BanKo

A subsidiary of BPI

ANNUAL REPORT 2017

TABLE OF CONTENTS

OUR BUSINESS ____ 3

FINANCIAL SUMMARY AND RESULT OF OPERATION ____ 6

CORPORATE GOVERNANCE ____ 7

OPERATING MANAGEMENT ____ 13

RISK MANAGEMENT ____ 15

COMPLIANCE ____ 20

INDEPENDENT AUDITOR'S REPORT

ABOUT BANKO

BPI Direct BanKo, Inc., A Savings Bank (BanKo), is BPI's vehicle for financial inclusion through the delivery of financial solutions to self-employed micro-entrepreneurs (SEMEs), a sector that rarely has access to formal banking. A product of the merger of two specialized thrift bank units of BPI—BPI Direct Savings Bank Inc. and BPI Globe BanKO, it aims to provide SEMEs with affordable and appropriate loan products, and empower its clients with expert financial advice and solutions that promote the growth and expansion of their enterprises.

BanKo' primary loan product for the SEMEs, NegosyoKo, is a loan that ranges from Php 25,000 to Php 300,000 that may be used for additional capital or business expansion. It was piloted in ten (10) branches in Davao, Dumaguete, Naga, Greenhills, Cainta, Caloocan, Angeles, General Santos, Iloilo, and Batangas after securing the approval of the Bangko Sentral ng Pilipinas (BSP) in October 2016. Two months later, the BSP and the Securities and Exchange Commission approved the merger of BPI Direct Savings Bank Inc. and BPI Globe BanKO now known as BPI Direct BanKO, Inc.,A, Savings Bank allowing the microfinance bank to scale up its operations. BSP also granted approval on the opening of 39 additional branches in May 2017 and 100 microbanking (MBOs) offices in June 2017.

For its efforts towards promoting financial inclusion, BanKo was named as The Microfinance Initiative of the Year by The Asian Banker in its Philippines Country Awards 2017. The Asian Banker, a leading provider of strategic intelligence on the financial services industry, acknowledged BanKo for developing a new credit-model that is more suitable for its target segment, given the difficulties of SEMEs in securing loans from regular banks.

With 103 operational branches and MBO's, a loan portfolio of Php 445M, and almost 9,000 clients as of December 2017, BanKo is poised to end 2018 with 200 branches and MBO's, and aims to achieve a Php2B loan portfolio with its new business model in place.

OUR MISSION AND VISION

Our Mission is …

"… to raise the quality of life of the unbanked and under-banked."

Our Vision is …

"… to be the preferred lender of the self- employed micro entrepreneurs in the next 5 years by providing access to fast and easy credit, with affordable rates and high touch delivery of service."

"…to be the preferred bank of at least 1M underserved and unbanked for their major transactional and savings requirements in the next 5 years, and to continually grow this client base and expand the relevant solutions offered with the goal of providing financial services to at least 90% of the bankable population."

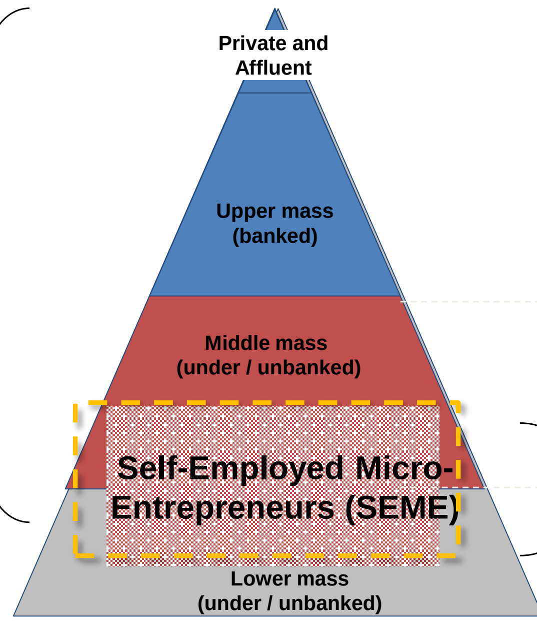
"…to provide relevant solutions to the underserved and unbanked on a sustainable basis."

BUSINESS MODEL

BanKo business model focuses on the Self-Employed Micro-Entrepreneur (SEME)

BPI | **BPI Family Savings Bank**

- **High-quality customer service and a comprehensive set of products**
- **Multi-channel delivery (e.g. branch, ATMs, Internet, telephone**
- **Stringent credit, risk and compliance processes**

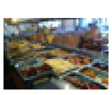


BanKo
A subsidiary of BPI

- **Highly-focused sales distribution and high-touch service delivery to SEME**
- **Branch network located near micro-enterprise locations primarily for loans solicitation, processing and servicing**
- **BanKo account officers to manage loan portfolio of SEME clients (C2 and D1)**
- **Deposits to continue using BPI Direct model; access via online and mobile network, as well as via BPI branch.**

The SEME segment is engaged in several industries and exhibits attractive characteristics and profiles

SEME composition by industry

Industries	Example	% of SEME
Wholesale and retail trading 	• Market stall owner • Sari-sari store	48%
Manual services 	• Hair dresser • Repair service • Tailor shop	
Food services 	• Carinderia • Bakery • Pastry	13%[1]
Agriculture (non-seasonal), **livestock** 	• Animal farming • Poultry (eggs) • Piggery	1%[2]

Characteristics and profiles

Key charac-teristics of SEME	• Strong **entrepreneurial** spirit • **Ownership** of 1 or more **businesses** • **Awareness** of borrowing options • **Understanding** of loan mechanics
Borrow-ing needs of SEME	• **Small amount** for operations (**<50K**): - Increase working capital - Pay unexpected operational expenses • **Large amount** for 'strategy' (**<300K**): - Invest in new businesses - Expand current businesses
Credit risk profiles of SEME	• Operate in **primary goods industries** (a-cyclical) • Show **low elasticity to interest** rates • Are **comfortable** with fixed re-payment schedule of **principal plus interest**

[1] It includes also accommodation services
[2] It refers to overall Agriculture, Forestry, and Fishing
Source: DTI, 2015 PSRC survey, Value Partners' analysis

SUMMARY OF FINANCIAL PERFORMANCE

RESULTS OF OPERATIONS

In 2017, BanKo realized a net profit of Php 84.5 million, This is its maiden year after the merger. The merger of BPI Globe BanKO with BPI Direct Savings Bank, the latter being the surviving entity which was approved December 29,2016.

