12,561,293
	97,089,442	104,203,084	**94,736,085**	101,832,553
Less allowance for credit losses (Note 16)	**13,497,223**	24,131,080	**13,270,803**	23,936,782
	₱83,592,219	₱80,072,004	**₱81,465,282**	₱77,895,771

As of December 31, 2006 and 2005, 57.48% and 62.91%, respectively, of the total loans receivables of the Parent Company were subject to periodic interest repricing. Remaining receivables carry annual fixed interest rates ranging from 5.25% to 13.26% in 2006 and 5.70% to 12.28% in 2005 for foreign currency-denominated receivables, and from 5.75% to 22.75% in 2006 and 5.70% to 29.0% in 2005 for peso-denominated receivables.

Sales contract receivables bear fixed interest rate per annum of 0.58% to 21% in 2006 and 0.58% to 19.05% in 2005.

The effective interest rates of 'Loans receivable', 'Unquoted debt instruments' and 'Sales contract receivables' range from 5.67% to 10.69% in 2006 and from 5.26% to 15.00% in 2005 for foreign currency-denominated receivables, and from 5.51% to 18.84% in 2006 and from 6.00% to 19.05% in 2005 for peso-denominated receivables.

BSP Circular 520 dated March 20, 2006 requires that the difference between the selling price and the carrying value of investment properties sold under installment should be recognized in profit or loss at the date of sale. Accordingly, the Parent Company reversed the outstanding deferred income and credits representing the unrealized gain on sale of investment properties amounting to ₱750.0 million and credited to the beginning balance of deficit, net of deferred income tax amounting to ₱225.0 million.

In 2004, the Parent Company sold the outstanding loans receivable of ₱5.3 billion from National Steel Corporation (NSC) to SPV companies under the provisions of Republic Act (RA) No. 9182, *The Special Purpose Vehicle Act of 2002.* In consideration for such sale, the Parent Company received zero-coupon notes and cash totaling ₱4.2 billion. In accordance with the BSP Memorandum dated February 16, 2004, *Accounting Guidelines on the Sale of Nonperforming Assets (NPAs) to Special Purpose Vehicles,* the ₱1.6 billion allowance for impairment losses previously provided for the NSC loans receivable was released by the Parent Company to cover additional allowance for credit and impairment losses required for other existing NPAs and other risk assets of the Parent Company. With the release of such allowance, the loss on the sale of the NSC loans receivable to the SPV amounting to ₱1.1 billion representing the difference between the carrying value of the receivables and consideration received was deferred by the Parent Company as allowed under the regulations issued by the BSP for banks and financial institutions availing of the provisions of RA No. 9182 (see Note 15).

Unquoted debt instruments include the zero-coupon notes received by the Parent Company on October 15, 2004 as discussed above at the principal amount of ₱803.5 million (Tranche A Note) payable in five years and at the principal amount of ₱3.4 billion (Tranche B Note) payable in eight years in exchange for the outstanding loans receivable from NSC of ₱5.3 billion. The notes are secured by a first ranking mortgage and security interest over the NSC plant assets.

As of December 31, 2004, the zero-coupon notes had an outstanding balance of ₱3.8 billion, after receipt of an additional cash payment of ₱140.3 million and the recognition of an allowance for credit losses of ₱259.8 million. Using a discount rate of 13.24%, the present value of such notes as of that date amounted to ₱1.9 billion. The ₱1.9 billion difference between the present value and the outstanding balance of the notes was deferred over a ten-year period in accordance with regulatory accounting policies prescribed by the BSP for banks and non-bank financial institutions availing of the provisions of RA No. 9182. However, on January 1, 2005, the Parent Company recognized this difference as a direct charge against deficit. As of December 31, 2006 and 2005, these notes had a carrying value of ₱2.2 billion and ₱2.0 billion, respectively.

In 2005, the Parent Company sold another pool of NPL with outstanding balance of ₱4.7 billion. Upon adoption of PAS 39 on January 1, 2005, the Parent Company did not set up allowance for credit losses on the NPLs sold to SPV since it availed of the provisions of RA No. 9182 in the recognition of the loss from sale of ₱4.3 billion (see Note 15).

In 2006, the Parent Company entered into a sale and purchase agreement for the sale of certain NPLs and foreclosed properties booked under 'Investment properties'. The loss on sale amounting to ₱1.9 billion was deferred and will be amortized over 10 years as allowed under RA No. 9182. As part of this sale and purchase agreement, another pool of NPLs will be sold in 2007. The additional required allowance for credit losses on these NPLs amounting to ₱1.3 billion is not recognized in the financial statements since upon sale, the loss will be deferred and amortized over 10 years (see Note 10).

Under RA No. 9182, losses on sale of NPL to SPV companies can be amortized over 10 years based on the following schedule:

End of Period From Date of Transaction	Cumulative Write-down of Deferred Charges
Year 1	5%
Year 2	10%
Year 3	15%
Year 4	25%
Year 5	35%
Year 6	45%
Year 7	55%
Year 8	70%
Year 9	85%
Year 10	100%

For the purpose of computing the Parent Company's regular corporate income tax, the loss is treated as an ordinary loss and will be carried over as a deduction from the Parent Company's taxable income for a period of five consecutive taxable years immediately following the year of sale.

Had the 2006 and 2004 losses been charged against operations and the allowance for impairment losses on the sold NPA in 2005 been set up as of January 1, 2005 as required by PFRS, deferred charges and equity would have decreased by ₱6.9 billion and ₱8.2 billion, respectively, and allowance for credit losses would have increased by ₱1.3 billion as of December 31, 2006, deferred charges and equity would have decreased by ₱5.2 billion as of December 31, 2005, and 2006 and 2004 net income would have decreased by ₱3.2 billion and ₱1.1 billion, respectively, and 2005 net income would have increased by ₱124.8 million.

In 2006 and 2005, the amortization of the loss on sale of NPAs amounting to ₱267.9 million and ₱54.0 million, respectively, was charged to deficit.

Unquoted debt instruments also include the following securities:

a. Twelve-year peso-denominated bonds with face value amounting to ₱11.2 billion. These bonds, with an original amount of ₱24.3 billion, were issued by the NG in settlement of the Parent Company's claims from NG. These bonds, which will mature in 2007, are eligible as part of the liquidity cover requirements on government deposits. These bonds were redeemable at any time at the option of the NG and were originally issued as nontransferable until the lifting of such restriction in 1997. In February 1998, ₱10.0 billion of these bonds were sold with an agreement to swap interest payments based on the average 91-day and 364-day T-bill rates during the three-month period preceding the annual repricing date for the remaining term of the bonds. These bonds are pledged to secure performance of the estimated net interest differential under the interest rate swap agreement (see Note 30). The interest rate swap agreement matured on August 1, 2006.

   As of December 31, 2006, these bonds are pledged as collateral to secure the Parent Company's borrowing from PDIC (see Note 18).

b. Bonds issued by Philippine Sugar Corporation (PSC) amounting to ₱2.8 billion. The bonds carry an annual interest rate of 4.00% and will mature in 2014. The full repayment of principal and accumulated interest to maturity is guaranteed by a sinking fund managed by the Parent Company's Trust Banking Group (TBG). As of December 31, 2006 and 2005, the net asset value of the sinking fund amounted to ₱3.9 billion and ₱3.0 billion, respectively, earning an average rate of return of 9.44% per annum. Management expects that the value of the sinking fund in the year 2014 will be more than adequate to cover the full redemption value of PSC bonds.

On November 27, 1997, Maybank Philippines, Inc. (Maybank) and the Parent Company signed a deed of assignment transferring to the Parent Company certain Maybank assets (included under accounts receivables) and liabilities amounting to ₱1.9 billion and ₱1.3 billion, respectively, in connection with the sale of the Parent Company's 60.00% equity in Maybank. As of December 31, 2006 and 2005, the balance of these receivables amounting to ₱2.0 billion and ₱2.4 billion, respectively, of which is included under loans and receivables, may be offset against the equivalent amount of transferred liabilities (included under Bills payable to BSP and local banks - Note 18). The excess of the transferred receivables over the transferred liabilities is fully covered by an allowance for credit losses amounting to ₱40.9 million and ₱38.3 million as of December 31, 2006 and 2005, respectively. The remaining equity ownership of the Parent Company in Maybank was sold in June 2000 (see Note 29).

Miscellaneous receivables include assets previously transferred to the NG as part of the Parent Company's rehabilitation in 1986. These receivables were repurchased by the Parent Company from the NG at a discount and are mostly secured by real estate mortgages. These receivables are likewise fully covered by allowance for credit losses amounting to ₱237.6 million and ₱339.8 million as of December 31, 2006 and 2005, respectively.

BSP Reporting

The information relating to loans receivables as to secured and unsecured and as to collateral follows:

	Consolidated			
	2006		2005	
	Amount	%	Amount	%
	(Amounts in Thousand Pesos)			
Secured:				
Real estate mortgage	₱24,094,623	38.74	₱32,520,658	45.33
Chattel mortgage	3,313,479	5.33	5,080,822	7.08
Bank deposit hold-out	1,413,766	2.27	1,522,865	2.12
Shares of stocks	1,218,750	1.96	1,631,539	2.27
Others	6,708,757	10.79	13,775,445	19.20
	36,749,375	59.09	54,531,329	76.00
Unsecured	25,438,578	40.91	17,216,555	24.00
	₱62,187,953	100.00	₱71,747,884	100.00

	Parent Company			
	2006		2005	
	Amount	%	Amount	%
	(Amounts in Thousand Pesos)			
Secured:				
Real estate mortgage	₱24,015,647	39.83	₱32,439,639	46.40
Chattel mortgage	2,643,098	4.38	4,885,738	6.99
Bank deposit hold-out	1,319,105	2.19	1,625,370	2.32
Shares of stocks	1,218,750	2.02	1,436,121	2.05
Others	5,848,232	9.70	12,804,664	18.32
	35,044,832	58.12	53,191,532	76.08
Unsecured	25,251,645	41.88	16,719,204	23.92
	₱60,296,477	100.00	₱69,910,736	100.00

The information on loan concentration as to industry follows:

	Consolidated			
	2006		2005	
	Amount	%	Amount	%
	(Amounts in Thousand Pesos)			
Wholesale and retail trade	₱13,520,267	21.74	₱8,547,133	11.91
Manufacturing	8,942,879	14.38	10,023,295	13.97
Transport, storage and communications	7,299,050	11.74	7,909,742	11.02
Real estate, renting and business activities	6,298,557	10.13	11,169,810	15.57
Public administration and defense	5,192,431	8.35	8,427,260	11.75
Electricity, gas and water	5,070,670	8.15	8,471,278	11.81
Financial intermediaries	4,341,166	6.98	4,855,878	6.77
Agriculture, hunting and forestry	3,239,527	5.21	3,540,693	4.93
Construction	2,399,576	3.86	2,594,055	3.62
Other community, social and personal services	2,274,673	3.66	3,158,873	4.40
Private household	2,135,232	3.43	1,681,407	2.34
Hotel and restaurant	646,937	1.04	355,079	0.50
Education	347,201	0.56	317,829	0.44
Mining and quarrying	171,261	0.28	280,933	0.39
Health and social work	12,274	0.02	19,114	0.03
Fishing	7,984	0.01	10,439	0.01
Others	288,268	0.46	385,066	0.54
	₱62,187,953	100.00	₱71,747,884	100.00

	Parent Company			
	2006		2005	
	Amount	%	Amount	%
	(Amounts in Thousand Pesos)			
Wholesale and retail trade	₱13,336,458	22.12	₱8,266,138	11.82
Manufacturing	8,276,657	13.73	9,479,953	13.56
Transport, storage and communications	6,900,442	11.45	7,755,334	11.09
Real estate, renting and business activities	6,272,362	10.40	11,169,810	15.98
Public administration and defense	5,118,785	8.49	8,427,260	12.05
Electricity, gas and water	5,070,670	8.41	8,471,278	12.12
Financial intermediaries	4,819,955	7.99	4,806,122	6.88
Agriculture, hunting and forestry	2,872,322	4.76	3,540,693	5.07
Construction	2,399,576	3.98	2,592,903	3.71
Other community, social and personal services	2,274,162	3.77	3,083,092	4.41
Private household	1,853,565	3.07	1,347,433	1.93
Hotel and restaurant	642,130	1.07	350,673	0.50

(Forward)

	Parent Company			
	2006		2005	
	Amount	%	Amount	%
	(Amounts in Thousand Pesos)			
Education	**₱263,786**	**0.44**	₱309,560	0.44
Mining and quarrying	**171,261**	**0.28**	280,933	0.40
Health and social work	**12,274**	**0.02**	19,114	0.03
Fishing	**7,984**	**0.01**	10,440	0.01
Others	**4,058**	**0.01**	–	–
	₱60,296,477	**100.00**	₱69,910,736	100.00

The BSP considers that loan concentration exists when the total loan exposure to a particular industry exceeds 30.00% of the total loan portfolio. As of December 31, 2006 and 2005, the Group and the Parent Company do not have loan concentration risk to any particular industry.

NPLs as to secured and unsecured follows:

	Consolidated		Parent Company	
	2006	2005	2006	2005
	(In Thousand Pesos)			
Secured	**₱7,436,035**	₱24,893,915	**₱7,436,035**	₱24,816,311
Unsecured	**4,860,651**	3,021,588	**4,702,983**	3,021,588
	₱12,296,686	₱27,915,503	**₱12,139,018**	₱27,837,899

Generally, NPLs refer to loans whose principal and/or interest is unpaid for thirty (30) days or more after due date or after they have become past due in accordance with existing BSP rules and regulations. This shall apply to loans payable in lump sum and loans payable in quarterly, semi-annual, or annual installments, in which case, the total outstanding balance thereof shall be considered nonperforming.

In the case of loans that are payable in monthly installments, the total outstanding balance thereof shall be considered nonperforming when three (3) or more installments are in arrears.

In the case of loans that are payable in daily, weekly, or semi-monthly installments, the total outstanding balance thereof shall be considered nonperforming at the same time that they become past due in accordance with existing BSP regulations, i.e., the entire outstanding balance of the receivable shall be considered as past due when the total amount of arrearages reaches ten percent (10%) of the total loan balance.

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

Loans which do not meet the requirements to be treated as performing loans shall also be considered as NPLs. Current banking regulations allow banks that have no unbooked valuation reserves and capital adjustments to exclude from nonperforming classification those loans classified as Loss in the latest examination of the BSP which are fully covered by allowance for credit losses, provided that interest on said receivables shall not be accrued.

The details of the NPL of the Group and of the Parent Company follow:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
	(In Thousand Pesos)			
Total NPL	**₱12,296,686**	₱27,915,503	**₱12,139,018**	₱27,837,899
Less NPL fully covered by allowance for credit losses	**2,117,804**	6,738,098	**1,974,600**	6,674,646
	₱10,178,882	₱21,177,405	**₱10,164,418**	₱21,163,253

Most of these loans are secured mainly by real estate or chattel mortgages.

