CAPITAL STRUCTURE AND ADEQUACY

Risk Tolerance Level to determine Significance of Risks
The Corporate Planning Group (Corplan) taking into consideration the Bank's projected levels for Qualifying Capital, Risk Weighted Assets, and CAR for the three-year period determines tolerance Level. The SMT and Board have approved a preset level of 0.20% or 20 basis points impact on CAR, which translates to a movement of Php8billion in RWA or Php1billion in Qualifying Capital.
Trigger Levels to activate Capital Contingency Plan
Trigger levels to initiate Capital Contingency Plan is determined by the Capital Management Subcommittee of ALCO and approved by the Executive Committee/Board. The Bank will maintain a Pillar 2 buffer for CET1 ratio and CAR in addition to the conservation buffer of 2.5% and DSIB buffer as prescribed by BSP for Pillar 1 under Basel III.
Stress Testing
Completed on 3 types: • Macroeconomic Stress Test • Event Driven Stress Test • Ad-hoc Stress Test Applied to Pillar 1 and Pillar 2 risks; corresponding RCSA is accomplished under the stressed scenarios. Additional scenarios are deliberated by the risk owners for individual risks should the above three types of stress test models not be applicable.
Implementation to Subsidiaries
The 3-year risk assessment is employed to the subsidiaries- both domestic and foreign, as well. Each of the subsidiaries is encouraged to perform stress testing relevant to their respective business condition and environment.

Through the Bank's ICAAP Document, the Bank advances its efforts to integrate the Bank's risk management culture in all its activities. Further, it is intended that the ICAAP document be a live document and will be continually amended / revised as the business sees fit. It is the intention that capital allocation among the Bank's risk-taking units are based on the risk weighted exposures that these units take.

MESSAGE FROM THE RISK OVERSIGHT COMMITTEE CHAIRMAN

FELIX ENRICO R. ALFILER
VICE-CHAIRMAN/DIRECTOR

The Risk Oversight Committee (ROC) has performed its duties independently according to the scope, duties and responsibilities assigned by the Board of Directors and in alignment with the bank's Enterprise Risk Management Framework (ERM). In 2016, the ROC (comprising of 3 directors) met 12 times (at least monthly) to discuss the bank's risk exposures from the identified material risks against the overall bank's strategy.

PNB follows a strong risk management framework (ERM) to ensure that it consistently maintains high standards of internal controls and risk management processes against the bank's risk appetite. The same framework works to ensure optimizing the risk / return ratio through the monitoring processes against limits and thresholds. The risk management framework resides at all levels within the bank and embedded into our core values. The 3 lines of defense (3LoD) for good risk management are very much at work at PNB!

The Risk Oversight Committee continues to expand its role not only in mainstream risk policy formulation, defining the appropriate level of risk, as well as communicating the risk appetite throughout the organization but also to oversee the creation of controls that keep the company operating within these established boundaries.

As regulators increase their demand for enhanced programs on capital planning and stress testing, (based on size, complexity, and systemic footprint), there also lies the increased challenge to expand the capabilities to access and provide high-quality data, single source of data for credible internal reporting mechanism and MIS that support regulatory reporting requirements. The bank's Enterprise Data Warehouse and Business Intelligence Systems continue to provide relevant reports and analytics to the various business units.

The continuing mission of risk management is to maintain a tight rein on the increasing risks as a consequence of new product and services offerings, as well as emerging trends on risks. Cyber security risks likewise raise new challenges as new policies have to be drafted and risk mitigation tools need to be identified and implemented. The Philippines had been at the receiving end of these globally advanced threats, as was experienced in 2016. The bank's response is characterized by increased diligence in identifying risks, changing regulatory environment and emerging of cyber security as a primary focus of awareness and risk mitigation. The message to all our stakeholder is very clear – NEVER BE COMPLACENT!

The bank's risk management team remains to be in the forefront of the Bank programs to support its mission, vision and objectives of optimal use of the Bank's domestic and international footprint to deliver innovative products and services to all our stakeholders/clients.