The Bank continues to deliver consistent value to its investor, posting a return on equity of 4.17% and return on assets of 0.56% in 2017.

Total revenue of Php745 million, increased 30% from last year's Php574 million, primarily brought by the proceeds from sale of investment and profit from asset sold.

Net interest income increased 5% to Php563 million from last year's Php535 million, the result of a Php14.96 billion or 2% expansion in average asset base and a 17-bp improvement in net interest margin.

Non-interest income at Php181.8 million, was 117% higher than last year's Php83.6 million, this mainly due to the additional profit from asset sold and gain from sale of investment.

Operating expenses ended at Php536 million, up Php169 million or 46% from last year's Php367 million. This increase driven mainly by the investment on SEME branch expansion.

FINANCIAL CONDITION

The Bank total resources ended at Php15.0 billion, Php397.5 million or 2.57% lower than last year's Php15.4 billion. The decrease was driven by the Php461 million or 3.4% decline in deposits which ended at Php12.8 billion.

Loans, net of impairment losses, amounted to Php4.5 billion, Php965 million or 17.6% lower than last year's Php5.4 billion. The Bank's gross 90-day non-performing loan ratio improved to 6.24% from its end-2016 level of 7.17%. Liquid assets at Php9.8 billion increased Php1.3 billion, or 15.4%, largely on higher deposits with the BSP.

CORPORATE GOVERNANCE

CORPORATE GOVERNANCE PHILOSOPHY

The Board of Directors and Management, employees and shareholders of the BPI Direct BanKo, Inc., A Savings Bank (BanKo) believe that a sound and effective corporate governance is the cornerstone of its strength and long term existence. It subscribes to a philosophy of adhering to honesty, integrity, and professionalism in the conduct of its business, exercising prudence in arriving at decisions, enforcing internal discipline and a system of checks and balances in its operating processes, and providing transparency to its various publics regarding basic management policies and practices, major business strategies and decisions and its operating results.

The Board of Directors and Management, hereby commit themselves to the principles and practices Contained in this Manual and acknowledge that the same will guide them in pursuing their corporate goals. They shall also undertake every effort necessary to create the necessary awareness of these principles and practices within the organization in order to ensure proper internalization by every member of the organization

GOVERNANCE STRUCTURE

Board of Directors

The Board of Directors (the Board) bears the primary responsibility for creating and enhancing the long term shareholder value of BanKo and ensuring that this objective is achieved in all its business activities. It must ensure BanKo's ability to satisfy the needs of its customers, sustain its leadership and competitiveness, and uphold its reputation in order to maintain BanKo's long term success and viability as a business entity. Its mandate consists of setting the strategic business directions of BanKo, appointing its senior executive officers, confirming its organizational structure, approving all major strategies and policies, overseeing all major risk-taking activities, monitoring the financial results, measuring and rewarding the performance of management, and generating a reasonable investment return to shareholders. It shall also provide an independent check on management.

Composition and Qualification

Unless otherwise provided in the Corporation Laws, The corporate powers of the Bank are exercised, its business conducted and its properties controlled and held, by a Board of Directors consisting of nine (9) members elected from among the stockholders of the Bank, said member so elected to hold their office for one (1) year and until their successors are elected annually by the stockholders during their annual meeting or adjournment thereof, or at any special meeting called for that purpose.

To the extent practicable, the members of the Board of Directors shall be selected from a broad pool of qualified candidates. A sufficient number of qualified non-executive members shall be elected to promote the independence of the Board from the views of senior management. For this purpose, non-executive members of the Board of Directors shall refer to those who are not part of the day to day management of banking operations and shall include the independent directors.

Powers of the Board of Directors

The corporate powers of a bank shall be exercised, its business conducted and all its property controlled and held, by its board of directors. The power of the board of directors as conferred by law are original and cannot be revoked by the stockholders. The directors hold their office charged with the duty to exercise sound and objective judgment for the best interest of the bank.

Duties and Responsibilities

The position of a bank director is a position of trust. A director assumes certain responsibilities to different constituencies or stakeholders, i.e., the bank itself, its stockholders, its depositors and other creditors, its management and employees, the regulators, deposit insurer and the public at large. These constituencies or stakeholders have the right to expect that the institution is being run in a prudent and sound manner. The board of directors is primarily responsible for approving and overseeing the implementation of the Bank's strategic objectives, risk strategy, corporate governance and corporate values. Further, the board of directors is also responsible for monitoring and overseeing the performance of senior management as the latter manages the day to day affairs of the institution.

Selection

Our shareholders may recommend candidates for board membership for consideration by the Nominations Committee. Such recommendations are sent to the Committee through the Office of the Corporate Secretary. Candidates recommended by shareholders are evaluated in the same manner as Director Candidates identified by any other means. The Committee itself may identify and recommend qualified individuals for nomination and election to the Board. For this purpose, the Committee may utilize professional search firms and other external groups to search for qualified candidates.

The Nominations Committee pre-screens the candidates and prepares a final list of candidates prior to the Annual Stockholders Meeting. Only nominees whose names appear on the final list of candidates are eligible for election to the Board.

No other nomination shall be entertained after the final list of candidates are drawn up. No nomination shall be entertained or allowed on the floor during the Annual Stockholders Meeting.

Board members are elected by BanKo stockholders who are entitled to one vote per share at the Bank's Annual Stockholders Meeting, where votes may be cumulated as provided for in the Corporation Code. The nominees receiving the highest number of votes are declared elected and hold office for one year until their successors, qualified in accordance with the by-laws, are elected at the next Annual Stockholders Meeting.