Restructured loans of the Group and of the Parent Company as of December 31, 2006 and 2005 amounted to ₱14.5 billion and ₱23.2 billion, respectively.

10. Receivables from Special Purpose Vehicle

Receivables from SPV represents the present value of the note received by the Parent Company from the sale of the first pool of NPAs to an SPV on December 29, 2006. The asset sale and purchase agreement (ASPA) were executed on December 19, 2006. The BSP issued the certificate of eligibility on January 31, 2007. However, the BSP confirmed that this transaction qualified as a true sale under RA No. 9182 and that the NPAs may be derecognized already from its books as of December 31, 2006.

The more significant terms of the sale are as follows:

a. Certain NPAs of the Parent Company will be sold to the SPV and divided into two pools. The sale of the first pool of NPAs with outstanding balance of ₱11.7 billion was made on December 29, 2006 for a total consideration of ₱11.7 billion. The sale of the second pool is expected to be completed on March 30, 2007 for a total consideration of ₱7.6 billion.

b. The agreed purchase price of the first pool of NPAs shall be paid as follows:

   i. An initial amount of ₱1.1 billion (included in Accounts receivable as of December 31, 2006), which was received in full and acknowledged by the Parent Company on February 14, 2007; and

   ii. The balance of ₱10.6 billion, through issuance of SPV Notes (the Notes), shall be paid over a period of five years based on a cash flow waterfall arrangement and at an interest equivalent to the 3-month MART prevailing as of the end of the quarter prior to the payment date.

The Parent Company availed of the incentives provided under RA No. 9182 in the recognition of loss from the sale amounting to ₱1.9 billion (included in deferred charges under 'Other assets'). Under RA No. 9182, the loss on sale of NPAs to SPV companies can be amortized over 10 years (see Note 9).

Under the ASPA, the sale of the second pool of NPAs amounting to ₱7.6 billion with allowance for credit losses of ₱5.5 billion shall be effective in 2007. However, the BSP already confirmed in its letter dated February 28, 2007 that these NPAs qualify as a true sale under RA No. 9182 as of December 31, 2006. As discussed in Note 9, since the Parent Company will again avail of the incentives mentioned above, it did not recognize the required additional allowance for credit losses on these NPAs amounting to ₱1.3 billion. The NPAs to be sold to SPV is included in 'Other assets' (see Note 15).

The sale of the NPAs to the SPV qualified for derecognition under BSP regulatory reporting rules. However, PFRS requires that the accounts of the SPV that acquired the NPA of the Parent Company should be consolidated into the Group's accounts. Had the accounts of the SPV been consolidated into the Group's accounts, total assets and minority interest in equity of consolidated entities would have increased by ₱30.0 million.

11. Investment Securities

This account consists of:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
	(In Thousand Pesos)			
AFS investments:				
Government securities (Notes 17 and 27)	**₱23,725,316**	₱38,790,610	**₱21,745,969**	₱36,986,894
Other debt securities	**18,066,094**	339,688	**18,292,509**	–
Equity securities - net of allowance for credit losses of ₱445.4 million and ₱122.8 million in 2006 and 2005, respectively (Note 16)	**1,033,400**	1,111,837	**783,861**	1,097,293
	42,824,810	40,242,135	**40,822,339**	38,084,187
HTM investments:				
Government securities (Note 27)	**1,528,051**	5,266,817	**1,420,044**	5,091,685
Other debt securities	**26,317**	–	–	–
	1,554,368	5,266,817	**1,420,044**	5,091,685
	₱44,379,178	₱45,508,952	**₱42,242,383**	₱43,175,872

Unquoted AFS equity securities as of December 31, 2006 and 2005, amounted to ₱358.0 million and ₱364.6 million, respectively.

Unrealized gain on AFS investments amounted to ₱862.2 million and ₱819.8 million as of December 31, 2006 for the Group and Parent Company, respectively. Unrealized gain on AFS investments amounted to ₱908.7 million (net of unrealized loss of ₱2.8 million of subsidiaries) and ₱868.7 million as of December 31, 2005 for the Group and Parent Company, respectively.

Effective interest rates range from 5.25% to 22.87% and 4.20% to 17.28% for peso-denominated and foreign currency-denominated AFS investments, respectively, in 2006. Effective interest rates range from 4.20% to 17.28% and 4.03% to 10.63% for peso-denominated and foreign currency-denominated AFS investments, respectively, in 2005.

Effective interest rate for peso-denominated HTM investments is 7.35% and ranges from 5.19% to 8.87% for foreign currency-denominated HTM investments in 2006. Effective interest rates range from 4.17% to 8.57% and 5.19% to 8.88% for peso-denominated and foreign currency-denominated HTM investments, respectively, in 2005.

Interest income on Investment securities consists of:

	Consolidated			Parent Company		
	2006	2005	2004	**2006**	2005	2004
			(In Thousand Pesos)			
Securities at FVPL	**₱1,102,862**	₱654,304	₱456,001	**₱1,102,862**	₱654,304	₱456,001
AFS investments	**2,668,438**	2,856,769	392,822	**2,584,733**	2,774,909	278,233
HTM investments	**377,246**	634,883	3,166,386	**365,551**	634,883	3,166,386
	₱4,148,546	₱4,145,956	₱4,015,209	**₱4,053,146**	₱4,064,096	₱3,900,620

12. Property and Equipment

The composition of and changes in furniture, fixtures and equipment and leasehold improvements follow:

	Consolidated			
	2006			
	Furniture, Fixtures and Equipment	Leasehold Improvements	Total	2005
		(In Thousand Pesos)		
Cost				
Balance at beginning of year	**₱3,130,447**	**₱176,822**	**₱3,307,269**	₱3,915,347
Additions	**309,316**	**27,257**	**336,573**	493,961
Disposals/others	**(836,138)**	**19,312**	**(816,826)**	(1,102,039)
Balance at end of year	**2,603,625**	**223,391**	**2,827,016**	3,307,269
Accumulated Depreciation and Amortization				
Balance at beginning of year	**2,437,301**	**81,091**	**2,518,392**	3,188,583
Depreciation and amortization	**200,913**	**18,681**	**219,594**	245,005
Disposals/others	**(662,876)**	**21,725**	**(641,151)**	(915,196)
Balance at end of year	**1,975,338**	**121,497**	**2,096,835**	2,518,392
Net Book Value at End of Year	**₱628,287**	**₱101,894**	**₱730,181**	₱788,877

	Parent Company			
	2006			
	Furniture, Fixtures and Equipment	Leasehold Improvements	Total	2005
		(In Thousand Pesos)		
Cost				
Balance at beginning of year	**₱2,893,249**	**₱118,140**	**₱3,011,389**	₱3,613,639
Additions	**293,024**	**22,017**	**315,041**	450,883
Disposals	**(795,268)**	**–**	**(795,268)**	(1,053,133)
Balance at end of year	**2,391,005**	**140,157**	**2,531,162**	3,011,389
Accumulated Depreciation and Amortization				
Balance at beginning of year	**2,272,372**	**38,672**	**2,311,044**	2,980,055
Depreciation and amortization	**156,900**	**18,448**	**175,348**	198,425
Disposals	**(619,146)**	**–**	**(619,146)**	(867,436)
Balance at end of year	**1,810,126**	**57,120**	**1,867,246**	2,311,044
Net Book Value at End of Year	**₱580,879**	**₱83,037**	**₱663,916**	₱700,315

The composition of and changes in land and buildings follow:

	Consolidated			
	2006			
	Land	Buildings	Total	2005
	(In Thousand Pesos)			
Appraised Value				
Balance at beginning of year	₱10,404,098	₱5,712,302	₱16,116,400	₱16,114,626
Appraisal increase	838,200	577,247	1,415,447	–
Additions	156,000	25,601	181,601	21,929
Disposals	(155,592)	(11,139)	(166,731)	(20,155)
Balance at end of year	11,242,706	6,304,011	17,546,717	16,116,400
Accumulated Depreciation				
Balance at beginning of year	–	1,250,113	1,250,113	1,108,351
Depreciation	–	145,353	145,353	144,833
Disposals	–	(2,494)	(2,494)	(3,071)
Balance at end of year	–	1,392,972	1,392,972	1,250,113
Allowance for Impairment Loss (Note 16)	264,388	42,538	306,926	325,922
Net Book Value at End of Year	₱10,978,318	₱4,868,501	₱15,846,819	₱14,540,365

	Parent Company			
	2006			
	Land	Buildings	Total	2005
	(In Thousand Pesos)			
Appraised Value				
Balance at beginning of year	₱10,404,098	₱5,705,468	₱16,109,566	₱16,101,454
Appraisal increase	838,200	574,668	1,412,868	–
Additions	156,000	25,601	181,601	21,929
Disposals/others	(155,592)	(1,726)	(157,318)	(13,817)
Balance at end of year	11,242,706	6,304,011	17,546,717	16,109,566
Accumulated Depreciation				
Balance at beginning of year	–	1,247,253	1,247,253	1,105,675
Depreciation	–	145,326	145,326	144,656
Disposals/others	–	393	393	(3,078)
Balance at end of year	–	1,392,972	1,392,972	1,247,253
Allowance for Impairment Loss (Note 16)	264,388	42,538	306,926	325,922
Net Book Value at End of Year	₱10,978,318	₱4,868,501	₱15,846,819	₱14,536,391

Depreciation on the revaluation increment of the buildings amounted to ₱57.3 million, ₱55.7 million and ₱60.3 million in 2006, 2005 and 2004, respectively, for the Parent Company.

Depreciation and amortization expense, inclusive of the depreciation on revaluation increment of the buildings, charged against operations of the Group amounted to ₱365.0 million, ₱550.6 million and ₱456.2 million in 2006, 2005 and 2004, respectively, and ₱310.5 million in 2006, ₱524.6 million in 2005 and ₱429.5 million in 2004 for the Parent Company. Had the land and buildings been carried at cost, the net book value of the land and buildings would have been ₱4.9 billion and ₱5.2 billion as of December 31, 2006 and 2005, respectively, for the Group and Parent Company.

Land and buildings with carrying amount of ₱9.8 billion as of December 31, 2005 were pledged as collateral to secure the Parent Company's borrowings from PDIC. In 2006, the mortgage agreement was amended replacing this collateral with investments in government securities (see Note 18).

13. Investments in Subsidiaries and an Associate

The details of this account follow:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
	(In Thousand Pesos)			
At equity:				
Acquisition cost of:				
PNB IIC	**P–**	P–	**P2,028,202**	P2,028,202
PNB Europe PLC	**–**	–	**785,309**	785,309
PNB IFL	**–**	–	**753,061**	753,061
PNB Holdings	**–**	–	**577,876**	577,876
PNB Capital	**–**	–	**350,000**	350,000
PNB Forex, Inc.	**–**	–	**50,000**	105,000
PNB Securities, Inc.	**–**	–	**62,351**	62,351
PNB Italy - SpA	**–**	–	**58,380**	58,380
PNB GFRS	**–**	–	**33,777**	–
PNB Remittance Center, Ltd.	**–**	–	**32,042**	32,042
Omicron Asset Portfolio (SPV - AMC), Inc.	**–**	–	**31,250**	31,250
Tanzanite Investments (SPV - AMC), Inc.	**–**	–	**31,250**	31,250
Tau Portfolio Investments (SPV - AMC), Inc.	**–**	–	**31,250**	31,250
PNB Corporation - Guam	**–**	–	**7,672**	7,672
PNB Austria	**–**	–	**6,721**	–
Japan - PNB Leasing	**–**	–	**103,176**	103,176
PNB Venture Capital Corporation (100% owned)	**5,061**	5,061	**5,061**	5,061
Beneficial - PNB Life Insurance Company, Inc. (40% owned)	**499,814**	499,814	**499,814**	507,461
OPII	**–**	–	**–**	31,250
	504,875	504,875	**5,447,192**	5,500,591
Accumulated equity in net earnings:				
Balance at beginning of year	**179,296**	138,843	**–**	–
Equity in net earnings for the year	**46,299**	49,665	**–**	–
Dividends/adjustment during the year	**(18,224)**	(9,212)	**–**	–
Balance at end of year	**207,371**	179,296	**–**	–
Share in the equity adjustments of an associate:				
Equity in net unrealized gain on AFS investments	**51,840**	–	**–**	–
Equity in revaluation increment	**33,438**	–	**–**	–
Equity in accumulated translation adjustment	**4,314**	–	**–**	–
	89,592	–	**–**	–
Less allowance for impairment losses	**–**	–	**7,672**	–
	P801,838	P684,171	**P5,439,520**	P5,500,591

On December 29, 2006, the investment in OPII was sold together with certain NPAs of the Parent Company (see Note 10).

As discussed in Note 2, the SEC approved on November 7, 2002 the application of the accumulated translation adjustment of P1.6 billion to eliminate the Parent Company's remaining deficit of P1.3 billion as of December 31, 2001, after applying the total reduction in par value amounting to P7.6 billion. The SEC approval is subject to the following conditions: (a) remaining translation adjustment of P310.7 million as of December 31, 2001 (shown as part of Capital Paid in Excess of Par Value) will not be used to wipe out losses that may be incurred in the future without prior approval of SEC; and (b) for purposes of dividend declaration, any future surplus account of the Parent Company shall be restricted to the extent of the deficit wiped out by the translation adjustment.

As of December 31, 2006 and 2005, acquisition cost of the investments in the Parent Company financial statements include the translation adjustment and accumulated equity in net earnings, net of dividends subsequently received from the quasi-reorganization date, that were closed to deficit on restructuring date.

14. Investment Properties

The composition of and changes in this account follow:

	Consolidated			
	2006			
	Land	Building and Improvements	Total	2005
	(In Thousand Pesos)			
Cost				
Balance at beginning of year	₱25,027,393	₱7,799,810	₱32,827,203	₱32,885,355
Additions	2,281,555	1,901,900	4,183,455	2,123,987
Disposals/others	(5,177,237)	(1,304,760)	(6,481,997)	(2,182,139)
Balance at end of year	22,131,711	8,396,950	30,528,661	32,827,203
Accumulated Depreciation and Impairment Losses				
Balance at beginning of year	3,210,227	2,769,209	5,979,436	4,895,384
Depreciation	–	746,417	746,417	316,268
Provision for impairment losses	642,616	13,030	655,646	218,219
Reversals/others	–	(1,734,914)	(1,734,914)	549,565
Balance at end of year	3,852,843	1,793,742	5,646,585	5,979,436
Net Book Value at End of Year	₱18,278,868	₱6,603,208	₱24,882,076	₱26,847,767

	Parent Company			
	2006			
	Land	Building and Improvements	Total	2005
	(In Thousand Pesos)			
Cost				
Balance at beginning of year	₱25,026,817	₱7,698,565	₱32,725,382	₱32,884,779
Additions	2,281,555	1,901,900	4,183,455	2,022,742
Disposals/others	(5,177,237)	(1,303,454)	(6,480,691)	(2,182,139)
Balance at end of year	22,131,135	8,297,011	30,428,146	32,725,382
Accumulated Depreciation and Impairment Losses				
Balance at beginning of year	3,210,075	2,750,286	5,960,361	4,895,384
Depreciation	–	746,324	746,324	297,345
Provision for impairment losses	642,616	13,030	655,646	218,219
Reversal/others	–	(1,737,933)	(1,737,933)	549,413
Balance at end of year	3,852,691	1,771,707	5,624,398	5,960,361
Net Book Value at End of Year	₱18,278,444	₱6,525,304	₱24,803,748	₱26,765,021

Certain investment properties consisting of prime commercial properties amounting to ₱1.8 billion as of December 31, 2005 were pledged as collateral to secure the Parent Company's bills payable to PDIC inclusive of the bills payable transferred from BSP (see Note 18).