FELIX ENRICO R. ALFILER
Risk Oversight Committee Chairman

RISK MANAGEMENT DISCLOSURE

INTRODUCTION

PNB's approach to risk management strives for an integrated view on strategy, risk tolerance, capital and funding and performance management. Putting high priority on risk management, the bank endeavours to continuously refine its framework for risk management, and at the same time ensuring that revenue targets are set and reviewed on a regular basis to maximize the growth of business. Capital Planning, Funding and Liquidity requirements are driven both by the business and by regulatory requirements.

The PNB Board and its Risk Oversight Committee operate as the highest level of PNB's risk governance. The bank's Board of Directors has delegated specific responsibilities to various board committees which are integral to the PNB's risk governance framework and allow executive management, through management committees, to evaluate the risks inherent in the business and to manage them effectively. Figure 1 below provides a list of the board level committees and management committees. Their corresponding functions, roles and responsibilities are highlighted in the Corporate Governance discussion in this annual report.

Executive officers are assigned to various management committees that provide the leadership and execution of the vision and policies approved by the bank's board of directors. The bank's business strategies are driven for most part by the day-to-day directions decided by these management committees with approvals and notation by the various board level committees.

BOARD OF DIRECTORS	PRESIDENT & CEO
• Corporate Governance Committee	• Senior Management Credit Committee
• Board Audit and Compliance Committee	• Senior Management Team Committee
• Risk Oversight Committee	• Acquired Assets Disposal Committee
• Board Oversight Committee - Domestic and Foreign Offices/Subsidiaries	• Asset Liability Committee Sub Committee on Capital Planning
• Board Oversight RPT Committee	• Operations Committee
• Executive Committee	• Ethical Standards Committee
• Trust Committee	• Procurement Committee
• Board Information Technology Governance Committee	• IT Evaluation Committee
	• Capital Management Sub-Committee of ALCO
	• Anti-Money Laundering Review Committee
	• IT Management Committee
	• Product Committee
	• Promotions Committee
	• Branch Site Selection Committee
	• Asset Disposal Committee (Head Office)
	• Selection Committee for Expatriate Personnel
	• Committee on Accreditation of Overseas Remittance Agent (CAORA)
	• Committee on Decorum and Investigation

Figure 1: Board & Management Committees

The PNB Board Risk Oversight Committee (ROC) is mandated to set risk appetite, approve frameworks, policies and processes for managing risk, and accept risks beyond the approval discretion provided to management.

The risk management policy includes:
- a comprehensive risk management approach;
- a detailed structure of limits, guidelines and other parameters used to govern risk-taking;
- a clear delineation of lines of responsibilities for managing risk;
- an adequate system for measuring risk; and
- effective internal controls and a comprehensive monitoring & risk-reporting process

ENTERPRISE RISK MANAGEMENT FRAMEWORK (ERM)

The approach to managing risk is outlined in the bank's Enterprise Risk Management (ERM) Framework which creates the context for setting policies and standards, and establishing the right practices throughout the PNB Group. It defines the risk management processes and sets out the activities, tools, and organizational structure to ensure material risks are identified, measured, monitored and managed.

Since 2006 the ERM Framework, with regular reviews and updates, has served PNB well and has been resilient through economic cycles. The organization has placed a strong reliance on this risk governance framework and the three lines-of-defense model (see Figure 2), which are fundamental to PNB's aspiration to be world-class at managing risk.