Remuneration

Under the Bank's Amended By-Laws, as approved by the shareholders, the Board of Directors, as a whole, determines the level of remuneration and/or benefits for directors sufficient to attract and retain directors and compensate them for their time commitments and responsibilities of their role.

Our Personnel and Compensation Committee recommends to the Board the fees and other compensation for directors, ensuring that compensation fairly remunerates directors for work required in a company size and scope. As provided by our Amended By-Laws and pursuant to a Board resolution, each director is entitled to receive fees and other compensation for his services as director. The Board has the sole authority to determine the amount, form, and structure of the fees and other compensation of the directors.

Board members receive per diems for each occasion of attendance at meetings of the Board or of a board committee. All fixed or variable remuneration paid to directors may be given as approved by stockholders during the Annual Stockholders Meeting, upon recommendation of the Personnel and Compensation Committee. Other than the usual per diem arrangement for Board and Committee meetings and the aforementioned compensation of Directors, there is no standard arrangement as regards compensation of directors, directly or indirectly, for any other service provided by the directors for the last completed fiscal year.

Board members with executive responsibilities are compensated as fulltime officers of the company, not as Executive Directors or Non-Executive Directors.

Chairman	Natividad N. Alejo
Members	Cezar P. Consing Rodolfo K. Mabiasen, Jr. Jerome B. Minglana Aurelio R. Montinola III Jesus V. Razon, Jr. (Independent) Jose Ferdinand B. De Luzuriaga (Independent)

Corporate Governance Committee

The Corporate Governance Committee assists the Board in fulfilling its corporate governance responsibilities, and ensures the Board's effectiveness and due observance of sound corporate governance principles and guidelines, as embodied in the Manual of Corporate Governance.

Chairman	Jose Ferdinand B. De Luzuriaga (Independent)
Members	Cezar P. Consing Jesus V. Razon, Jr. (Independent)

Nomination Committee

The Nominations Committee ensures that the Board of Directors is made up of individuals of proven integrity and competence, and that each possesses the ability and resolve to effectively oversee the Bank in his capacity as board member and member in their respective board committee. This Committee also reviews and evaluates the qualifications of all persons nominated to the Board.

Chairman	Aurelio R. Montinola III
Members	Cezar P. Consing Natividad N. Alejo

Audit Committee

The Audit Committee monitors and evaluates the adequacy and effectiveness of the Bank's system of internal control systems, risk management, and governance practices. It provides oversight on the integrity of the Bank's financial statements and financial reporting process, performance of the internal and external audit functions and compliance with bank policies, applicable laws, and regulatory requirements. This Committee also reviews the external auditor's annual audit plan and scope of work, and assesses its overall performance and effectiveness. In consultation with management, this Committee also approves the external auditor's terms of engagement and audit fees.

Chairman	Jesus V. Razon, Jr. (Independent)
Members	Cezar P. Consing Jose Ferdinand B. De Luzuriaga (Independent)

Risk Management Committee

The Risk Management Committee is tasked with nurturing a culture of risk management across the enterprise. It supports the Board by overseeing and managing the Bank's exposures to financial and non-financial risks, assesses new and emerging risk issues across the Bank, regularly reviews the Bank's risk management appetite, policies, structures and metrics, and monitors overall liquidity and capital adequacy, in order to meet and comply with regulatory and international standards on risk measurement and management.

Chairman	Cezar P. Consing
Members	Natividad N. Alejo Jose Ferdinand B. De Luzuriaga (Independent)

Personnel and Compensation Committee

The Personnel and Compensation Committee directs and ensures the development and implementation of long-term strategies and plans for the Bank's human resources, in alignment with the Board's vision for the organization.

Chairman	Aurelio R. Montinola III
Members	Natividad N. Alejo Jesus V. Razon Jr. (Independent)

Related Party Committee

The Related Party Transaction Committee which is under the Corporate Governance Committee is charged with ensuring that the Bank's dealings with the public and various stakeholders are imbued with the highest standards of integrity. In conjunction with the Executive, Audit, Risk, and Corporate Governance Committees, this Committee endeavors to ensure compliance with Bangko Sentral regulations and guidelines on related party transactions. t independently reviews, vets, and endorses significant and material related party transactions—above and beyond transactions qualifying under directors, officers, shareholders, and related interests restrictions—such that these transactions are dealt on terms no less favorable to the Bank than those generally available to an unaffiliated third party under the same or similar circumstances.

Chairman	Jose Ferdinand B. De Luzuriaga (Independent)

Members	Cezar P. Consing Jesus V. Razon Jr. (Independent)

Executive Officers of BanKo

The executive Officers of BanKo are the President,Vice President, Secretary and Treasurer. The Executive Officers shall be appointed by the Board of Directors. In addition, the Board of Directors shall appoint (from time to time) such other senior officers as provided for in the BANKO By-Laws.

President	Jerome B. Minglana
Vice President	Rodolfo K. Mabiasen, Jr.

Performance Evaluation and Self-Assessment

Monitoring of governance by the Board requires a continuous review of the internal structure of the Bank to ensure that there are clear lines of accountability for management throughout the organization.

In this regard, the Board, under the guidance of the Corporate Governance Committee, annually conducts a self-assessment to ascertain the alignment of leadership fundamentals and issues, validate the Board's appreciation of its roles and responsibilities and confirm that the Board possesses the right mix of background and competencies. Performance of the Board is measured on the basis of what it delivers and how it delivers, how it meets its responsibilities to all BPI stakeholders, and how it addresses issues that impact the Board's ability to effectively fulfill its fiduciary duties.

Succession Development Plan

In consultation with the President/CEO, the PerCom reviews the talent development process within the bank to ensure it is effectively managed. In consultation with the Board and the President/CEO, either the PerCom as a whole or a sub-committee thereof, shall, as part of the executive planning process, evaluate, and nominate potential successors to the President/CEO. It shall also initiate, require, and review as well as receive periodic feedback regarding the quality and status of the overall organizational morale and degree of job satisfaction within the bank.