The fair value of the investment properties as of December 31, 2006 and 2005 amounted to ₱34.1 billion and ₱34.4 billion, respectively, as determined by independent and/or in-house appraisers.

15. Other Assets

This account consists of:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
	(In Thousand Pesos)			
Deferred charges	**₱6,886,491**	₱5,287,440	**₱6,883,295**	₱5,287,190
NPAs to be sold to SPV - net of allowance for credit losses of ₱5.5 billion (Notes 10 and 16)	**2,053,934**	–	**2,053,934**	–
Deferred tax assets - net (Note 25)	**1,847,258**	2,627,463	**1,794,291**	2,598,934
Prepaid expenses	**229,617**	123,139	**53,140**	108,103
Sundry debits	**51,192**	78,076	**51,192**	76,992
Miscellaneous	**1,131,531**	1,686,225	**971,932**	1,277,776
	12,200,023	9,802,343	**11,807,784**	9,348,995
Less allowance for impairment losses (Note 16)	**515,512**	1,008,022	**513,591**	906,181
	₱11,684,511	₱8,794,321	**₱11,294,193**	₱8,442,814

Deferred charges mainly represent the loss on sale to SPVs being amortized over 10 years as allowed by RA No. 9182 (see Notes 9 and 10).

Miscellaneous include exchange trading rights. Under the PSE rules, all exchange trading rights are pledged at its full value to the PSE to secure the payment of all debts due to other members of the PSE arising out of or in connection with the present or future members' contracts.

The carrying values of the investment in PSE shares and the exchange trading right in the accounts of PNB Securities were as follows:

	2006	2005
	(In Thousand Pesos)	
AFS investments - 50,000 PSE shares	**₱14,000**	₱7,500
Exchange trading rights	**967**	967
	₱14,967	₱8,467

As of December 31, 2006 and 2005, the latest transacted price of the exchange trading right (as provided by the PSE) amounted to ₱5.0 million and ₱3.5 million, respectively. As of December 31, 2006, the market value of the PSE shares based on quoted price is ₱280 per share.

16. Allowance for Impairment and Credit Losses

Changes in the allowance for impairment losses follow:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
	(In Thousand Pesos)			
Balance at beginning of year				
Property and equipment	**₱325,922**	₱325,922	**₱325,922**	₱325,922
Investment properties	**4,036,162**	4,143,964	**4,036,162**	4,143,964
Other assets	**1,008,022**	254,696	**906,181**	211,515
	5,370,106	4,724,582	**5,268,265**	4,681,401
Provisions during the year	**636,650**	504,213	**636,649**	502,855
Disposals, transfers and others	**(1,050,107)**	141,311	**(942,514)**	84,009
Balance at end of year				
Property and equipment (Note 12)	**306,926**	325,922	**306,926**	325,922
Investment properties (Note 14)	**4,134,211**	4,036,162	**4,134,211**	4,036,162
Other assets (Note 15)	**515,512**	1,008,022	**513,591**	906,181
Investments in subsidiaries and an associate (Note 13)	**–**	–	**7,672**	–
	₱4,956,649	₱5,370,106	**₱4,962,400**	₱5,268,265

Changes in the allowance for credit losses follow:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
	(In Thousand Pesos)			
Balance at beginning of year				
Loans and receivables	**₱24,131,080**	₱27,524,016	**₱23,936,782**	₱27,338,072
AFS investments	**122,846**	527,421	**122,846**	527,421
	24,253,926	28,051,437	**24,059,628**	27,865,493
Allowance on SPV subordinated notes charged to deficit (Note 9)	**–**	1,868,299	**–**	1,868,299
Effect of change in accounting for impairment losses	**–**	1,920,801	**–**	1,913,544
Balance at beginning of year, as restated	**24,253,926**	31,840,537	**24,059,628**	31,647,336
Provisions during the year	**2,165,633**	–	**2,098,087**	–
Accounts charged off, transfers and others	**(7,010,598)**	(7,586,611)	**(6,975,174)**	(7,587,708)
Balance at end of year				
Loans and receivables (Note 9)	**13,497,223**	24,131,080	**13,270,803**	23,936,782
AFS investments (Note 11)	**445,428**	122,846	**445,428**	122,846
NPAs to be sold to SPV (Note 15)	**5,466,310**	–	**5,466,310**	–
	₱19,408,961	₱24,253,926	**₱19,182,541**	₱24,059,628

17. Deposit Liabilities

Of the total deposit liabilities of the Parent Company, ₱7.4 billion in 2006 and ₱6.6 billion in 2005 are noninterest-bearing. Remaining deposit liabilities generally earned annual fixed interest rates ranging from 0.50% to 5.13% in 2006 and from 0.50% to 4.62% in 2005 for foreign currency-denominated deposit liabilities, and from 0.50% to 13.94% in 2006 and from 0.50% to 12.66% in 2005 for peso-denominated deposit liabilities.

Under existing BSP regulations, non-FCDU deposit liabilities of the Parent Company are subject to liquidity reserves equivalent to 11.00% and statutory reserves equivalent to 10.00%. Available reserves follow:

	2006	2005
	(In Thousand Pesos)	
Cash on hand	**₱4,051,961**	₱4,040,539
Due from BSP	**12,566,759**	3,719,362
Securities held under agreements to resell	**15,700,000**	12,300,000
AFS investments	**10,383,733**	9,477,683
	₱42,702,453	₱29,537,584

As of December 31, 2006 and 2005, the Parent Company was in compliance with such regulations.

18. Bills and Acceptances Payable

This account consists of:

	Consolidated		Parent Company	
	2006	2005	2006	2005
	(In Thousand Pesos)			
Bills payable to:				
BSP and local banks	**₱2,571,515**	₱2,931,894	**₱2,072,515**	₱2,539,894
Foreign banks	**1,425,893**	1,824,408	**1,140,888**	1,513,817
PDIC and others	**6,548,580**	8,328,539	**6,738,352**	8,328,539
	10,545,988	13,084,841	**9,951,755**	12,382,250
Acceptances outstanding	**409,960**	61,033	**409,960**	61,033
	₱10,955,948	₱13,145,874	**₱10,361,715**	₱12,443,283

As of December 31, 2006 and 2005, 70.31% and 70.70% of the bills payable of the Group and the Parent Company, respectively, are subject to periodic interest repricing. The annual interest rates ranged from 3.70% to 6.19% in 2006 and from 2.13% to 5.43% in 2005 for foreign currency-denominated borrowings, and from 3.50% to 12.00% in 2006 and from 3.00% to 12.00% in 2005 for peso-denominated borrowings.

The Parent Company's bills payable to BSP includes the transferred liabilities from Maybank amounting to ₱1.9 billion and ₱2.4 billion as of December 31, 2006 and 2005, respectively, (see Note 9).

Under the MOA mentioned in Note 2, notes payable to BSP of ₱13.9 billion as of October 28, 2001 was assigned to PDIC. Such assignment increased the Parent Company's total obligation to PDIC to ₱23.9 billion. In October 2001, of the total obligation, (a) ₱10.0 billion was settled thru "dacion en pago" of the Parent Company's assets comprising of loans to, and debt securities issued by various government entities, (b) ₱7.8 billion was converted into convertible preferred shares of the Parent Company, and (c) the balance of ₱6.1 billion was converted into a notes payable in ten years with interest of 91-day T-bill rate plus 1.00%. As of December 31, 2006 and 2005, the balance of the notes payable included under bills payable to PDIC amounted to ₱6.1 billion.

On October 14, 2006, the Bank and PDIC amended the loan and mortgage agreement by way of substitution of collateral at the request of the Parent Company. PDIC has agreed to release its mortgage lien on the real estate properties and in substitution, the Parent Company assigned in favor of PDIC certain government securities with a face value of ₱6.2 billion as of December 31, 2006 (see Note 9).

Bills Payable - Others also includes funding from the Development Bank of the Philippines, Land Bank of the Philippines and the Social Security System under which the Parent Company acts as a conduit for certain financing programs of these institutions. Lending to such programs is shown under Loans and receivables (see Note 9).

Interest expense on Bills payable and other borrowings consists of:

	Consolidated			Parent Company		
	2006	2005	2004	**2006**	2005	2004
	(In Thousand Pesos)					
Bills payable	**₱636,779**	₱696,920	₱728,887	**₱589,637**	₱673,172	₱700,161
Borrowings	**663,362**	380,803	382,592	**663,362**	380,803	382,592
Others	**254,074**	46,643	45,133	**252,090**	43,473	42,867
	₱1,554,215	₱1,124,366	₱1,156,612	**₱1,505,089**	₱1,097,448	₱1,125,620

19. Accrued Taxes, Interest and Other Expenses

This account consists of:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
	(In Thousand Pesos)			
Interest	**₱2,575,054**	₱2,972,222	**₱2,579,782**	₱2,963,687
Taxes	**114,010**	154,209	**101,177**	142,403
Others	**2,210,363**	1,608,236	**2,142,852**	1,484,526
	₱4,899,427	₱4,734,667	**₱4,823,811**	₱4,590,616

20. Subordinated Debt

On May 26, 2006 and August 3, 2006, the Parent Company's BOD approved the issuance of unsecured subordinated notes of ₱5.5 billion that qualify as lower tier 2 capital. The MB in its Resolution Nos. 979 dated August 3, 2006 and 874 dated July 6, 2006 approved this issuance subject to the Parent Company's compliance with certain conditions.

Relative to this, on August 10, 2006, the Parent Company issued ₱5.5 billion, 10% subordinated notes (the 2006 Notes) due in 2016.

Among the significant terms and conditions of the issuance of such 2006 Notes are:

(a) Issue price at 100.00% of the principal amount;
(b) The 2006 Notes bear interest at the rate of 10.0% per annum from and including August 10, 2006 to but excluding August 10, 2011. Interest will be payable quarterly in arrears on the 10th of February, May, August and November of each year, commencing on August 10, 2006. Unless the 2006 Notes are previously redeemed, interest from and including August 10, 2011 to but excluding August 10, 2016 will be reset at the equivalent of the five-year Money Market Association of the Philippines 1 Fixed Rate Treasury Notes (MART1 FXTN) as of reset date multiplied by 80.0%, plus a spread of 4.4935% per annum. The stepped-up interest will be payable quarterly in arrears on February, May, August and November of each year, commencing on November 10, 2011;
(c) The 2006 Notes constitute direct, unconditional unsecured and subordinated obligations of the Parent Company and at all times rank pari passu without preference among themselves and at least equally with all other present and future unsecured and subordinated obligations of the Parent Company;
(d) The Parent Company may redeem the 2006 Notes in whole but not in part at a redemption price equal to 100.00% of the principal amount together with accrued and unpaid interest on the day following the last day of the tenth interest period from issue date, subject to the prior consent of the BSP. The 2006 Notes may not be redeemed at the option of the noteholders; and
(e) Each noteholder, by accepting the 2006 Notes, irrevocably agrees and acknowledges that: (a) it may not exercise or claim any right of set-off in respect of any amount owed by the Parent Company arising under or in connection with the 2006 Notes; and (b) it shall to the fullest extent permitted by applicable law, waive and be deemed to have waived all such rights of set-off.

On December 19, 2003, the Parent Company's BOD approved the raising of lower tier 2 capital through the issuance in the local capital market of subordinated notes with maximum principal amount of ₱3.0 billion maturing in 10 years but callable with step-up on August 16, 2009. The notes bear a coupon rate of 12.50% per annum with step-up after five years.

The issuance of the foregoing subordinated notes under the terms approved by the BOD was approved by the MB, in its Resolution No. 06/01-23-04 dated January 22, 2004, subject to the Parent Company's compliance with certain conditions.

Relative to this, on February 16, 2004, the Parent Company issued ₱3.0 billion, 12.50% Subordinated Notes (the 2004 Notes) due in 2014. As discussed in Note 30, on March 2, 2004, the Parent Company swapped the proceeds from the 2004 Notes into USD, which are then invested in USD-denominated interbank placements, Republic of the Philippines (ROP) and US Treasury bonds.

Among the significant terms and conditions of the issuance of such Notes are:

(a) Issue price at 100.00% of the principal amount;
(b) The 2004 Notes bear interest at the rate of 12.50% per annum from and including February 16, 2004 to but excluding February 16, 2009. Interest will be payable semi-annually in arrears on February 16 and August 16 of each year, commencing on August 16, 2004. Unless the Notes

are previously redeemed, interest from and including February 16, 2009 to but excluding February 16, 2014 will be reset at 11.23%, the equivalent of the five-year MART1 FXTN as of February 9, 2004, plus a spread of 5.27% per annum. The stepped-up interest will be payable semi-annually in arrears on February 16 and August 16 of each year, commencing on August 16, 2009;

(c) The 2004 Notes constitute direct, unconditional unsecured and subordinated obligations of the Parent Company and at all times rank pari passu without preference among themselves and at least equally with all other present and future unsecured and subordinated obligations of the Parent Company;

(d) The Parent Company may redeem the 2004 Notes in whole but not in part at a redemption price equal to 100.00% of the principal amount together with accrued and unpaid interest on the day following the last day of the tenth interest period from issue date, subject to the prior consent of the BSP. The 2004 Notes may not be redeemed at the option of the noteholders; and

(e) Each noteholder, by accepting the 2004 Notes, irrevocably agrees and acknowledges that: (a) it may not exercise or claim any right of set-off in respect of any amount owed by the Parent Company arising under or in connection with the 2004 Notes; and (b) it shall to the fullest extent permitted by applicable law, waive and be deemed to have waived all such rights of set-off.

As of December 31, 2006 and 2005, subordinated debt is net of unamortized transaction cost of ₱110.3 million and ₱41.6 million, respectively.