1. The *first line of defense* is made up of the management of business lines and legal entities. Business units are responsible for their risks. Initial risk assessments, both of the customer relationship and the individual proposed transactions, ensure that the correct decisions are made. The business units ensure that transactions are correctly priced and that the resulting risks are managed throughout the life of the transaction. Effective first line management includes:
   a. the proactive self-identification / assessment of issues and risks, including emerging risks
   b. the design, implementation and ownership of appropriate controls
   c. the associated operational control remediation
   d. a strong control culture of effective and transparent risk partnership.
2. The *second line of defense* comes from both the risk management function and the compliance function of the Bank, which is independent of business operations. The risk management unit implements the risk management framework, provides independent oversight over specific board directives and is responsible for regular reporting to the Risk Oversight Committee. The compliance function develops and implements governance standards, frameworks and policies for each material risk type to which the group is exposed. This ensures consistency in approach across the group's business lines and legal entities. The compliance function report directly to the Board Audit and Compliance Committee.
3. The *third line of defense* is the internal audit function& the compliance testing function which provides an independent assessment(s) of the adequacy and effectiveness of the overall risk management framework and governance structures. The internal audit function& compliance testing function report directly to the Board Audit & Compliance Committee.

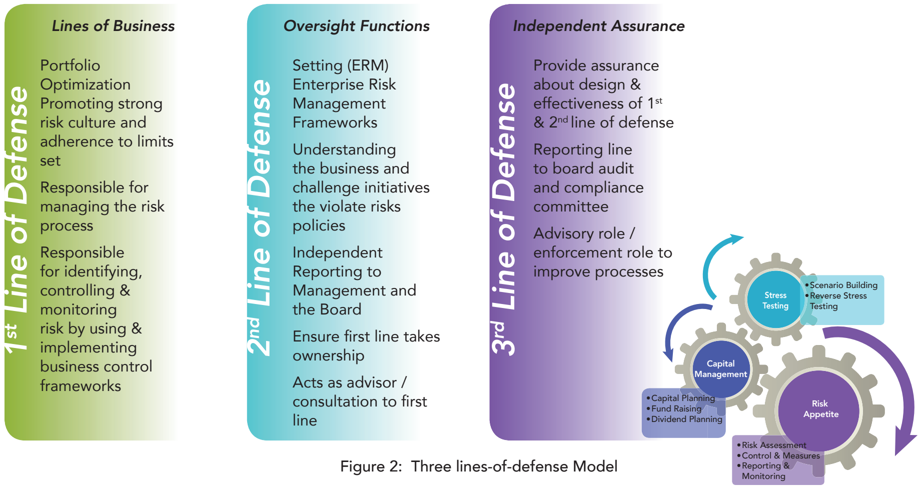

Figure 2: Three lines-of-defense Model

	awareness of RPT policies and procedures of bank employees; 4. Conduct regular monthly meetings or as necessary to review, approve and endorse RPT proposals to the Board for final approval.	RPT policy guidelines. 4. Bank's RPT dealings are reviewed/ approved/noted by BORC and endorsed to Board for final approval per existing RPT policy guidelines

F. RISK MANAGEMENT SYSTEM

1) Disclose the following:

(a) Overall risk management philosophy of the Bank:

PNB's approach to risk management strives for an integrated view on strategy, risk tolerance, capital and funding and performance management. Putting high priority on risk management, the bank endeavours to continuously refine its framework for risk management, and at the same time ensuring that revenue targets are set and reviewed on a regular basis to maximize the growth of business. Capital Planning, Funding and Liquidity requirements are driven both by the business and by regulatory requirements.

The PNB Board and its Risk Oversight Committee operate as the highest level of PNB's risk governance. The bank's Board of Directors has delegated specific responsibilities to various board committees which are integral to the PNB's risk governance framework and allow executive management, through management committees, to evaluate the risks inherent in the business and to manage them effectively. Figure 1 below provides a list of the board level committees and management committees. Their corresponding functions, roles and responsibilities are highlighted in the Corporate Governance discussion in this annual report.

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Board of Directors

- Corporate Governance Committee
- Board Audit and Compliance Committee
- Risk Oversight Committee
- Board Oversight Committee - Domestic and Foreign Offices/Subsidiaries
- Board Oversight RPT Committee
- Executive Committee
- Trust Committee
- Board Information Technology Governance Committee

President & CEO

- Senior Management Credit Committee
- Senior Management Team Committee
- Acquired Assets Disposal Committee
- Asset Liability Committee
- Sub Committee on Capital Planning
- Operations Committee
- Ethical Standards Committee
- Procurement Committee
- IT Evaluation Committee
- Capital Management Sub-Committee of ALCO
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   a. the proactive self-identification / assessment of issues and risks, including emerging risks
   b. the design, implementation and ownership of appropriate controls
   c. the associated operational control remediation
   d. a strong control culture of effective and transparent risk partnership.