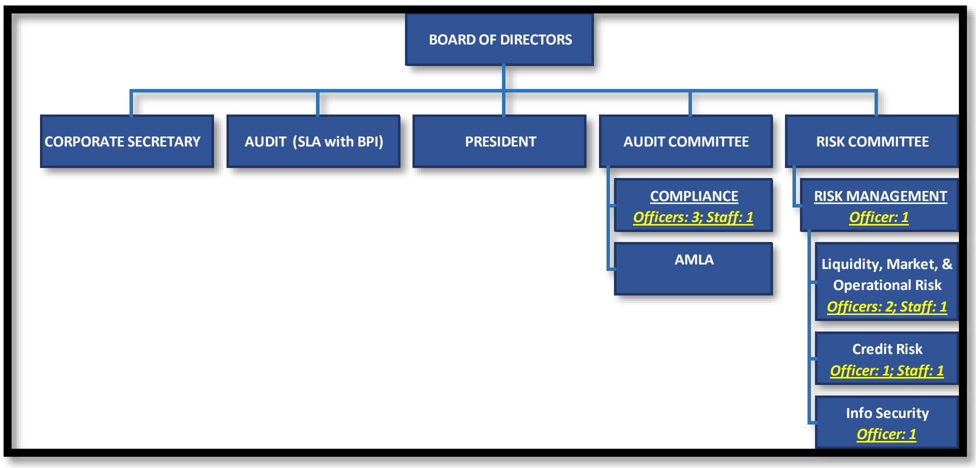
Dividend Policy

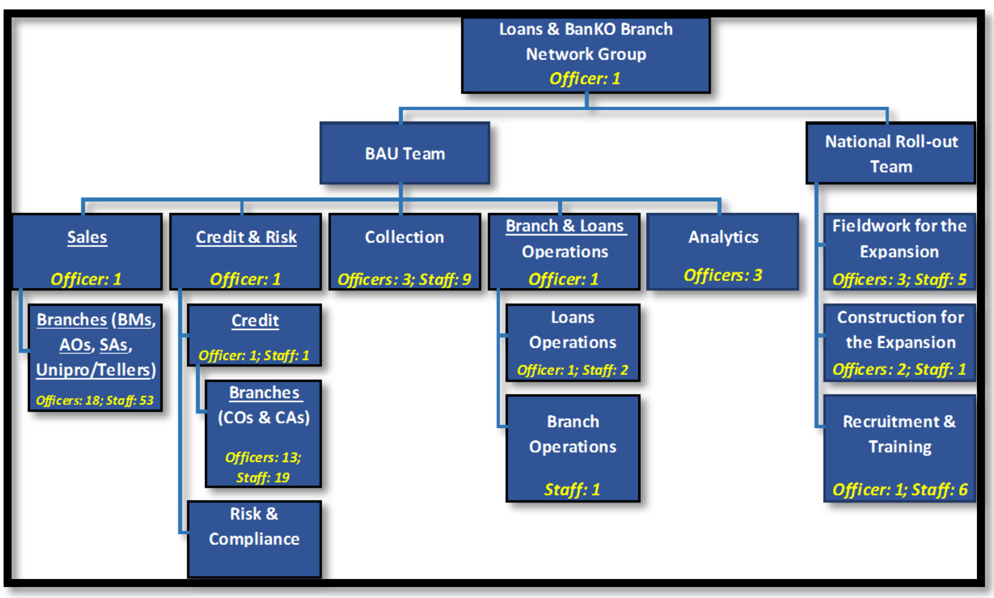
Stockholders have the right to receive dividends subject to the discretion of the Board. However, the Commission may direct BanKO to declare dividends when its retained earnings is in excess of 100% of its paid-in capital stock, except: a)when justified by definite corporate expansion projects or programs approved by the Board or b) when BanKO is prohibited under any loan agreement with any financial institution or creditor, whether local or foreign, from declaring dividends without its consent, and such consent has not been secured; or c) when it can be clearly shown that such retention is necessary under special circumstances obtaining , such as when there is a need for a special reserve for probable contingencies.

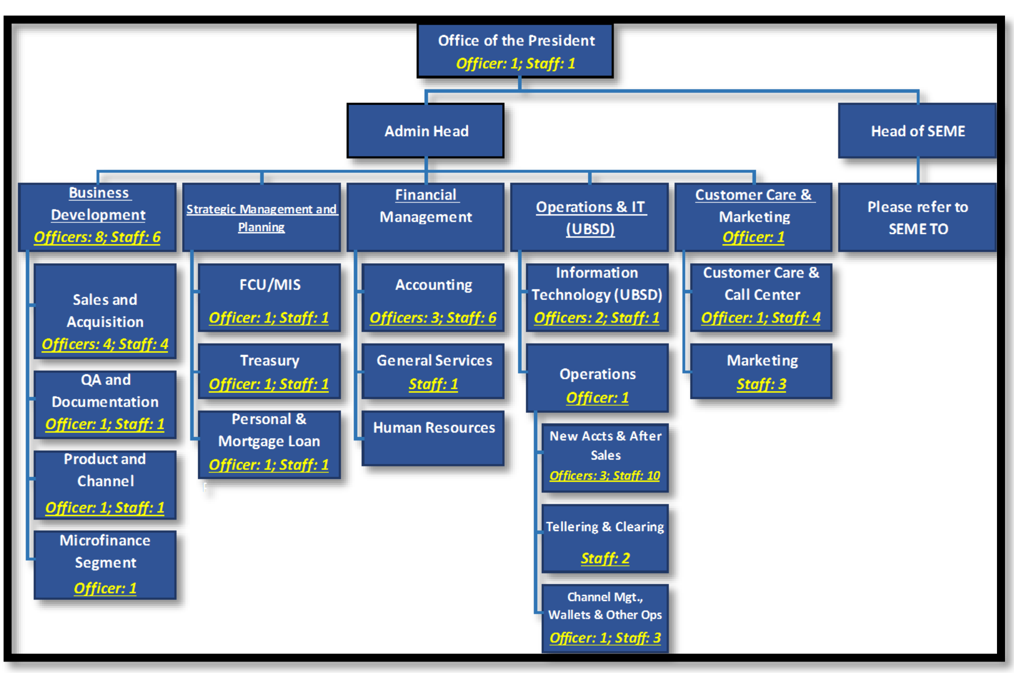
OPERATING MANAGEMENT

The following is an overview of the Bank's principal activities and its functional organization and corporate information (as of December 31, 2017):

BanKo TABLE OF ORGANIZATION







GENERAL INFORMATION SHEET
STOCK CORPORATION

================================ PLEASE PRINT LEGIBLY ================================

CORPORATE NAME: BPI DIRECT BANKO, INC., A SAVINGS BANK (formerly BPI Direct Savings Bank, Inc.)