21. Other Liabilities

This account consists of:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
	(In Thousand Pesos)			
Accounts payable	**₱4,129,444**	₱4,236,718	**₱3,503,276**	₱3,580,144
Bills purchased - contra	**2,993,225**	2,894,237	**2,993,225**	2,894,237
Manager's checks and demand drafts outstanding	**1,987,410**	472,805	**1,987,410**	472,805
Margin deposits and cash letters of credit	**506,282**	69,527	**506,282**	69,527
Due to other banks	**436,387**	766,561	**413,096**	829,884
Reserve for unearned premiums	**287,079**	293,547	**–**	–
Retirement liability (Note 23)	**283,943**	179,824	**283,943**	179,824
Due to BSP	**114,312**	115,704	**114,312**	115,704
Deferred credits	**102,810**	349,646	**102,625**	348,270
Miscellaneous	**1,961,534**	1,704,654	**1,177,668**	1,571,759
	₱12,802,426	₱11,083,223	**₱11,081,837**	₱10,062,154

22. Equity

Capital stock as of December 31, 2006 and 2005 consists of (in thousand pesos except for par value and number of shares):

	2006		2005		2004	
	Shares	**Amount**	Shares	Amount	Shares	Amount
Preferred - ₱40 par value						
Authorized	**195,175,444**		195,175,444		195,175,444	
Issued and outstanding						
Balance at beginning of year	**54,357,751**	**₱2,174,310**	195,175,444	₱7,807,018	195,175,444	₱7,807,018
Conversion to common stock	**–**	**–**	(140,817,693)	(5,632,708)	–	–
Balance at end of year	**54,357,751**	**2,174,310**	54,357,751	2,174,310	195,175,444	7,807,018
Common - ₱40 par value						
Authorized	**1,054,824,557**		1,054,824,557		1,054,824,557	
Issued and outstanding						
Balance at beginning of year	**518,888,165**	**20,755,527**	378,070,472	15,122,819	378,070,472	15,122,819
Conversion from preferred stock	**–**	**–**	140,817,693	5,632,708	–	–
Balance at end of year	**518,888,165**	**20,755,527**	518,888,165	20,755,527	378,070,472	15,122,819
		₱22,929,837		₱22,929,837		₱22,929,837

The Parent Company shares are listed in the PSE.

The preferred shares have the following features:

(a) Non-voting, non-cumulative, fully participating in dividends with the common shares;

(b) Convertible, at any time at the option of the holder who is qualified to own and hold common shares;

(c) With mandatory and automatic conversion into common shares upon the sale of such preferred shares to any person other than the NG or any GOCC's; and

(d) With rights to subscribe to additional new preferred shares with all of the features described above.

In 2005, the NG sold a portion of its preferred shareholdings in the Parent Company to LTG. In accordance with the Articles of Incorporation, the preferred shares were automatically converted into common shares.

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 accounting policies, which differ from PFRS in some respects. 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 10.00% for both solo basis (head office and branches) and consolidated basis (parent bank and subsidiaries engaged in financial allied undertakings but excluding insurance companies). Qualifying capital and risk-weighted assets are computed based on BSP regulations.

As discussed in Note 2, the BSP has approved the booking of additional appraisal increment of ₱431.8 million in 2001 on properties and recognition of the same in determining the capital adequacy ratio, and booking of translation adjustment of ₱1.6 billion in 2001 representing the increase in peso value of the investment in foreign subsidiaries for purposes of the quasi-reorganization and rehabilitation of the Parent Company provided that the same shall be excluded for dividend purposes. As of December 31, 2006 and 2005, the Group was in compliance with the capital adequacy ratio. The capital-to-risk assets ratio of the Group as reported to the BSP as of December 31, 2006 and 2005, was 19.6% and 17.2%, respectively.

23. Retirement Plan

The Parent Company has separate funded noncontributory defined benefit retirement plans covering substantially all its officers and regular employees. Under these retirement plans, all covered officers and employees are entitled to cash benefits after satisfying certain age and service requirements.

The Parent Company's annual contribution to the retirement plan consists of a payment covering the current service cost, amortization of the unfunded actuarial accrued liability and interest on such unfunded actuarial liability. The retirement plan provides a retirement benefit equal to one hundred and twelve percent (112.00%) of plan salary per month for every year of credit service.

The following table shows the actuarial assumptions as of January 1, 2006 and 2005 used in determining the retirement benefit obligation of the Parent Company:

	2006	2005
Expected rate of return on plan assets	**10%**	10%
Discount rate	**14%**	12%
Salary rate increase	**8%**	₱1,000 effective July 1, 2006 6% per year thereafter

As of December 31, 2006, the discount rate used in determining the retirement obligation is 7%.

The overall expected rate of return on plan assets is determined based on the market prices prevailing on that date applicable to the period over which the obligation is to be settled.

Actuarial valuation is made at least every two years.

The amount of liability recognized in the Parent Company statement of condition (included under Other liabilities) is as follows (in thousand pesos):

	2006	2005
Present value of defined benefit obligation	**₱1,986,807**	₱775,689
Fair value of plan assets	**945,053**	710,317
	1,041,754	65,372
Unrecognized actuarial losses (gains)	**(757,811)**	114,452
Retirement liability	**₱283,943**	₱179,824

The amounts included in Compensation and fringe benefits in the Parent Company statement of income are as follows (in thousand pesos):

	2006	2005
Current service cost	**₱68,859**	₱60,403
Interest cost	**108,597**	93,425
Expected return on plan assets	**(71,032)**	(67,733)
Net actuarial gains recognized during the year	**(2,305)**	(2,399)
	₱104,119	₱83,696

The actual return on plan assets amounted to ₱289.9 million, ₱78.5 million and ₱37.5 million in 2006, 2005 and 2004, respectively.

The movements in the retirement liability recognized in the Parent Company statement of condition follow (in thousand pesos):

	2006	2005
Balance at beginning of year	**₱179,824**	₱96,128
Retirement expense	**104,119**	83,696
Balance at end of year	**₱283,943**	₱179,824

Changes in the present value of the defined benefit obligation are as follows (in thousand pesos):

	2006	2005
Defined benefit obligation at beginning of year	**₱775,689**	₱667,328
Interest cost	**108,597**	93,425
Current service cost	**68,859**	60,403
Benefits paid	**(55,168)**	(45,467)
Actuarial loss	**1,088,830**	–
Defined benefit obligation at end of year	**₱1,986,807**	₱775,689

Changes in the fair value of the plan assets are as follows (in thousand pesos):

	2006	2005
Fair value of plan assets at beginning of year	**₱710,317**	₱677,330
Expected return	**71,032**	67,733
Benefits paid	**(55,168)**	(45,467)
Actuarial gain	**218,872**	10,721
Fair value of plan assets at end of year	**₱945,053**	₱710,317

The fair value of the plan assets as of December 31, 2006 and 2005 includes the fair value of the investments in the Parent Company shares of stocks amounting to ₱344.7 million and ₱184.1 million, respectively.

The Bank believes that the plan has enough funds to pay any retiring employee in 2007. Accordingly, it does not expect to contribute to the plan in 2007.

The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:

	2006	2005
Debt securities	**53%**	66%
Parent Company's own common shares	**37**	25
Receivables from related parties	**10**	8
Equity securities and others	–	1
	100%	100%

Information on the Parent Company's pension plan in 2006 (in thousand pesos) is as follows:

Present value of the define benefit obligation	₱1,986,807
Fair value of plan assets	945,043
Deficit in plan assets	1,041,764
Experience adjustments arising on plan liabilities	52,968
Experience adjustments arising on plan assets	218,872

As of December 31, 2006 and 2005, the net retirement liability (asset) included in Miscellaneous liabilities and assets, respectively, of certain subsidiaries of the Group follows (in thousand pesos):

	PNB Europe	PNB Capital	PNB Securities	Japan-PNB	PNB Gen
December 31, 2005	₱–	₱–	₱–	₱2,169	(₱7,015)
December 31, 2006	50,893	(1,597)	95	1,813	(7,836)

Retirement expense of the Group charged to operations, included in Compensation and fringe benefits in the statement of income amounted to ₱107.9 million, ₱92.4 million and ₱80.5 million in 2006, 2005 and 2004, respectively.

24. Leases

The Parent Company leases the premises occupied by majority of its branches (about 41.59% of the branch sites are Parent Company-owned). Some of its subsidiaries also lease the premises occupied by their Head Offices and most of their branches. The lease contracts are for periods ranging from 1 to 25 years and are renewable at the Group's option under certain terms and conditions. Various lease contracts include escalation clauses, most of which bear an annual rent increase of 10%.

Rent expense charged against current operations (included in 'Occupancy and equipment-related costs' in the statement of income) amounted to ₱346.28 million in 2006, ₱383.2 million in 2005 and ₱369.0 million in 2004 for the Group, of which ₱247.63 million in 2006, ₱274.7 million in 2005 and ₱235.1 million in 2004 pertain to the Parent Company.

Future minimum rentals payable under non-cancelable operating leases follow:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
	(In Thousand Pesos)			
Within one year	**₱246,298**	₱229,228	**₱150,358**	₱165,632
Beyond one year but not more than five years	**498,531**	294,313	**348,704**	270,990
Beyond more than five years	**90,483**	42,019	**51,689**	42,019
	₱835,312	₱565,560	**₱550,751**	₱478,641

The Parent Company has entered into commercial property leases on its investment property. These non-cancelable leases have remaining lease terms of between two and five years. Some leases include escalation clauses (such as 5% per year). In 2006, 2005 and 2004, total rent income (included under 'Miscellaneous income') amounted to ₱209.9 million, ₱172.2 million and ₱188.5 million, respectively, for the Group and ₱207.5 million, ₱171.04 million and ₱187.4 million, respectively, for the Parent Company.

Future minimum rentals receivable under non-cancelable operating leases follow:

	2006	2005
	(In Thousand Pesos)	
Within one year	**₱30,587**	₱44,400
Beyond one year but not more than five years	**6,290**	22,200
	₱36,877	₱66,600

25. Income and Other Taxes

Under Philippine tax laws, the Parent Company and certain subsidiaries are subject to percentage and other taxes (presented as Taxes and Licenses in the statement of income) as well as income taxes. Percentage and other taxes paid consist principally of gross receipts tax and documentary stamp tax.

Income taxes include the corporate income tax, discussed below, and final taxes paid which represents final withholding tax on gross interest income from government securities and other deposit substitutes and income from the FCDU transactions. These income taxes, as well as the deferred tax benefits and provisions, are presented as 'Provision for income tax' in the statement of income.

Prior to November 1, 2005, the RCIT rate was 32%. Interest allowed as a deductible expense is reduced by an amount equivalent to 38% of interest income subjected to final tax. RA No. 9337, *An Act Amending National Internal Revenue Code*, provides that effective November 1, 2005, the RCIT rate shall be 35% until December 31, 2008. Starting January 1, 2009, the RCIT rate shall be 30%. Interest expense allowed as a deductible expense is reduced by 42% starting November 1, 2005 until December 31, 2008. Starting January 1, 2009, interest expense allowed as a deductible expense shall be reduced by 33% of interest income subjected to final tax.

An MCIT of 2% on modified gross income is computed and compared with the RCIT. Any excess of MCIT over the RCIT is deferred and can be used as a tax credit against future income tax liability for the next three years. In addition, NOLCO is allowed as a deduction from taxable income in the next three years from the period of incurrence for the Parent Company and certain subsidiaries.

FCDU offshore income (income from non-residents) is tax-exempt while gross onshore income (income from residents) is generally subject to 10% income tax. In addition, interest income on deposit placement with other FCDUs and offshore banking units (OBUs) is taxed at 7.50%. RA No. 9294, which became effective in May 2004, provides that the income derived by the FCDU from foreign currency transactions with non-residents, OBUs, local commercial banks including branches of foreign banks is tax-exempt while interest income on foreign currency loans from residents other than OBUs or other depository banks under the expanded system is subject to 10.00% income tax.

Provision for income tax consists of:

	Consolidated			Parent Company		
	2006	2005	2004	**2006**	2005	2004
			(In Thousand Pesos)			
Current	**₱738,552**	₱712,602	₱614,783	**₱538,852**	₱552,654	₱478,793
Deferred	**194,127**	1,179,124	3,359	**220,022**	1,179,124	–
	₱932,679	₱1,891,726	₱618,142	**₱758,874**	₱1,731,778	₱478,793

The components of net deferred tax assets included in 'Other assets' follow:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
		(In Thousand Pesos)		
Deferred tax asset on:				
Allowance for impairment losses	**₱3,283,783**	₱3,490,509	**₱3,254,691**	₱3,470,311
NOLCO and others	**104,491**	17,020	–	–
	3,388,274	3,507,529	**3,254,691**	3,470,311
Deferred tax liability on:				
Revaluation increment on land and buildings	**882,352**	634,415	**882,352**	634,415
Unrealized trading gains on derivatives	**325,744**	138,850	**325,744**	138,850
Unrealized gain on AFS investments	**43,250**	106,801	**33,104**	98,112
Others	**289,670**	–	**219,200**	–
	1,541,016	880,066	**1,460,400**	871,377
	₱1,847,258	₱2,627,463	**₱1,794,291**	₱2,598,934

Deferred tax charged (credited) directly to equity during the year is as follows:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
		(In Thousand Pesos)		
Revaluation increment on land and buildings	**₱424,634**	(₱42,294)	**₱424,634**	(₱42,294)
Unrealized gain on AFS investments	**(63,551)**	98,112	**(65,008)**	98,112
Others	**224,995**	–	**224,995**	–
	₱586,078	₱55,818	**₱584,621**	₱55,818

Based on the five-year financial forecast prepared by management and duly approved by the Executive Committee of the BOD, the Parent Company's deferred tax assets of ₱1.8 billion and ₱2.6 billion as of December 31, 2006 and 2005, respectively, is expected to be realized from its taxable profits within the next three to five years. The Parent Company and certain subsidiaries did not recognize deferred tax assets on the following temporary differences:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
	(In Thousand Pesos)			
Investment properties:				
Allowance for impairment losses	**₱4,134,211**	₱4,036,162	**₱4,134,211**	₱4,036,162
Accumulated depreciation	**2,268,266**	1,924,199	**2,268,266**	1,924,199
Fair value adjustment	**(6,063,609)**	(4,057,047)	**(6,063,609)**	(4,057,047)
	338,868	1,903,314	**338,868**	1,903,314
Allowance for impairment losses on loans and receivables	**8,251,435**	12,604,086	**8,165,093**	12,375,272
NOLCO	**20,874,427**	10,899,139	**20,851,059**	10,899,139
MCIT	**55,983**	42,891	**54,911**	41,459
Others	**1,468,379**	617,937	**1,396,488**	627,614
	₱30,989,092	₱26,067,367	**₱30,806,419**	₱25,846,798

Details of the Group's NOLCO follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousand Pesos)		
1992 to 1999	₱12,121	₱6,324	₱5,797	2002 to 2009
2003	2,228,206	2,228,206	–	2006
2004	1,700,948	–	1,700,948	2007
2005	7,029,130	–	7,029,130	2008 to 2010
2006	12,174,522	–	12,174,522	2009 to 2011
	₱23,144,927	₱2,234,530	₱20,910,397	

The Group's NOLCO of ₱12.1 billion in 2006 and ₱7.0 billion in 2005 includes the Parent Company's loss on sale of NPAs to SPV companies amounting to ₱9.6 billion in 2006 and ₱5.4 billion in 2005 which can be claimed as deductions from taxable income for a period of five consecutive taxable years immediately following the year of sale.