2. The *second line of defense* comes from both the risk management function and the compliance function of the Bank, which is independent of business operations. The risk management unit implements the risk management framework, provides independent oversight over specific board directives and is responsible for regular reporting to the Risk Oversight Committee. The compliance function develops and implements governance standards, frameworks and policies for each material risk type to which the group is exposed. This ensures consistency in approach across the group's business lines and legal entities. The compliance function report directly to the Board Audit and Compliance Committee.

3. The *third line of defense* is the internal audit function & the *compliance testing* function which provides an independent assessment(s) of the adequacy and effectiveness of the overall risk management framework and governance structures. The internal audit function & compliance testing function report directly to the Board Audit & Compliance Committee.

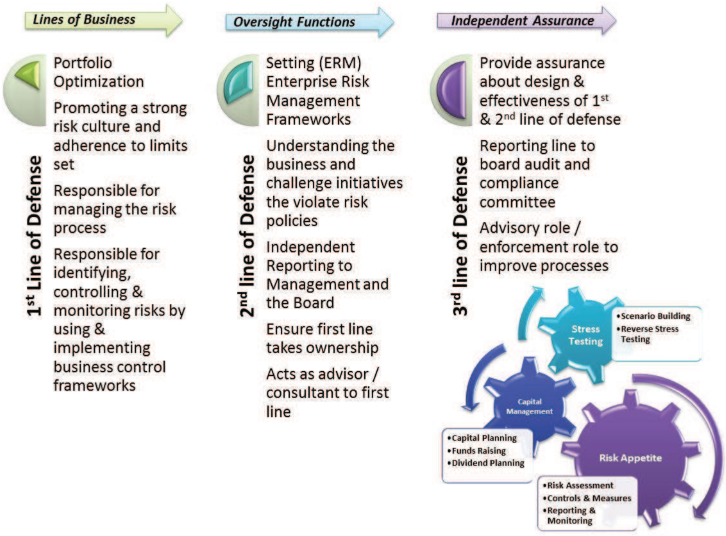


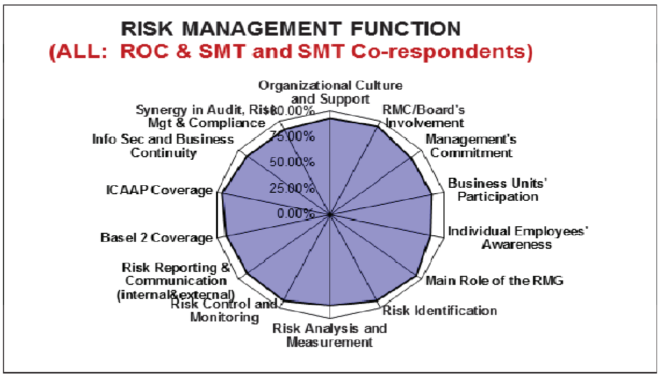
Figure 1: Three lines-of-defense Model

Risk Management Group (RMG) is independent from the business lines and is organized in 7 divisions: Credit Risk Division, ICAAP & BASEL Implementation Division, Market & ALM Division, Operational Risk Division, Information Security and Technology Risk Division (to include Business Continuity Management), Trust Risk Division and Business Intelligence & Data Warehouse Division.

Each division is tasked to monitor the implementation of the processes and procedures that support the policies for risk management applicable to the organization. These policies clearly define the types of risks to be managed, set forth the risk organizational structure and provide appropriate training necessary to manage and control risks. The policies also provide for the validation, audits & compliance testing, to measure the effectiveness and suitability of the risk management structure.