TOTAL NUMBER OF STOCKHOLDERS: 8 **NO. OF STOCKHOLDERS WITH 100 OR MORE SHARES EACH:** 1

TOTAL ASSETS BASED ON LATEST AUDITED FINANCIAL STATEMENTS: P 15,493,029,190

STOCKHOLDER'S INFORMATION

NAME AND NATIONALITY	SHARES SUBSCRIBED				AMOUNT PAID (PhP)
	TYPE	NUMBER	AMOUNT (PhP)	% OF OWNERSHIP	
1. BANK OF THE PHILIPPINE ISLANDS Filipino	Common A	3,455,714	345,571,400.00	100.00%	405,571,400.00
	Common B	600,000	60,000,000.00		
	TOTAL	4,055,714	405,571,400.00		
2. NATIVIDAD N. ALEJO Filipino	Common A	1	100.00	0.00%	100.00
	TOTAL	1	100.00		
3. CEZAR P. CONSING Filipino	Common A	1	100.00	0.00%	100.00
	TOTAL	1	100.00		
4. JOSE FERDINAND B. DE LUZURIAGA Filipino	Common A	1	100.00	0.00%	100.00
	TOTAL	1	100.00		
5. RODOLFO K. MABIASEN, JR. Filipino	Common A	1	100.00	0.00%	100.00
	TOTAL	1	100.00		
6. JEROME P. MINGLANA Filipino	Common A	1	100.00	0.00%	100.00
	TOTAL	1	100.00		
7. AURELIO R. MONTINOLA, III Filipino	Common A	1	100.00	0.00%	100.00
	TOTAL	1	100.00		
8. JESUS V. RAZON, JR. Filipino	Common A	1	100.00	0.00%	100.00
	TOTAL	1	100.00		
TOTAL AMOUNT OF SUBSCRIBED CAPITAL		4,055,721	405,572,100.00	100.00%	405,572,100.00
TOTAL AMOUNT OF PAID-UP CAPITAL					

INSTRUCTION: SPECIFY THE TOP 20 STOCKHOLDERS AND INDICATE THE REST AS OTHERS

Note: For PDTC Nominee included in the list, please indicate further the beneficial owners owning more than 5% of any class of the company's voting securities. Attach separate sheet, if necessary.

RISK MANAGEMENT

Comprehensive Framework

Risk management in the Bank covers all perceived areas of risk exposure, even as it continuously endeavors to uncover hidden risks. Capital management is understood to be a facet of risk management. The Board of Directors is the Bank's principal risk and capital manager, and the Bank's only strategic risk taker. The Board of Directors provides written policies for overall risk management, as well as written procedures for the management of credit risk, operational and IT risk, foreign exchange risk, interest rate risk, equity risk, liquidity risk, and contingency risk, among others.

The primary objective of the Bank is the generation of recurring acceptable returns to shareholders' capital. To this end, the Bank's policies, business strategies, and business activities are directed towards the generation of cash flows that are in excess of its fiduciary and contractual obligations to its depositors, and to its various other funders and stakeholders.

To generate acceptable returns to its shareholders' capital, the Bank understands that it has to bear risk, that risk-taking is inherent in its business. Risk is understood by the Bank as the uncertainty in its future income - an uncertainty that emanates from the possibility of incurring losses that are due to unplanned and unexpected drops in revenues, increases in expenses, impairment of asset values, or increases in liabilities.

The possibility of incurring losses is, however, compensated by the possibility of earning more than expected income. Risk-taking is, therefore, not entirely a bad step to be avoided. Risk-taking presents opportunities if risks are accounted, deliberately taken, and are kept within rationalized limits.

The most important risks that the Bank manages are credit risk, liquidity risk, market risk, operational and information technology (IT) risks. Market risk includes currency exchange risk, interest rate risk and other price risks.

Credit Risk

The Bank takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss to the Bank by failing to discharge an obligation. Significant changes in the economy, or in the prospects of a particular industry segment that may represent a concentration in the Bank's portfolio, could result in losses that are different from those provided for at the reporting date. Management therefore carefully manages its exposure to credit risk.

Credit exposures arise principally in loans and advances, due from BSP, due from other banks, and accrued interest receivable and accounts receivable under other resources, net.
In measuring credit risk of loans and advances at a counterparty level, the Bank considers three components (i) the probability of default by the client or counterparty on its contractual obligations; (ii) current exposures to the counterparty and its likely future development; and (iii) the likely recovery ratio on the defaulted obligations. In the evaluation process, the Bank also considers the conditions of the industry/sector to which

the counterparty is exposed, other existing exposures to the group where the counterparty may be related, as well as the client and Bank's fallback position assuming the worst-case scenario. Outstanding and potential credit exposures are reviewed to likewise ensure that they conform to existing internal credit policies.

The Bank assesses the probability of default of individual counterparties using internal rating tools tailored to the various categories of counterparty. The Bank has internal credit risk rating systems designed for retail accounts. The consumer credit scoring system is a formula-based model for evaluating each credit application against a set of characteristics that experience has shown to be relevant in predicting repayment. The Bank regularly validates the performance of the rating systems and their predictive power with regard to default events, and enhances them if necessary.

Market, Interest Rate in the Banking Book and Liquidity Risk

The Bank is exposed to market risk - the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk is managed by the Risk Management Office (RMO) and confirmed by the Board of Directors.