The Group's NOLCO includes net operating losses of PNB Corporation - Guam from 1992 to 1999 amounting to ₱12.1 million recognized based on applicable tax laws similar to those of USA. Guam's NOLCO matures 10 years from the date such NOLCO was incurred.

Details of the Group's MCIT follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousand Pesos)		
2003	₱953	₱953	₱–	2006
2004	16,428	–	16,428	2007
2005	25,510	–	25,510	2008
2006	14,045	–	14,045	2009
	₱56,936	₱953	₱55,983	

Details of the Parent Company's NOLCO follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousand Pesos)		
2003	₱2,180,979	₱2,180,979	₱–	2006
2004	1,689,030	–	1,689,030	2007
2005	7,029,130	–	7,029,130	2008 to 2010
2006	12,132,899	–	12,132,899	2009 to 2011
	₱23,032,038	₱2,180,979	₱20,851,059	

Details of the Parent Company's MCIT follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousand Pesos)		
2003	₱176	₱176	₱–	2006
2004	15,773	–	15,773	2007
2005	25,510	–	25,510	2008
2006	13,628	–	13,628	2009
	₱55,087	₱176	₱54,911	

The reconciliation between the statutory income tax rate to effective income tax rate follows:

	Consolidated			Parent Company		
	2006	2005	2004	**2006**	2005	2004
Statutory income tax rate	**35.00%**	32.50%	32.00%	**35.00%**	32.50%	32.00%
Tax effects of:						
Unrecognized deferred tax assets	**39.52**	76.27	74.87	**41.13**	96.82	141.28
Non-deductible expenses	**10.76**	10.38	37.72	**12.74**	13.19	71.18
FCDU income before tax	**(16.12)**	(25.35)	(44.86)	**(19.28)**	(32.21)	(84.65)
Tax-exempt income	**(12.01)**	(12.38)	(7.96)	**(14.37)**	(15.73)	(15.02)
Tax-paid income	**(3.94)**	(6.96)	(27.70)	**(3.41)**	(7.23)	(52.28)
Others - net	–	0.63	(0.78)	–	–	–
Effective income tax rate	**53.21%**	75.09%	63.29%	**51.81%**	87.34%	92.51%

Revenue Regulations (RR) No. 10-2002 defines expenses to be classified as entertainment, amusement and recreation expenses (EARE) and set a limit for the amount that is deductible for tax purposes. EARE are limited to 1.00% of net revenues for sellers of services. EARE charged against current operations (included in 'Miscellaneous expense') amounted to ₱111.7 million in 2006, ₱116.1 million in 2005 and ₱102.4 million in 2004 for the Group and ₱111.7 million in 2006, ₱110.1 million in 2005 and ₱98.2 million in 2004(see Note 26).

26. Miscellaneous Income and Expenses

Miscellaneous income consists of:

	Consolidated			Parent Company		
	2006	2005	2004	**2006**	2005	2004
			(In Thousand Pesos)			
Net gain on sale or exchange of assets	**₱1,317,083**	₱372,542	₱638,612	**₱1,317,083**	₱372,542	₱635,130
Rental (Notes 24 and 28)	**209,918**	172,200	188,504	**207,535**	171,038	187,373
Others	**626,785**	783,579	884,276	**726,032**	604,951	759,874
	₱2,153,786	₱1,328,321	₱1,711,392	**₱2,250,650**	₱1,148,531	₱1,582,377

Miscellaneous expenses consist of:

	Consolidated			Parent Company		
	2006	2005	2004	**2006**	2005	2004
	(In Thousand Pesos)					
Insurance	**₱383,333**	₱424,245	₱399,188	**₱379,922**	₱422,380	₱396,258
Foreclosure	**187,135**	247,888	223,165	**187,135**	247,888	223,165
Promotional	**156,325**	153,910	85,028	**146,331**	152,192	85,027
Management and professional fees	**152,895**	358,683	143,199	**110,229**	243,251	129,480
Transportation and travel	**133,742**	123,917	123,080	**127,498**	118,064	120,642
Stationery and supplies used	**132,958**	120,076	107,704	**126,179**	119,632	105,768
Representation and entertainment (Note 25)	**117,710**	116,099	102,395	**111,655**	110,100	98,215
Others	**1,270,139**	1,097,713	849,184	**815,420**	601,528	305,282
	₱2,534,237	₱2,642,531	₱2,032,943	**₱2,004,369**	₱2,015,035	₱1,463,837

Miscellaneous - others include information technology-related expenses, postage, telephone and telegraph, repairs and maintenances, EARE and litigation expenses.

27. Trust Operations

Securities and other properties held by the Parent Company in fiduciary or agency capacities for its customers are not included in the accompanying statement of condition since these are not assets of the Parent Company. Such assets held in trust were carried at a value of ₱14.1 billion and ₱14.9 billion as of December 31, 2006 and 2005, respectively (see Note 29). In connection with the trust functions of the Parent Company, government securities amounting to ₱157.9 million and ₱152.0 million (included under 'AFS investments' and 'HTM investments') as of December 31, 2006 and 2005, respectively, are deposited with the BSP in compliance with trust regulations.

In compliance with existing banking regulations, the Parent Company transferred from deficit to surplus reserves of ₱17.1 million in 2006, ₱13.4 million in 2005 and ₱36.5 million in 2004, corresponding to the 10.00% of the net income realized from its trust, investment management and other fiduciary business until such related surplus reserve constitutes 20.00% of its regulatory capital.

28. Related Party Transactions

In the ordinary course of business, the Parent Company has loans and other transactions with its subsidiaries and affiliates, and with certain DOSRI. Under the Parent Company's policy, these loans and other transactions are made substantially on the same terms as with other individuals and businesses of comparable risks. The amount of direct credit accommodations to each of the Parent Company's DOSRI, 70.00% of which must be secured, should not exceed the amount of their respective deposits and book value of their respective investments in the Parent Company. In the aggregate, DOSRI loans generally should not exceed the Parent Company's equity or 15% of the Parent Company's total loan portfolio, whichever is lower. As of December 31, 2006 and 2005, the Parent Company was in compliance with such regulations.

The information relating to the DOSRI loans of the Group follows (amounts in thousand pesos):

	2006	2005
Total outstanding DOSRI loans		
Inclusive of loans extended to NG and GOCCs	**₱12,574,264**	₱10,714,504
Exclusive of loans extended to NG and GOCCs	**2,473,405**	2,757,635
Percent of DOSRI loans to total loans		
Inclusive of loans extended to NG and GOCCs	**20.85%**	15.33%
Exclusive of loans extended to NG and GOCCs	**4.10%**	3.94%
Percent of unsecured DOSRI loans to total DOSRI loans		
Inclusive of loans extended to NG and GOCCs	**0.75%**	1.61%
Exclusive of loans extended to NG and GOCCs	**3.82%**	6.25%
Percent of past due DOSRI loans to total DOSRI loans	**1.23%**	0.05%
Percent of nonperforming DOSRI loans to total DOSRI loans	–	–

In accordance with existing BSP regulations, the reported DOSRI performing loans exclude loans extended to certain borrowers before these borrowers became DOSRI.

The information relating to Parent Company's receivables and other accommodations to government units follows:

	2006	2005
	(In Thousand Pesos)	
NG/GOCCs with NG guaranty	**₱7,628,955**	₱5,052,804
GOCCs	**2,471,903**	2,904,065
	₱10,100,858	₱7,956,869

In the computation of the minimum allowance DOSRI loans (the lower of the Parent Company's equity or 15% of the Parent Company's total portfolio), the receivables from NG and GOCCs with NG guaranty are not included.

The Parent Company has lease agreements with some of its subsidiaries. In 2005, the lease agreement was amended to indicate the share of the subsidiaries in the maintenance of the building in lieu of rental payments. The income related to these agreements amounting to ₱4.8 million in 2006, ₱4.7 million in 2005 and ₱2.4 million in 2004 is included in 'Miscellaneous income' in the statement of income.

On January 31, 2007, BSP Circular No. 560 was issued providing the rules and regulations that govern loans, other credit accommodations and guarantees granted to subsidiaries and affiliates of banks and quasi-banks. Under the said Circular, total outstanding exposures to each of the bank's subsidiaries and affiliates shall not exceed 10% of bank's net worth, the unsecured portion of which shall not exceed 5% of such networth. Further, the total outstanding exposures to subsidiaries and affiliates shall not exceed 20% of the networth of the lending bank. BSP Circular No. 560 is effective on February 15, 2007.

The significant account balances with respect to related parties included in the financial statements (after appropriate eliminations have been made) follow:

Related Party	2006 Loans Receivable	2006 Interest Income	2005 Loans Receivable	2005 Interest Income
	(In Thousand Pesos)			
Fortune Tobacco Corporation	**₱1,500,000**	**₱125,962**	₱1,500,000	₱95,172
Asia Brewery Inc.	**500,000**	**43,667**	500,000	49,385
Asian Institute of Management	**144,854**	**15,313**	154,425	12,342
Philippine Airlines	**6,497**	–	–	–
Others	**322,055**	**12,072**	282,913	71,202
	₱2,473,406	**₱197,014**	₱2,437,338	₱228,101

The compensation of the key management personnel follows:

	Consolidated			Parent Company		
	2006	2005	2004	**2006**	2005	2004
	(In Thousand Pesos)					
Short term employee benefits	**₱109,213**	₱101,522	₱106,458	**₱48,296**	₱46,059	₱54,538
Post-employment benefits	**4,843**	6,002	5,912	**2,527**	3,781	4,253
	₱114,056	₱107,524	₱112,370	**₱50,823**	₱49,840	₱58,791

29. Commitments and Contingent Liabilities

In the normal course of business, the Group makes various commitments and incurs certain contingent liabilities that are not presented in the financial statements including several suits and claims remain unsettled. No specific disclosures on such unsettled assets and claims are made because any such specific disclosures would prejudice the Group's position with the other parties with whom it is in dispute. Such exemption from disclosures is allowed under PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. The Group and its legal counsel believe that any losses arising from these contingencies which are not specifically provided for will not have a material adverse effect on the financial statements.

In November 1994, the BSP, Maybank and the Parent Company executed a Memorandum of Agreement (MA) providing for the settlement of Maybank's ₱3.0 billion liabilities to the BSP. Under this MA, the Parent Company is jointly and severally liable with Maybank for the full compliance and satisfaction of the terms and conditions therein. The MA provides for the creation of an escrow fund to be administered by the BSP where all collections from conveyed assets and certain annual guaranteed payments required under the MA are to be deposited.

Relative to the sale of the Parent Company's 60% interest in Maybank, the Parent Company has requested the BSP to consider the revision of the terms of the MA to, among others, (a) delete the provision on the annual guaranteed payments in consideration of an immediate payment by the Parent Company of an agreed amount, and (b) exclude Maybank as a party to the MA. On May 7, 1997, the BSP approved the Parent Company's request to amend the terms of the MA, subject to the following conditions among others:

a) The Parent Company shall remit ₱150.0 million to the escrow account out of the proceeds from sale;

b) The Parent Company shall remit to the escrow account an amount equivalent to 50% of any profit that may be realized by the Parent Company on account of the sale; and

c) If the amount in the escrow account has not reached the total of ₱3.0 billion by June 30, 2013, the difference shall be paid by the Parent Company by way of a debit to its regular account with the BSP.

On November 28, 1997, the Parent Company remitted ₱150.0 million in compliance with item (a). The Parent Company anticipates that the payment of ₱150.0 million to the BSP together with the existing balance of the funds in escrow as of that date will allow the escrow account to reach the required ₱3.0 billion earlier than programmed. This has effectively released the Parent Company from any further payments under the MA. As of December 31, 2006 and 2005, the total trust assets of the escrow account maintained with the BSP amounted to ₱2.0 billion and ₱1.7 billion, respectively. Average yield during the year ranged from 11.00% to 16.00%. Management expects that the value of the escrow account by 2013 will be more than adequate to cover the ₱3.0 billion liability due the BSP.

The Parent Company's remaining investment in Maybank was sold on June 29, 2000. The sale was approved by the BSP on August 16, 2000.

The following is a summary of various commitments, contingent assets and contingent liabilities at their equivalent peso contractual amounts:

	Consolidated		Parent Company	
	2006	2005	**2006**	2005
	(In Thousand Pesos)			
Trust department accounts (Note 27)	**₱14,130,582**	₱14,938,781	₱14,130,582	₱14,938,781
Deficiency claims receivable	**12,772,446**	9,929,287	12,763,100	9,929,287
Unused commercial letters of credit	**6,962,819**	5,229,104	6,962,819	5,229,104
Inward bills for collection	**6,533,310**	8,585,697	6,533,310	8,585,697
Confirmed export letters of credit	**2,733,999**	2,968,974	2,733,999	2,968,974
Outstanding guarantees issued	**351,967**	172,683	101,967	167,376
Outward bills for collection	**152,738**	218,009	152,738	218,009
Other contingent accounts	**55,608**	47,900	52,561	49,900
Items held as collateral	**3,779**	1,760	3,779	1,748

30. **Derivative Financial Instruments**

The table below shows the fair values of derivative financial instruments entered into by the Parent Company, recorded as derivative assets or derivative liabilities, together with the notional amounts. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding as of December 31, 2006 and 2005 and are not indicative of either market risk or credit risk (amounts in thousands, except average forward rate).