(b) A statement that the directors have reviewed the effectiveness of the risk management system and commenting on the adequacy thereof:

The risk management system and the directors' criteria for assessing its effectiveness are revisited on an annual basis and limit settings are discussed with the Business Units and presented to the Risk Oversight Committee for endorsement for final Board Approval.



Overall, members of the Board Risk Committee evaluated the bank's risk function at achieved an evaluated rating of 88.34%. This means that the "Risk Management processes is embedded in all "*lines of defense*" in the organization."

Figure 2: 2016 Overall Assessment of the Risk Management Function

Regular review and assessment of the Enterprise Risk Management Function is completed by both the senior management team (including 1-downs) and the Risk Oversight Committee members. The above evaluation refers to the review by the members of the Risk

Oversight Committee.

(c) Period covered by the review;

One year.

(d) How often the risk management system is reviewed and the directors' criteria for assessing its effectiveness?

Annually.

(e) Where no review was conducted during the year, an explanation why not.

Not Applicable.

2) Risk Policy

(a) Company

Give a general description of the company's risk management policy, setting out and assessing the risk/s covered by the system (ranked according to priority), along with the objective behind the policy for each kind of risk:

The following are the basic principles that the Bank must adhere to in conducting its business, with the objective of minimizing risks and optimizing return on capital:

- First, the boards of directors and its delegated committees have the responsibility for managing the bank's overall strategies and objectives.
- Second, the bank works on the basis that risk taking decisions should always be made by a committee consisting of at least three persons, and not by one person alone, no matter how high he is in the organization.
- Third, the bank has policies and procedures in place to guide line management in actually originating, approving and managing these risks.
- Fourth, the Board Risk Oversight Committee is designated by the PNB Board of Directors to assist the board to oversee the risk profile and the development/maintenance of the risk management framework of PNB and its related allied subsidiaries and affiliates. It is mandated to set risk appetite, approve frameworks, policies and processes for managing risk, and accept risks beyond the approval discretion provided to management.
- Final Approval of the bank's overall risk framework is accomplished by the Board of Directors en banc.

(b) Group

Give a general description of the Group's risk management policy, setting out and assessing the risk/s covered by the system (ranked according to priority), along with the objective behind the policy for each kind of risk:

Risk Exposure	Risk Management Policy	Objective
Enterprise Risk Management (ERM) Framework	ERM Policy Document	To formalize the bank's ERM Framework and to articulate the roles and responsibilities of the Board of Directors, management and employees, and relevant committees accordingly. It is intended that this framework will provide the overall guidance in the Risk Management functions of *identification, measurement, analysis, monitoring and control of risks*.
Market Risk	Market Risk Management Manual	The Market Risk Manual covers subsidiaries and affiliate with market risk exposure. This include Value At Risk (VaR) Monitoring and setting of VaR Limits
Liquidity Risk	Liquidity Risk Management Manual	The Liquidity Risk Management Manual covers subsidiaries and affiliate with funding liquidity risk exposure. This would include monitoring of liquidity gaps and the setting of cumulative liquidity gap limit up to one –year.
Interest Rate Risk	Interest Rate Risk in the Banking Book	The Interest Rate Risk Management Manual covers subsidiaries and affiliate with exposure in net interest income arising from mismatch of repriceable assets and repriceable liabilities. This would include the monitoring of repricing gap and the setting of the Earnings at Risk Limit for the repricing gap per tenor bucket.
Market Risk Price Risk in the Trading Portfolio	The Bank's trading positions are sensitive to changes in the market prices and rates. PNB is subject to trading market risk in its position taking activities for the fixed income, foreign exchange and equities markets. The Bank also employs the stop loss monitoring tool to monitor the exposure in the price risks. Stop loss limits are set up to prevent	To calculate the risks in the trading portfolio, the Bank employs the Value at Risk (VAR) methodology with 99% confidence level and one holding period (equities and FX VAR) to ten day holding period for fixed income VAR. VAR limits have been established annually and exposures against the VAR limits are monitored on a daily basis. The VAR figures are back tested against actual (interest rates) and hypothetical profit and loss