Market risk management is incumbent on the Board of Directors through its Risk Management Committee (RMC). Market risk management in the Bank covers managing exposures to trading risk, foreign exchange risk, counterparty credit risk, interest rate risk of the banking book and liquidity risk.

At the management level, the Bank's market risk exposure is managed RMO, headed by the Bank's Chief Risk Officer (CRO) who reports directly to the RMC. In addition, Internal Audit is responsible for the independent review of risk assessment measures and procedures and the control environment.

The Bank reviews and controls market risk exposures of both its trading and non-trading portfolios. Trading portfolios include those positions arising from the Bank's market-making transactions.

Non-trading portfolios primarily arise from the interest rate management of the Bank's retail and commercial banking assets and liabilities.

Value-at-Risk (VaR) measurement is an integral part of the Bank's market risk control system. This metric estimates, at 99% confidence level, the maximum loss that a trading portfolio may incur over a trading day. This metric indicates as well that there is 1% statistical probability that the trading portfolios' actual loss would be greater than the computed VaR. In order to ensure model soundness, the VaR is periodically subject to model validation and back testing. VaR is supplemented by other risk metrics and measurements that would provide preliminary signals to Treasury and to the management to assess the vulnerability of Bank's positions. To control the risk, the RMC sets risk limits for trading portfolios which are consistent with the Bank's goals, objectives, risk appetite, and strategy.

Stress tests indicate the potential losses that could arise in extreme conditions that would have detrimental effect to the Bank's positions. The Bank periodically performs stress testing (price risk and liquidity risk) to assess the Bank's condition on assumed stress scenarios. Contingency plans are periodically reviewed to ensure the Bank's preparedness in the event of real stress. Results of stress tests are reviewed by senior management and by the RMC.

There are two types of interest rate risk - (i) fair value interest rate risk and (ii) cash flow interest rate risk. Fair value interest rate risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market interest rates. Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may also result in losses in the event that unexpected movements arise.

The Board of Directors sets limits on the level of mismatch of interest rate repricing that may be undertaken, which is monitored daily by the RMO.

Interest rate risk in the banking book arises from the Bank's core banking activities. The main source of this type of interest rate risk is repricing risk, which reflects the fact that the Bank's assets and liabilities are of different maturities and are priced at different interest rates.

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfill commitments to lend.

The Bank's liquidity profile is observed and monitored through its metric, the Minimum Cumulative Liquidity Gap (MCLG). The MCLG is the smallest net cumulative cash inflow (if positive) or the largest net cumulative cash outflow (if negative) over the next three (3) months. The MCLG indicates the biggest funding requirement in the short term and the degree of liquidity risk present in the current cash flow profile of the Bank. The MCLG is computed monthly and reported in the RMC meetings. A red flag is immediately raised and reported to management and the RMC when the MCLG level projected over the next 3 months breaches the RMC prescribed MCLG limit.

Operational and Information Technology Risk

Our Operational and Information Technology Risk Management unit monitors risks arising from inadequate or failed internal processes, people, and systems or from external events such as natural disasters that damage physical assets, electrical or telecommunication failures that disrupt business. Operational risk is inherent in all banking products and services, and may include risks that give rise to adverse legal, tax, regulatory, or reputational consequences. Information technology is a significant risk factor assumed in conjunction with operational risk, given the highly automated nature of our processes and services. We define IT risk as the risk of any potential adverse outcome arising from the use of or reliance on IT (i.e. computer hardware, software, devices, systems, applications and networks). IT risk includes, but is not limited to, information security, service availability, reliability and availability of IT operations, completion-on specification of IT development projects, and regulatory compliance pursuant to the Bangko Sentral's policy guidelines on Information Technology Risk Management.

Capital Adequacy

Capital adequacy ratio, or CAR, is a measure of the Bank's total qualifying capital relative to its risk-weighted assets, and indicates the ability of its capital funds to cover various business risks.

The Bank ensures compliance with regulatory and internal minimum capital adequacy requirements, referred to as the Bank's internal minimum CAR, or IMCAR, and the CAR management action trigger, or CARMAT, which incorporate the Bank's internal capital buffers and limit triggers, and capture risks beyond Pillar 1 (credit, market, and operational).

Furthermore, the Bank is responsible for assessing and raising the strategic capital needs of the Bank, as well as initiating approvals for dividend payments to shareholders.

Effective capital management supports the Bank's assets and absorbs losses that may arise from credit, market and liquidity, operational and IT, and other risk exposures. The Bank's capital management framework ensures that on stand-alone and group bases, there is sufficient capital buffer at all times to support the respective risk profiles of the various businesses of the Bank, as well as changes in the regulatory and accounting standards and other future events.

The Bank submits a comprehensive internal capital adequacy assessment process, or ICAAP , document annually to the Bangko Sentral through Parent Bank, in accordance with the Pillar 2 guidelines of the Basel framework.

As of December 31, 2017, BanKo's CAR stood at 33.90%, higher than the minimum regulatory requirement of 10% and the Bank's internally set IMCAR and CARMAT.

The table below shows the Bank's CAR components for December 2017 and 2016:

Risk (Php Mn)	2017	2016
Credit Risk	3,910	4,120
Market Risk	10	7
Operational Risk	1,329	1,360
Total	**5,249**	**5,487**

Capital Adequacy (Php Mn)	2017	2016
CET1/Net Tier1 1⁄	1,740	1,508
T2/Net Tier2 2⁄	39	42
Total QC 3⁄	**1,779**	**1,550**
Total CRWA 4⁄	3,910	4,120
Total MRWA 5⁄	10	7
Total ORWA 6⁄	1,329	1,360
TRWA 7⁄	**5,249**	**5,487**
Ratios (%)		
CAR	**33.60**	**28.25**
CET1	**33.14**	**27.49**

1⁄ Common Equity Tier 1 Capital/Net Tier 1

2⁄ Tier 2 Capital/Net Tier 2

3⁄ Qualifying Capital

4⁄ Credit risk-weighted assets

5⁄ Market risk-weighted assets

6⁄ Operational risk-weighted assets

7⁄ Total risk-weighted assets

Related Party Transactions

In the ordinary course of business, the Bank has transactions with its directors, officers, stockholders and related interests (DOSRI) and with its Parent Bank such as cash deposit arrangements, purchase of investment securities and outsourcing of certain services, primarily loans operations, branch operations and human resource-related functions.