	2006			
	Assets	**Liabilities**	**Average Forward Rate**	**Notional Amount***
Freestanding derivatives:				
Currency forwards and swaps				
BUY:				
USD	**₱267**	**₱–**	**49.00**	**2,855**
JPY	**–**	**5,160**	**117.40**	**1,130,000**
CAD	**61**	**–**	**1.16**	**1,500**
Others	**87**	**486**	**–**	**2,698**
SELL:				
USD	**74,442**	**510**	**49.34**	**163,000**
EUR	**1,216**	**289**	**1.32**	**5,900**
JPY	**68**	**–**	**117.42**	**15,000**
Others	**1,676**	**188**	**–**	**6,492**
Cross currency swaps	**768,367**	**–**	**56.34**	**53,253**
Embedded derivatives:				
Currency forwards	**8,101**	**–**	**–**	**446**
Credit default swaps	**106,782**	**–**	**–**	**121,700**
	₱961,067	**₱6,633**		

	2005			
	Assets	Liabilities	Average Forward Rate	Notional Amount*
Freestanding derivatives:				
Currency forwards and swaps				
BUY:				
USD	₱224,420	₱20,964	53.01	22,963
CHF	6,980	–	1.28	1,281
JPY	90,041	–	116.17	1,000,000
SELL:				
CAD	14,349	17,731	1.15	2,798
EUR	–	89,795	1.19	10,000
USD	–	38,217	53.25	136,558
Others	9,586	99,857	–	9,436
Cross currency swaps	278,511	–	56.34	53,253
Forward sell of ROP bonds	–	196,016	–	108,400
Interest rate swap	–	267,375	–	10,000,000
Embedded derivatives:				
Currency forwards	50,299	6,720	–	93,253
Bond options	30,325	58,274	–	124,900
Credit default swaps	80,611	–	–	36,700
	₱785,122	₱794,949		

* The notional amounts pertain to the original currency except for the 'Others', which represent the equivalent US$ amounts of other currencies.

As discussed in Note 9, the Parent Company sold in February 1998 ₱10.0 billion bonds with an agreement to swap interest payments based on the average 91-day and 364-day T-bill rates of the auction result immediately preceding the annual repricing date for the remaining term of the bonds. As of December 31, 2005, the fair value of the interest rate differential on the basis swap agreement, representing the net present value of the interest differential that the Parent Company has to pay the counterparty, amounted to ₱267.4 million. The agreement expired on August 1, 2006.

On March 2, 2004, the Parent Company entered into a cross currency swap agreement with a counterparty bank in which the proceeds from the Notes were swapped for USD. The USD amounts were then invested by the Parent Company in ROP and US Treasury bonds. Under the swap agreement, the Parent Company is committed to sell USD and buy PHP in 2009 at a specified exchange rate. On a semi-annual basis, the Parent Company pays 5.66% on the USD leg and receives 12.5% on the PHP leg. As of December 31, 2006 and 2005, the aggregate notional amount of the cross currency swap is US$53.25 million or ₱3 billion while the positive fair value amounted to ₱768.4 and ₱278.5 million, respectively.

The Parent Company enters into certain financial and non-financial contracts that contain embedded derivatives which are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at FVPL. Such derivatives include conversion options in convertible debt instruments, credit default swaps and foreign-currency derivatives in structured notes and deposits, call and put options in investment securities and loans and receivables, bond-linked deposits, and foreign currency derivatives on non-financial contracts such as purchase orders and service agreements.

Among the embedded derivatives that have been bifurcated include the following:

i. Credit derivatives in structured notes and deposits with a notional reference of US$121.7 million and US$36.7 million with a positive fair value of ₱106.8 and ₱123.6 million as of December 31, 2006 and 2005, respectively.

ii. Conversion option in a foreign currency denominated convertible preferred share with a notional quantity of 18,495 shares with a positive fair value of ₱7 million as of December 31, 2005. The related investment in convertible preferred shares was disposed of in 2006.

iii. Foreign currency derivative in a structured note with a notional reference of ₱40.0 million with a negative fair value of ₱6.7 million as of December 31, 2005. The related structured note matured in 2006.

iv. Derivative embedded in bond-linked deposits with a notional amount of US$124.9 million with a positive fair value of ₱30.3 million as of December 31, 2005. These deposits matured in 2006.

31. Earnings Per Share

The earnings per share of the Group, attributable to equity holders of the Parent Company, are calculated as follows:

	2006	2005	2004
a) Net income attributable to equity holders of the Parent Company (in thousand pesos)	**₱814,435**	₱620,921	₱351,917
Less income attributable to convertible preferred stocks classified as equity (in thousand pesos)	**77,228**	160,565	119,819
b) Net income attributable to common shareholders	**₱737,207**	₱460,356	₱232,098
c) Weighted average number of common shares for basic earnings per share	**518,888,165**	425,009,703	378,070,472
d) Effect of dilution: Convertible preferred shares	**54,357,751**	148,236,213	195,175,444
e) Adjusted weighted average number of common shares for diluted earnings per share	**573,245,916**	573,245,916	573,245,916
f) Basic earnings per share (b/c)	**₱1.42**	₱1.08	₱0.61
g) Diluted earnings per share (a/e)	**1.42**	1.08	0.61

32. Financial Performance

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

	Consolidated			Parent Company		
	2006	2005	2004	**2006**	2005	2004
Return on average equity	**3.44%**	2.59%	1.41%	**3.17%**	1.11%	0.16%
Return on average assets	**0.35%**	0.28%	0.17%	**0.30%**	0.11%	0.02%
Net interest margin on average earning assets	**3.78%**	3.93%	2.63%	**3.59%**	3.77%	2.42%

33. Maturity Profile of Assets and Liabilities

The following table shows an analysis of assets and liabilities of the Group and Parent Company analyzed according to whether they are expected to be recovered or settled within one year and beyond one year from statement of condition date (amounts in thousand pesos):

	Consolidated					
	2006			2005		
	Less than Twelve Months	Over Twelve Months	Total	Less than Twelve Months	Over Twelve Months	Total
Financial Assets						
Cash and other cash items	**₱4,820,155**	**₱–**	**₱4,820,155**	₱5,670,002	₱–	₱5,670,002
Due from BSP	**12,566,759**	**–**	**12,566,759**	3,719,362	–	3,719,362
Due from other banks	**3,555,603**	**–**	**3,555,603**	5,494,793	–	5,494,793
Interbank loans receivable	**22,412,817**	**–**	**22,412,817**	16,914,045	–	16,914,045
Securities held under agreements to resell	**15,700,000**	**–**	**15,700,000**	12,300,000	–	12,300,000
Securities at FVPL	**1,137,835**	**–**	**1,137,835**	1,323,591	–	1,323,591
Loans receivables - gross (Note 9)	**38,175,846**	**24,012,107**	**62,187,953**	40,161,414	31,586,470	71,747,884
Unquoted debt securities classified as loans (Note 9)	**11,208,371**	**10,093,353**	**21,301,724**	–	20,495,265	20,495,265
Other receivables - gross (Note 9)	**11,826,731**	**2,316,895**	**14,143,626**	10,823,915	2,370,590	13,194,505
Receivables from SPV	**–**	**1,361,074**	**1,361,074**	–	–	–
AFS investments - gross (Note 11)	**14,113,947**	**29,156,291**	**43,270,238**	20,602,294	19,762,687	40,364,981
HTM investments	**–**	**1,554,368**	**1,554,368**	–	5,266,817	5,266,817
	135,518,064	**68,494,088**	**204,012,152**	117,009,416	79,481,829	196,491,245
Nonfinancial Assets						
Property and equipment - net						
At cost	**–**	**730,181**	**730,181**	–	788,877	788,877
At appraised value	**–**	**15,846,819**	**15,846,819**	–	14,540,365	14,540,365
Investments in subsidiaries and an associate	**–**	**801,838**	**801,838**	–	684,171	684,171
Investment properties - net	**–**	**24,882,076**	**24,882,076**	–	26,847,767	26,847,767
Other assets - gross (Note 15)*	**10,513,395**	**7,152,938**	**17,666,333**	1,115,760	8,686,583	9,802,343
	10,513,395	**49,413,852**	**59,927,247**	1,115,760	51,547,763	52,663,523
Less: Allowance for impairment and credit losses (Note 16)	**–**	**(19,924,473)**	**(19,924,473)**	–	(25,261,948)	(25,261,948)
Unearned and other deferred income (Note 9)	**–**	**(543,861)**	**(543,861)**	–	(1,234,570)	(1,234,570)
	–	**(20,468,334)**	**(20,468,334)**	–	(26,496,518)	(26,496,518)
	₱146,031,459	**₱97,439,606**	**₱243,471,065**	₱118,125,176	₱104,533,074	₱222,658,250

* - includes prepaid expenses, intangibles (software), deferred tax assets

	Consolidated					
	2006			2005		
	Less than Twelve Months	Over Twelve Months	Total	Less than Twelve Months	Over Twelve Months	Total
Financial Liabilities						
Deposit liabilities	**₱171,498,944**	**₱10,168,748**	**₱181,667,692**	₱157,235,517	₱10,591,260	₱167,826,777
Bills payable	**4,197,881**	**6,758,067**	**10,955,948**	3,852,507	9,293,367	13,145,874
Subordinated debt	**–**	**8,389,297**	**8,389,297**	–	2,958,437	2,958,437
Accounts payable	**4,129,444**	**–**	**4,129,444**	4,236,718	–	4,236,718
Bills purchased - contra	**2,993,225**	**–**	**2,993,225**	2,894,237	–	2,894,237
Managers' checks and demand drafts outstanding	**1,987,410**	**–**	**1,987,410**	472,805	–	472,805
Marginal deposits	**506,282**	**–**	**506,282**	69,527	–	69,527
Due to other banks	**436,387**	**–**	**436,387**	766,561	–	766,561
Due to BSP	**114,312**	**–**	**114,312**	115,704	–	115,704
Derivative liabilities	**6,633**	**–**	**6,633**	794,949	–	794,949
	185,870,518	**25,316,112**	**211,186,630**	170,438,525	22,843,064	193,281,589
Nonfinancial Liabilities						
Accrued interest and other liabilities **	**2,714,790**	**2,184,637**	**4,899,427**	2,614,508	2,120,159	4,734,667
Other liabilities	**2,628,733**	**–**	**2,628,733**	1,732,722	–	1,732,722
	5,343,523	**2,184,636**	**7,528,159**	4,347,230	2,120,159	6,467,389
	₱191,214,041	**₱27,500,749**	**₱218,714,790**	₱174,785,755	₱24,963,223	₱199,748,978

** - income tax payable, withholding taxes payable, and other tax payable

	Parent Company					
	2006			2005		
	Less than Twelve Months	Over Twelve Months	Total	Less than Twelve Months	Over Twelve Months	Total
Financial Assets						
Cash and other cash items	₱4,753,539	₱–	₱4,753,539	₱5,333,783	₱–	₱5,333,783
Due from BSP	12,566,759	–	12,566,759	3,719,362	–	3,719,362
Due from other banks	2,314,288	–	2,314,288	4,897,004	–	4,897,004
Interbank loans receivable	22,093,537	–	22,093,537	16,881,081	–	16,881,081
Securities held under agreements to resell	15,700,000	–	15,700,000	12,300,000	–	12,300,000
Securities at FVPL	1,109,137	–	1,109,137	1,297,213	–	1,297,213
Loans receivables - gross (Note 9)	37,581,739	22,714,738	60,296,477	60,531,091	9,379,645	69,910,736
Unquoted debt securities classified as loans (Note 9)	11,208,371	10,093,353	21,301,724	–	20,495,265	20,495,265
Other receivables - gross (Note 9)	10,439,857	3,129,465	13,569,322	9,272,160	3,289,133	12,561,293
Receivables from SPV	–	1,361,074	1,361,074	–	–	–
AFS investments - gross (Note 11)	12,111,477	29,156,290	41,267,767	18,444,346	19,762,687	38,207,033
HTM investments	–	1,420,044	1,420,044	–	5,091,685	5,091,685
	129,878,704	67,874,964	197,753,668	132,676,040	58,018,415	190,694,455
Nonfinancial Assets						
Property and equipment - net						
At cost	–	663,916	663,916	–	700,345	700,345
At appraised value	–	15,846,819	15,846,819	–	14,536,391	14,536,391
Investments in subsidiaries and an associate - gross (Note 13)	–	5,439,520	5,439,520	–	5,500,591	5,500,591
Investment properties - net	–	24,803,748	24,803,748	–	26,765,021	26,765,021
Other assets - gross (Note 15)*	9,165,640	8,108,454	17,274,094	662,412	8,686,583	9,348,995
	9,165,640	54,862,457	64,028,097	662,412	56,188,931	56,851,343
Less: Allowance for impairment and credit losses (Note 16)	–	(19,696,132)	(19,696,132)	–	(24,965,809)	(24,965,809)
Unearned and other deferred income (Note 9)	–	(431,438)	(431,438)	–	(1,134,741)	(1,134,741)
	–	(20,127,570)	(20,127,570)	–	(26,100,550)	(26,100,550)
	₱139,044,344	₱102,609,851	₱241,654,195	₱133,338,452	₱88,106,796	₱221,445,248

* - includes prepaid expenses, intangibles (software) and deferred tax assets - net

	Parent Company					
	2006			2005		
	Less than Twelve Months	Over Twelve Months	Total	Less than Twelve Months	Over Twelve Months	Total
Financial Liabilities						
Deposit liabilities	₱173,564,214	₱10,168,750	₱183,732,964	₱159,504,620	₱10,591,260	₱170,095,880
Bills payable	3,603,647	6,758,068	10,361,715	3,466,051	8,977,232	12,443,283
Subordinated debt	–	8,389,297	8,389,297	–	2,958,437	2,958,437
Accounts payable	3,503,276	–	3,503,276	3,580,144	–	3,580,144
Bills purchased - contra	2,993,225	–	2,993,225	2,894,237	–	2,894,237
Managers' checks and demand drafts outstanding	1,987,410	–	1,987,410	472,805	–	472,805
Marginal deposits	506,282	–	506,282	69,527	–	69,527
Due to other banks	413,096	–	413,096	829,884	–	829,884
Due to BSP	114,312	–	114,312	115,704	–	115,704
Derivative liabilities	6,633	–	6,633	794,949	–	794,949
	186,692,095	25,316,115	212,008,210	171,727,921	22,526,929	194,254,850
Nonfinancial Liabilities						
Accrued interest and other liabilities **	2,623,198	2,200,613	4,823,811	2,758,559	1,832,057	4,590,616
Other liabilities	1,273,660	283,943	1,557,603	1,125,080	179,824	1,304,904
	3,896,858	2,484,556	6,381,414	3,883,639	2,011,881	5,895,520
	₱190,588,953	₱27,800,671	₱218,389,624	₱175,611,560	₱24,538,810	₱200,150,370

** - includes income tax payable, withholding taxes payable, and other tax payable

34. Notes to Statements of Cash Flows

Of the total interbank loans receivable of the Group and the Parent Company as of December 31, 2006, ₱3.1 billion has original maturity of more than three months.

35. Reclassification

Certain accounts in the 2005 and 2004 financial statements were reclassified to conform with the 2006 presentation which takes into account the fundamental nature and significance of the transactions as well as general financial statement presentation giving consideration to BSP chart of accounts as applicable under PFRS reporting.

Disclosure on Risk Management

PNB, as a financial institution, recognizes that it is in the business of taking risks; recognizing that it is vulnerable to various forms of risks. The key risks that the Bank faces are as follows: CREDIT RISK, MARKET RISK and OPERATIONAL RISK. However, as the global financial community becomes more sophisticated, PNB is also exposed to various other types of risks that must be considered: TECHNOLOGY RISK, STRATEGIC AND BUSINESS RISKS, COMPLIANCE RISK, and LEGAL RISK.