As part of the Bank's effort to ensure that transactions with related parties are normal banking activities and are done at arm's length, vetting is done either by the Board-level Related Party Transaction Committee or Management Vetting Committee, defending on materiality, prior to implementation.

Significant related party transactions are disclosed in the Audited Financial Statements, particularly Note 19 on RPTs.

COMPLIANCE

Regulatory Compliance

The Bank views compliance to mean not only adherence to laws, regulations, and standards but, more importantly, the *consistent conduct of the affairs of the Bank within a culture of high integrity, bounded by conformity to ethical business practice, abiding by the principles of fair dealing, accountability and transparency.* This ensures that in all our areas of activity, the Bank and its stakeholders are protected from business risks as comprehensively as possible. We value most our reputation and the fact that we are trusted by our shareholders, clients, employees, partners, and members of the communities we serve.

Oversight of the management of the Bank's business risk and implementation of its compliance function is the responsibility of our Board of Directors, through the Audit Committee. At the management level, the compliance function is carried out by the Compliance Office, led by our Compliance Officer.

Anti- Money Laundering Compliance

The prevention of financial crimes is a top priority of BanKo, not only because they pose a significant threat to our reputation, but because they weaken the integrity of the global financial system. Hence, our Compliance Office extends its ambit beyond the Bank, its policies, and its employees to ensure that our clients also act within the law and do not use the Bank for illegal activities.

The Compliance Office's Anti-Money Laundering Department is responsible for monitoring customer and counterparty transactions in compliance with the Anti-Money Laundering Law, its implementing rules and regulations, and Bangko Sentral Circular No. 950. Developed under the guidance of the Bangko Sentral's Money Laundering and Terrorist Financing Prevention Program.

Financial Consumer Protection

The Bank establish a financial consumer protection governance structure that aims to establish a business environment that protects the interest of financial consumers and create an institutional culture of fair and responsible treatment of customers through good governance exercised by the Board and governing bodies, and reinforced by the various functions that own, manage, oversee, or provide independent assurance over consumer protection activities.

BanKo Customer Care Office in coordination with other units in BanKo Compliance Office shall be responsible for creating a Consumer Protection Compliance Program aimed at preventing or reducing regulatory violations and protecting customer from harm or loss associated with non-compliance.

Data Privacy

BanKo has a strong Data Privacy Policy in place, which describes to whom the policy applies to, what personal data the Bank collects and how such data is collected, how the Bank may use personal data for core business and marketing purposes, how the Bank may disclose and share such personal data, how such personal data is stored and retained, and how such data can be accessed or corrected. The Data Privacy Policy is posted on the company website and complies with the requirements of the Data Privacy Act and the National Privacy Commission.

SUPPLEMENTARY SCHEDULES ON CAPITAL AND RISK MANAGEMENT DISCLOSURES PURSUANT TO THE BANKO SENTRAL'S MEMORAMDUM M-2017-011

Capital Structure

The Bank's qualifying capital for the years ended 2017 and 2016 were Php1.78 billion and Php1.55 billion, respectively. The Bank's total qualifying capital for 2017 and 2016 were largely composed of CET1 capital and Tier1 at 98.0% and 97.3%, respectively.

The table below shows the composition of the Bank's capital structure and total qualifying capital.

Capital Structure (Php Mn)	December 31, 2017			December 31, 2016		
	CET1/ Tier1	Tier 2	TOTAL	CET1/ Tier1	Tier 2	TOTAL
Core Capital	**2,047**	**39**	**2,086**	**1,791**	**42**	**1,833**
Paid-up common stock	405	-	405	405	-	405
Additional paid-in capital	-	-	-	-	-	-
Retained earnings	1,556	-	1,556	1,074	-	1,074
Undivided profits	80	-	80	307	-	307
Net unrealized gains or losses on AFS securities	2	-	2	3	-	3
Cumulative foreign currency translation	-	-	-	-		-
Remeasurements of Net Defined Benefit Liability (Asset)	4	-	4	2	-	2
Minority interest 1⁄	-	-	-	-	-	-
General loan loss provision 2⁄		39	39	-	42	42
Deductions	**307**	**-**	**307**	**283**	**-**	**283**
Total O/S unsecured credit accommodations 3⁄	-	-	-	-	-	-
Total O/S unsecured loans 4⁄	-	-	-	-	-	-
Deferred tax assets	264	-	264	231	-	231
Other intangible assets	30	-	30	43	-	43
Defined benefit pension fund assets	13	-	13	9	-	9
Investments in equity 5⁄	-	-	-	-	-	-
Significant minority investments 6⁄	-	-	-	-	-	-
Other equity investments 7⁄	-	-	-	-	-	-
TOTAL QUALIFYING CAPITAL	**1,740**	**39**	**1,779**	**1,508**	**42**	**1,550**
% to Total	**98%**	**2%**	**100%**	**97%**	**3%**	**100%**

1⁄ Minority interest in subsidiary banks, which are less than wholly-owned
2⁄ General loan loss provision, limited to a maximum of 1% of credit risk-weighted assets, and any amount in excess thereof shall be deducted from the credit risk-weighted assets in computing the denominator of the risk-based capital ratio
3⁄ Total outstanding unsecured credit accommodations, both direct and indirect, to directors, officers, stockholders and their related interests (DOSRI)
4⁄ Total outstanding unsecured loans, other credit accommodations and guarantees granted to subsidiaries and affiliates
5⁄ Investments in equity of unconsolidated subsidiary banks and quasi-banks, and other financial allied undertakings (excluding subsidiary securities dealers/brokers and insurance companies), after deducting related goodwill, if any (for solo basis only and as applicable) and Investments in equity of unconsolidated subsidiary securities dealers/brokers and insurance companies after deducting related goodwill, if any (for both solo and consolidated bases and as applicable)
6⁄ Significant minority investments (10%-50% of voting stock) in securities dealers/brokers and insurance companies, after deducting related goodwill, if any (for both solo and consolidated bases)
7⁄ Other equity investments in non-financial allied undertakings and non-allied undertakings

Credit risk-weighted assets. Using the Basel regulatory standardized approach, our total credit risk-weighted assets as of December 31, 2017 amounted to Php3.95 billion, and composed of on-book credit exposures after risk mitigation of Php3.91 billion.