The approval of the Risk Management process, framework, policies, risk appetite and infrastructure is vested in the Risk Management Committee (RMC), a Board level committee in charge of the oversight functions of the bank's risk management. With the above in mind, the group has adopted the Enterprise Risk Management Framework where the above risks are not only monitored under their separate and distinct components, but also monitored with the interrelated components in mind.

PNB's Enterprise Risk Management Framework revolves around concrete risk management objectives as follows:

- Institutionalize the Risk Management Process
- Define and disseminate the bank's risk philosophy and objectives.
- Develop the Risk Management infrastructure
- Identify, measure, analyze, and manage risks inherent in all the bank's activities.
- Assist the risk-taking business and operating units in understanding and measuring risk/return profiles.

The above objectives are translated into tasks and activities where interrelated components adopt an integrated framework by which all major defined risk categories are managed:

- Identification of risk areas within PNB and its affiliates - This ensures that all the bank's risk taking business units are identified, to include subsidiaries and affiliates
- Identification of risks - This revolves around the three main risks, namely: Market, Credit and Operations. Further, the approach extends risk monitoring to other risk areas such as: Technology, Compliance, and Legal Risks, among others. As the bank's Risk Management function matures, the framework should encompass all aspects of risk to approach over-all interrelated business risks.
- Outline of the Risk Management Process – The bank's risk management process adopts the ERM components and involves four main aspects: Identification, Measurement, Analysis, and Management.

With the BSP's introduction of new circulars and guidelines to conform to the Basel II Framework, it is within this mandate that the group will undertake its future overall Risk Management approach at an integrated framework. No longer will each of the originally defined risks (Credit, Market, Operational) operate under separate management approaches. There is a need to consolidate these management approaches to ensure that the correlation between the three major risks are understood and subsequently managed.

The succeeding sections aim to outline the ERM approach to major risks identified.

Credit Risk

Effective Credit Risk Management is a very vital component of the Enterprise Risk Management (ERM), lending activity being the heart of banking. Hence, PNB carefully manages its credit risk at various levels (i.e. strategic level, portfolio level and down to individual credit or transaction level). PNB has been creating an appropriate credit risk environment and has adopted the standardized approach to identify, measure, monitor and control credit risk.

The actual involvement of the Board through the oversight function of the Risk Management Committee (RMC) and direct participation of Senior Management in managing credit are the core principles of the bank's ERM.

PNB defines the Credit Risk Management infrastructures across the group as follows:

- Credit risk policies, systems and procedures are in place. A continuing review of such are undertaken to respond to government legislation, competition posed by peer banks, and directives from Management/the Board based on their perspective and thrust.

- The credit risk functional organization is rationalized wherein Risk-Taking Personnel (RTPs), risk management functions and compliance functions (audit and compliance office) are independent. The objective of this set-up is to have a "check-and-balance" environment to attain quality loans without compromising the prompt delivery of service.

- On top of regulatory limits, PNB gauges its tolerance by establishing an internal credit limit structure. The Board approves the limits (SBL, DOSRI, group of borrowers, industry segment, products, etc.). Actual exposures against limits are monitored daily via the Central Liability System (CLS). Subsequently, these limits are annually reviewed and/or as when the need arises.

- PNB adopts state-of-the art systems/tools and technology to support the management of credit. Lately, it acquired a new core banking system to suit the size of its loan portfolio and the complexity of its various loan products.

- Centralized effective Management Information System (MIS) capable of capturing accurate data on credit. A well-defined reporting system supports the Board in its policy-formulation and Management in its decision function.

- As an initial step towards Basel compliance, PNB has increased its existing Credit Risk Rating System (CRRS) from 10 grades to 14 grades. This aims to have an accurate risk profile of its loan portfolio and ensure that impairment provisions are provided for losses.

  Moving forward, PNB will prepare for the key challenges of the Basel II advanced approach in 2010. Initially, the Bank has engaged the services of a third party advisor to conduct the gap analysis and formulate the implementation of a roadmap to address the identified gaps.

Market Risk

With regard to Market, Balance Sheet & Liquidity risks, these are managed using a framework of risk management policies, control procedures and limits and are supported by active Board and Senior Management oversight. The limits are reviewed annually by the Risk Management Group (RMG) and approved by the bank's Assets & Liabilities Committee (ALCO), the Risk Management Committee (RMC) and the Board of Directors. The Board and Senior Management, through the RMC, is kept abreast of market and liquidity risks arising from the activities of the risk taking units through periodic reporting of the RMG. The following are the regular monitors:

- Market Risk - this is dimensioned and controlled in both the trading book and in the balance sheet. In the trading book, market risk is controlled by a daily analysis of the Value-At-Risk (VAR) of trading instruments under normal market conditions. The volatilities used for this regular analysis are those for a rolling one-year period, updated quarterly. The risk amounts computed are for 99% confidence level. The VAR figures are back tested against profit and loss of the trading book to validate the robustness of the VAR model.

  Below is a table showing the VAR of the parent company for the year ended December 31, 2006.

Risk Factor-Trading Book	YEAR END	AVERAGE	HIGH	LOW
Interest Rate Risk	44.01	134.15	450.23	11.95
Foreign Exchange Risk	3.06	5.20	16.83	0.90
Total VAR	47.07	139.35	411.29	13.46

*Note: * The high and low of the total portfolio may not equal the sum of the individual components as the high and lows of the individual portfolios may have occurred on different trading days.*

Likewise, to complement the VAR measure, PNB performs stress tests wherein the trading portfolios are valued under extreme market scenarios not covered by the confidence interval of the bank's VAR model. Stress tests determine the effects of potentially extreme market developments on the value of our market risk sensitive exposures. Other limits employed include the dealer's limit and loss limits.

- Interest Rate Risk in the Banking Book - the impact of changes in interest rates are assessed over a one year period in the banking book using Earnings-At-Risk (EAR), which arrays assets and liabilities according to their repricing profile and tempered by approved assumptions.

- Liquidity Risk - this is monitored and controlled primarily via a gap analysis of maturities of relevant assets and liabilities reflected in the MCO report, as well as an analysis of liquid assets. These measures provide an indication of the bank's ability to generate sufficient liquidity. Further, an internal liquidity ratio has been set to determine sufficiency of liquid assets over deposit liabilities. Also, a concentration risk in funding is tracked by the Large Funders Report.

Operational Risk

Going beyond compliance to protect the capital and earnings of the Bank is the core guiding principle of PNB in managing Operational Risk. Management of Operational Risk in an organized manner to prevent fraud, system failures, damage to physical assets and reduce errors is not a new practice at PNB. Sufficient internal control mechanisms in its business lines/operating units and systems/procedures are clearly defined in its operating manuals.

However, with the promulgation of Basel II and the related legislations of the BSP, the bank is now embarking seriously in the implementation of Basel II compliant Operational Risk controls. While the Bank opted to compute capital charge for Operational Risk using the simple Basic Indicator Approach, management of Operational Risk at PNB now follows a more structured and sophisticated framework such as risk identification, analysis, monitoring and mitigation.

Further, the bank is now adopting the following principles on best practices for Operational Risk Management imposed by Basel II:

- Oversight of the Board of Directors through the Risk Management Committee (RMC)
- Accountability and direct involvement of Management in managing Operational Risk
- Well-defined Risk Management policies contained in the ERM Manual – Operational Risk Management Manual
- Designation of a Risk Overseer in each business line and operating unit
- Independent risk management function, compliance function and audit function
- Shared risk management responsibility across the organization from top level to the lowest staff in the organization

The Risk Management Group introduced the following tools to fully institutionalize Operational Risk Management:

- Risk Control & Self Assessment (RCSA)
  Qualitative tool focused on the present situation to identify potential Operational Risk vs. a menu of vulnerabilities. The owner of the RCSA is line management which knows the strengths and weaknesses of its operations.

  Aggregate risk information by selected criteria (e.g. by risk categories, by business units, by business processes etc.) are reported to the RMC. RCSA also shows the weak areas or area vulnerable to risk in the organization.

- Key Risk Indicators (KRIs)
  These are lead indicators which serve as "warning signals" of the occurrence of risks. As such, appropriate preventive controls can be done to avoid the occurrence of actual losses. Data collection and interview with business lines and operating units are on-going to come up with meaningful and relevant KRIs per office.

- Historical Data on Loss Events
  The bank has started collecting operational loss events as an initial step toward the advanced measurement approach in 2010. It provides a platform for analyzing the causes of loss events as basis for remedial action. Business lines, event type and causes are fully aligned to Basel II guidelines.

- Business Continuity Plan (BCP)
  The bank has defined a recovery site, a calling tree, and contingency plans for the continuity of business in case of emergency business disruptions. The BCP are tested and reviewed at least annually to determine its readiness and relevance.

- Product Manual/Operating Manual
  Prior to launching any given product, the bank outlines and compiles the description, processes, marketing strategies and objectives in a product manual. These manuals form the "bible" by which any future actions and activities revolving around the product is governed. This ensures the uniform application of risk policies/procedures throughout the bank.

Information Security and Technology Risk

Information Security and Technology Risk is the responsibility of everyone in the bank. The Board, however, performs oversight functions in managing said risk. At the outset, the Board plays a major role of reviewing the impact of new technology projects to the bank's operations and approving it. Senior Management, on the other hand, takes care of the day-to-day monitoring of said projects.

Internal controls and monitoring efforts established by Management to manage and address these risks are:

- Creation of an independent Information Security & Technology Risk Unit under the umbrella of RMG
- Adoption and customization of the technology risk management framework and the conduct of information security assessment.
- Inventory, review or updating of all existing systems to determine its efficiency and applicability
- Documentation of policies and procedures on information security and technology process (e.g. Quality Assurance Standards, Project Management Manual, etc.)
- Continuous training of existing manpower to keep abreast with technology development and continuous screening of qualified applicants to maintain a sufficient workforce considering the rate of staff turn-over in the IT industry
- Defining and testing the Business Continuity Plan including system software back-ups to ensure continuity of operations in the event of disruptions
- Conduct of vulnerability assessment and penetration testing to avoid unauthorized intrusion
- Monitoring/review of all outsourcing activities
- Consistent monitoring of systems to address downtime and causes of failure

The technology-related risk management process is designed to help the bank to identify, measure, monitor, and control its risk exposure. The bank is engaged in the following activities to manage technology related risks:

1. **Plan for its use of technology** - When considering whether to adopt a new technology or to upgrade existing systems, the Bank assesses how it will use the technology within the context of its overall strategic goals and its market

2. **How to Implement the Technology** - Proper implementation of projects and initiatives are needed to convert plans into better products and services, delivery channels, and processes

3. **Measure and monitor risk-taking activities** - Management also monitors and measures the performance of technology-related products, services, delivery channels, and processes in order to avoid potential operational failures and to mitigate the damage that may arise if such failures occur. Technology processes are also reviewed periodically for quality and compliance with control requirements.

Corporate Governace

The Bank adheres to the principles of good governance as culled from leading best practices internationally and on a national level. It subscribes to the philosophy of integrity, accountability and transparency in its manner of doing business, fair dealing with its clients, investors, staff, stockholders and its various publics, professionalism in managing the company and its subsidiaries, and respect for the laws and regulations of the countries where it conducts business. Internally, it follows a philosophy of rational checks and balances as well as a structured approach to its operating processes.

To this end, the Bank has promulgated a Revised Manual on Corporate Governance and appointed a senior officer to ensure compliance with the provisions of the Manual. The Directors, Advisors and Executive Officers of the Bank have taken a course on Corporate Governance to be able to understand and implement the principles thereof in a consistent and satisfactory manner.

- **Measures to fully comply with Corporate Governance**

Under the Manual, compliance with the principles of good corporate governance principally starts with the Board of Directors. It is the Board's responsibility to foster the long-term success of the corporation and secure its sustained competitiveness in accordance with its fiduciary responsibility. In order to have a central focus for the Bank's activities, the Board has appropriately established the company's Mission and Vision Statements.

To have a structure for compliance, the Manual established and defined the responsibilities and functions of the Board and the various Committees necessary for good governance, i.e., the Corporate Governance Committee, the Audit and Compliance Committee, the Risk Management Committee and the roles of the External and Internal Auditors and the Corporate Secretary. The Manual also established an evaluation system by which the Directors and the Executive Officers can rate the Bank periodically against certain leading practices and principles on good corporate governance. Last but not the least, the Manual made provisions for the protection of Investors' Rights including Minority Interests.

- **Evaluation System**

The evaluation system which was provided to measure or determine the extent of compliance with the Manual of Corporate Governance consists of a Self-Assessment Questionnaire which is filled up by the various functional groups indicating the compliance rating of certain institutional units/processes/activities which include the Board of Directors, Management, Organizational and Procedural Controls, the Nomination Process, Independent Audit Mechanisms and Disclosure and Transparency among others. The evaluation process includes a self-assessment scorecard which is filled up by the Members of the Board. The above are submitted to the Compliance Officer who issues the required certificate of compliance with the corporate governance mechanism to the SEC. The Manual provides for a set of graduated penalties for non-compliance with/violation of its provisions.

- **No material deviations**

Because of the heightened sense of accountability among the staff and an enhanced culture of compliance within the whole bank, there have been no material deviations noted by the Compliance Officer.

- **Plans to improve Corporate Governance**

The Manual was updated on March 5, 2004, January 28, 2005, April 8, 2006 and February 17, 2007. Apart from these there are no other plans to change the Manual for the moment.

The Board and Management Team

Board of Directors
Board of Advisors
Senior Management Team

The Board of Directors

The Board of Directors

Florencia G. Tarriela
Chairperson

Omar Byron T. Mier
Vice Chairman

Virgilio R. Angelo
Director

Domingo T. Chua
Director

The Board of Directors

The Board of Directors

Washington Z. SyCip
Director

Lucio C. Tan
Director

Feliciano L. Miranda, Jr.
Director

Eric O. Recto
Director

The Board of Directors

The Board of Directors

Ricardo M. Tan
Director

Macario U. Te
Director

Renato J. Fernandez
Corporate Secretary

Florido P. Casuela
Director

The Board of Advisors

The Board of Advisors

Jose A. R. Melo
Advisor

Santiago S. Cua Jr.
Board Advisor

Jose Ngaw
Board Advisor

Alejandro R. Roces
Board Advisor

Cielo M. Salgado
Board Advisor

Senior Management Team

Senior Management Team

Anthony Q. Chua
Executive Vice President
Global Operations Sector

Carmen G. Huang
Executive Vice President
Chief of Staff
Chief Financial Officer

Renato A. Castillo
Executive Vice President
Business Development Sector
Remedial Management Sector

Cynthia V. Javier
Executive Vice President
Global Technology Sector

building strengths...

Senior Management Team

Senior Management Team

Cris S. Cabalatungan
First Senior Vice President
Internal Audit Group

Ramon L. Lim
First Senior Vice President
Treasury Sector

Isabelita Manalastas-Watanabe
First Senior Vice President
International Banking and
Overseas Remittance Sector
(Europe, Israel & African Continent)

Edgardo T. Nallas
First Senior Vice President
Human Resource Group

nurturing growth

Senior Management Team

Senior Management Team

Ma. Elena S. Sarmiento
First Senior Vice President
and Trust Officer
Trust Banking Group

Christian Jerome O. Dobles
Senior Vice President
Asset Management Sector

Alvin C. Go
Senior Vice President
and Chief Legal Counsel
Legal Group

Rafael Z. Sison, Jr.
Senior Vice President
Retail Banking Sector

managing risks...

Senior Management Team

Senior Management Team

Carmela A. Pama
Senior Vice President
and Chief Risk Officer
Risk Management Group

Rommel R. Garcia
Sector Head
North American Region

Maria Paz D. Lim
Senior Vice President
and Treasurer

providing opportunities

The Bank's Congenerics

Banking

Philippine National Bank (Europe) PLC

Philippine National Bank (Europe) PLC is a wholly-owned subsidiary incorporated in the United Kingdom. It is engaged in full service banking which includes, among others, deposit services, loans, fund transfers, FX trading and documentary credits. It has an extension office at Nottinghill Gate to primarily handle remittances.

Foreign Exchange Trading

PNB Forex, Inc.

PNB Forex, Inc. was organized to engage in the buying and selling of foreign currencies. However, it is now in dormant status.

Holding Company

PNB Holdings Corporation

PNB Holdings Corporation is the parent company of PNB General Insurers Co., Inc.

PNB International Investments Corporation

PNB International Investments Corporation (PNB IIC) is a non-bank holding subsidiary of PNB and is the parent company of PNB Remittance Centers, Incorporated (PNB RCI). PNB RCI has a network of 40 money transfer offices in 11 states of the United States of America.

PNB RCI also owns PNB RCI Holding Company, Ltd., established to be the holding company of PNB Remittance Company (Canada) [PNB RCC]. PNB RCC has eight offices serving the remittance requirements of Filipinos in Canada.

PNB RCI Holding Company, Ltd.

This company was incorporated on August 18, 1999 in California as a limited liability company. PNB RCI Holding is the direct owner of PNB Remittance Company, Canada.

General Insurance

PNB General Insurers Co., Inc.

A non-life insurance company that offers fire, marine, motor car, surety, casualty, engineering and accident insurance.

Investment Banking

PNB Capital and Investment Corporation

The PNB Capital and Investment Corporation is the investment banking subsidiary of PNB. It provides services such as loan syndication, debt and equity underwriting, and financial advisory services. PNB Capital and Investment Corporation also assists in structuring and packaging mergers and acquisitions, project finance, and securitization transactions.

Leasing and Financing

Japan-PNB Leasing and Finance Corporation

Japan-PNB Leasing and Finance Corporation is a joint venture between PNB and well-established Japanese financial institutions, IBJ Leasing Co., Ltd. and Mizuho Corporate Bank. The principal activities of Japan-PNB Leasing and Finance Corporation are financial leasing, chattel mortgage loans, and installment notes discounting.

Lending

PNB International Finance, Ltd.

The PNB International Finance, Ltd. (PNB IFL) is PNB's wholly-owned subsidiary in Hong Kong principally engaged in granting retail loans to Filipino overseas workers and professionals. Its main office is in Central, Hong Kong with branches in Shatin and Yuen Long.

Remittance

PNB Remittance Centers, Ltd.

The PNB Remittance Center, Ltd. (PNB RCL) is PNB's wholly-owned remittance subsidiary based in Hong Kong. It has nine branches providing money remittance services for overseas Filipino workers in Hong Kong. The company also services the remittance requirements of Indonesian overseas workers in Hong Kong through a remittance tie-up with Bank Mandiri.

PNB Remittance Company (Canada)

Established and incorporated on April 26, 2000 in Nova Scotia, Canada as an unlimited liability company. PNB RCC is authorized to engage in money transfer business in Canada. The company has seven (7) branches and one (1) marketing office.

PNB Remittance Center, Ltd. (Hong Kong)

Established on April 24, 1994 as a wholly owned subsidiary based in Hong Kong engaged in the remittance business and money exchange. In addition to its corporate office, RCL has eight (8) branches spread around Hong Kong and Kowloon. One branch in Causeway Bay caters primarily to servicing the Indonesian market in partnership with Bank Mandiri–Hongkong Branch. PNB RCL is regulated by the Company's Registry of Hong Kong.

PNB Italy SpA

PNB Italy SpA is a wholly-owned subsidiary incorporated in Italy. Presently, its principal business is to service the remittance requirements of overseas Filipino workers in Italy. It has offices in Rome, Milan and Florence. It owns PNB Netherlands B.V., a remittance company operating in the Netherlands with its main office in Amsterdam and an extension office in Rotterdam.

PNB Netherlands B.V.

PNB Netherlands B.V. is a subsidiary of PNB Italy, SpA which started operations on April 5, 2004 to engage in remittance service. On August 15, 2005, it opened its extension office in Rotterdam to service the remittance needs of Filipino seamen.

PNB Corporation, Guam

The PNB Corporation, Guam (PCG) is a wholly-owned subsidiary of PNB organized to engage in money transfer business. Its principal office is located in Guam. PCG has a branch in Saipan.

PNB Austria Financial Services GmbH

PNB Austria Financial Services GmbH is a wholly-owned subsidiary of PNB which started operations on June 6, 2006. It is a registered limited liability company in Vienna, Austria engaged in providing remittance services to Filipinos in Austria and Switzerland.

PNB Global Filipino Remittance Spain, S.A.

PNB Global Filipino Remittance Spain, S.A. is a wholly-owned subsidiary of PNB which started operations on November 15, 2006. It was granted a license by Banco de Espana to provide remittance services to Filipinos in Spain. It has a branch in Barcelona that caters primarily to the remittance needs of Filipino seamen.

Stock Brokerage

PNB Securities, Inc.

The PNB Securities, Inc. (PNB SI) is the wholly-owned stock brokerage subsidiary of PNB that deals in the trading of shares of stocks listed at the stock exchange.

DEPOSITS AND RELATED SERVICES

Peso Accounts
- Regular Passbook Savings Account
- Superteller Savings Account
- First Access Savings Account
- PNB Prime Savings Account
- OFW Account
- SSS Account
- GSIS Account
- Regular Checking Account
- Budget Checking Account
- PNBig Check Account
- Priority One Checking Account
- eXecutive Checking Account
- COMBO Account
- Regular Time Deposit
- PNBig Savings Account
- Peso Wealth Multiplier Account

Foreign Currency Accounts
Dollar Accounts
- U.S. Dollar Savings Account
- Greencheck (Interest-bearing U.S. Dollar Checking Account)
- Greenmarket (U.S. Dollar Time Deposit)
- PNB $ M.I.N.T. Account
- Dollar Wealth Multiplier Account

Euro Accounts
- Euro Savings Account
- Euro Time Deposit Account

Business Banking Solutions
- e-Collect (Collection System)
- Cash Mover (Deposit Pick-up Services)
- Automatic Debit Arrangements (ADA)
- Corporate e-Pay
- Paywise (Payroll Services)
- PNB e-Tax Payment Facility

e-Banking Services
- Personal Internet Banking
- Corporate Internet Banking
- Phone Banking
- Mobile Banking
- ATM Related Services

Other Services
- Safety Deposit Boxes
- Government-Related Services
  - SSS Payments
  - BOC Duties and Taxes
  - Philhealth Payments
  - National Home Mortgage Finance Corp.

BANCASSURANCE

Life Insurance
- PNB Pangarap Series Pangkabuhayan Package
- PNB Pangarap Series Education Package
- PNB Pangarap Series DollarMAX

Non-Life Insurance
- Auto Protector Plan
- House Protector Plan
- 6-in-1 Family Protector Plan

FUND TRANSFER SERVICES

Money Transfers (Foreign and Domestic)
- Remittance via
  - Rapid Remit
  - Electronic Remittance Processing System (ERPS)
  - Integrated Remittance System (IRS)
  - Payroll Remittance Interface System (PRIS)
  - Internet Banking
  - Phone Banking
  - Debit/Credit Cards (PNB (Europe) PLC)
- PNB 3D (Door-to-Door Delivery) Remittance Service
  - Check 3D Remittance Service
  - Cash 3D Remittance Service
  - Door-To-Bank (DTB) Remittance Service
  - US$ 3D Remittance Service
  - Bills Payment Delivery Service
- PNB Global Filipino Money Card (GFMC)
- Remittance Bills Payment Service
- Advise & Pay Anywhere Service
  - Domestic Branches
  - Pay-out Agents
- Telegraphic/Telex Transfers
- S.W.I.F.T. Transfers
- Philippine Domestic Dollar Transfer System (PDDTS)
  - Gross Settlement Real Time (GSRT)
  - Real Time Gross Settlement (RTGS-Inward)-Peso
  - End of Day Netting (PCHC)-Dollar
  - End of Day Netting (EPCS)-Peso
- Demand Drafts (Local/Foreign)
- Cashier's/Manager's Checks

Travel Funds
- FX Currency Notes
- PNB Mabuhay Peso Travelers Cheque
- Other Foreign Travelers Cheque
  - AMEXCO
- Regular Collections (Foreign and Domestic)
- Final Credit Service (Special U.S. Dollar Check Collection)
- PNB Direct Deposit Program
- PNB Mabuhay Peso Gift Cheque

TREASURY PRODUCTS AND SERVICES

Foreign Currency
- Foreign Exchange (Spot, Forward, Swap)
- Foreign Currency Money Market Transactions
- Bonds Dealership
  - Euro-Notes/Bonds
  - Convertible Bonds
  - R.P. Sovereign Bonds (ROP, BSP)
  - U.S. Treasury Bonds

Local Currency
- Money Market Transactions
- Securities Dealership
  - Government Securities
    - Treasury Bills
    - Fixed Rate Treasury Notes/Bonds
    - Retail Treasury Bonds
    - Zero-Coupon Bonds
    - Local Government Unit Bonds
  - Commercial Papers

EXPORT /IMPORT SERVICES

Export Services
- Advising of Letters of Credit
- Confirmation of Letters of Credit
- Export Negotiation
  - Drawings under Letters of Credit, Documents against Payment (DP) and Documents against Acceptance (DA)
  - Payment of Exports under Prepayment and Open Account (OA) Arrangements

Import Services
- Issuance and negotiation of Letters of Credit (Foreign/Domestic)
- Issuance of Shipside Bonds
- Trust Receipt Financing
- Servicing of Importations under DA/OA and DP Arrangements
- Servicing of Collection of Final Customs Duties

Special Financing Services
- Issuance of Bank Guarantees in the form of Standby Letters of Credit which serve the purpose of :
  - Loan Repayment Guarantee
  - Advance Payment Bonds
  - Bid Bonds
  - Performance Bonds
  - Other Bonds
- Issuance of Standby Letters of Credit under PNB's "Own a Philippine Home Loan Program"
- Issuance and Servicing of Deferred Letters of Credit as mode of payment for :
  - Importation or Local Purchase of Capital Goods
  - Services Rendered (e.g., Construction Projects, etc.)

LENDING SERVICES

Commercial and Industrial Loans
- Credit Lines
  - Revolving Credit Line (RCL)
  - Non-revolving Credit Line
  - Omnibus Line
  - Peso/FX Convertible Credit Line
  - Contract to Sell Financing
  - Suppliers Credit Financing
- Export Financing Facilities
  - Export Advance Loan
  - Export Advance Line
  - Exporters' Express Financing
  - Small and Medium Exporters' Financing Program
- Bills Purchased Lines
  - Domestic Bills Purchased Line
  - Export Bills/Drafts Purchased Line
  - Discounting Line
- Import-Related Loans
  - LC Line
  - LC/TR Line
- Term Loans
  - Medium-and Long-Term Loan
  - Short-Term Loan
- Standby Letters of Credit
- Loans Against Deposit Hold Out
- Time Loans
  - Agricultural
  - Commercial
- Structured Trade Finance
  - Export Credit Agency Lines
  - US-EXIM Guarantee Program
- Specialized Lending Programs
  - DBP Wholesale Lending Facilities
  - LBP Wholesale Lending Facilities
  - SSS Wholesale Lending Facilities
  - BSP Rediscounting Facility
- Sugar Financing Program
  - Sugar Crop Production Line (SCPL)
  - Sugar Quedan Financing Line (SQFL)
  - Time Loan Agricultural (TLA)
  - Operational Loan (OpL)
- Small Business Loans for SMEs
  - Short-Term/Revolving Credit Line
  - Omnibus Line
  - Term Loan

Local Guarantee Facilities
- PhilEXIM Guarantee
- SB Corp. Guarantee Program

Loans to Local Government Units (LGUs)
- Term Loans
- Import LC Facility against Loan or Cash
- Standby Letters of Credit
- Loans Against Deposit Hold Out
- LGU Contractor Financing
- LGU Bond Flotation (thru PNB Capital and Investment Corp.)

Loans to Government-Owned and Controlled Corporations/National Government Agencies
- Term Loans
- Credit Lines
- Export Financing Facilities
- Bills Purchased Lines
- Import Letters of Credit/Trust Receipts Line
- Standby Letters of Credit
- Structured Trade Finance
  - Export Credit Agency Lines
  - Guarantee Program

Consumer Loans
- Sure Fund (Salary Loan)
- Sure Wheels (Motor Vehicle Loan)
- Sure Home (Housing Loan)
  - Sure Home Flexi Loan
- Contract to Sell Financing
- Own a Philippine Home
- Own an Overseas Home Loan
- Loans Against Deposit Hold Out
  - Peso Loan vs. Peso/FX Deposits

Credit Card Services
- PNB VISA Card
- ASTRA Secured Kredit (ASK) Card

TRUST PRODUCTS AND SERVICES

Unit Investment Trust Funds (UITF)
- PNB Mabuhay Plus UITF
- PNB Mabuhay Prime UITF
- PNB Mabuhay Prestige UITF
- PNB Dollar Profit UITF
- PNB Dollar Punla UITF
- PNB Peso Punla UITF
- PNB PHISIX UITF

Personal Trust Services
- Estate Planning
- Living Trust Accounts
- Investment Management Accounts
- Insurance Trust
- Educational Trust
- Guardianship
- Custodianship

Corporate Trust Services
- Trusteeship
- Securitization
- Investment Portfolio Management
- Administration of Employee Benefit, Pension and Retirement Plans
- Trust Indenture
- Global Custodial Services
- Custodianship Services for Local Corporations

Agency
- Escrow
- Bond Registrar
- Facility Agency
- Stock Transfer
- Receiving Bank

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we provide opportunities.

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