The table below provides a summary of the Bank's credit risk-weighted assets for 2017 and 2016:

	Amount	
Credit RWAs (Php Mn)	2017	2016
Total RWA (On-balance sheet) 0/	3,956	4,163
Total RWA (Off-balance sheet) 0/	0	0
Total counterparty RWA (banking book) 1/	0	0

Total counterparty RWA (trading book)	0	0
Total RWA credit-linked notes (banking book)	-	-
Total Gross RWA	**3,956**	**4,163**
Deductions: General loan loss provision 2/	46	43
Total Credit RWAs	**3,910**	**4,120**

0/ Risk-weighted assets
1/ For derivatives and repo-style transactions
2/ In excess of the amount permitted to be included in upper Tier 2

Schedule A

December 31, 2017 (Php Mn)	Exposure after risk mitigation	Risk Weights 0%	20%	50%	75%	100%	150%	Total CRWA 1/
Cash on hand	26	26	-	-	-	-	-	26
Checks and other cash items	-	-	-	-	-	-	-	-
Due from BSP	8,807	8,807	-	-	-	-	-	8,807
Due from other banks	967		-	882		85	-	967
Available-for-sale (AFS)	103	-	103	-	-	-	-	103
Held-to-maturity (HTM)	-	-	-	-	-	-	-	-
UDSCL 2/	-	-	-	-	-	-	-	-
Loans and receivables	4,314		-	2,528	455	1,312	19	4,314
Loans and receivables - Others 3/	165	-	-	-	-	-	-	165
Sales contract receivables	-	-	-	-	-	-	-	-
ROPA 4/	76	-	-	-	-		76	76
Sub-total	**14,458**	**8,999**	**103**	**3,409**	**455**	**1,397**	**95**	**14,458**
Other assets	349	-	-	-	-	349	-	349
Total exposure, plus other assets	**14,807**	**8,999**	**103**	**3,409**	**455**	**1,746**	**95**	**14,807**
Total risk-weighted OBSA (no CRM) 0/5 /			21	1,705	342	1,746	142	3,956
Total risk-weighted OBSA (with CRM)5 /			-	-	-	-	-	-
Total RWA (On-Balance Sheet)			**21**	**1,705**	**342**	**1,746**	**142**	**3,956**

December 31, 2016 (Php Mn)	Exposure after risk mitigation	Risk Weights 0%	20%	50%	75%	100%	150%	Total CRWA 1/
Cash on hand	4	4	-	-	-	-	-	4
Checks and other cash items	-	-	-	-	-	-	-	-
Due from BSP	4,192	4,192	-	-	-	-	-	4,192
Due from other banks	982		-	929		53	-	982
Available-for-sale (AFS)	104	-	104	-	-	-	-	104
Held-to-maturity (HTM)	367	367	-	-	-	-	-	367
UDSCL 2/	-	-	-	-	-	-	-	-
Loans and receivables	5,058		-	3,211	-	1,823	24	5,058
Loans and receivables - Others 3/	4,242	4,242	-	-	-	-	-	4,242
Sales contract receivables	-	-	-	-	-	-	-	-
ROPA 4/	56	-	-	-	-		56	56
Sub-total	**15,005**	**8,805**	**104**	**4,140**	**-**	**1,876**	**80**	**15,005**
Other assets	75	-	-	-	-	75	-	75
Total exposure, plus other assets	**15,080**	**8,805**	**104**	**4,140**	**-**	**1,951**	**80**	**15,080**
Total risk-weighted OBSA (no CRM) 0/5 /			20	2,070	0	1,951	122	4,163
Total risk-weighted OBSA (with CRM)5 /			-	-	-	-	-	-
Total RWA (On-Balance Sheet)			**20**	**2,070**	**0**	**1,951**	**122**	**4,163**

0/ On-balance sheet assets

1/ Credit risk-weighted assets
2/ Unquoted debt securities classified as loans
3/ Loans and receivables arising from repurchase agreements, certificates of assignment/participation with recourse, and securities lending and borrowing transactions
4/ Real and other properties acquired
5/ Not covered by, and covered by credit risk mitigants, respectively

Market risk-weighted assets. In terms of capital usage using the Basel standardized approach, total market risk-weighted assets stood at Php9 million as of end-2017, of which foreign exposures accounted for more than half, followed by interest rate exposures and equity exposures, respectively.

The table below presents the breakdown of the Bank's market risk-weighted assets for 2017 and 2016:

MARKET RWA (Php Mn)	AMOUNT	
	2017	**2016**
Using standardized approach		
Interest rate exposures	-	-
Foreign exposures	9	7
Equity exposures	-	-
TOTAL MARKET RWA 0/	**9**	**7**

0/ Risk-weighted assets

Operational risk-weighted assets. We currently use the Basel regulatory basic indicator approach to quantify operational risk-weighted assets, by using the historical total annual gross income as the main measure of risk. In 2017, the Bank's total operational risk-weighted assets stood at Php1, 329 million.

The table below presents the breakdown of the Bank's market risk-weighted assets for 2017 and 2016:

	AMOUNT	
OPERATIONAL RWA (Php Mn)	**2017**	**2016**
Gross income (a)	2,127	2,176
Capital requirement 1/	319	326
Average capital requirement (b) 2/	106	109
Adjusted capital charge (c) 3/	133	136
TOTAL OPERATIONAL RWA 0/ 4/	**1,329**	**1,360**

0/ Risk-weighted assets
1/ (a) multiplied by 15 percent
2 / Average of 15 percent of (a) for the past (3) years
3 / (b) multiplied by 125 percent
4 / (c) multiplied by factor 10