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BPI Direct BanKo, Inc., A Savings Bank

(Formerly BPI Direct Savings Bank, Inc.)

Foreign Currency Deposit Unit

Financial Statements
As at and for the years ended December 31, 2020 and 2019

Isla Lipana & Co.

Isla Lipana & Co.

Independent Auditor's Report

To the Board of Directors and Shareholder of
BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
G/F BanKo Center Building
Ortigas Avenue, North Greenhills
San Juan, Metro Manila

Report on the Audits of the Financial Statements

Our Opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Foreign Currency Deposit Unit of BPI Direct BanKo, Inc., A Savings Bank (formerly BPI Direct Savings Bank, Inc.) (the "Bank") as at December 31, 2020 and 2019, and its financial performance and its cash flows for the years then ended in accordance with the reporting guidelines of the Bangko Sentral ng Pilipinas, as shown in the books maintained in the Philippines.

What we have audited

The financial statements of the Bank comprise:

- the statements of condition as at December 31, 2020 and 2019;
- the statements of income for the years ended December 31, 2020 and 2019;
- the statements of comprehensive income for the years ended December 31, 2020 and 2019;
- the statements of changes in due (from) to regular banking unit for the years ended December 31, 2020 and 2019;
- the statements of cash flows for the years ended December 31, 2020 and 2019; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Basis for Opinion

We conducted our audits in accordance with Philippine Standards on Auditing (PSAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report.

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

Independence

We are independent of the Bank in accordance with the Code of Ethics for Professional Accountants in the Philippines (Code of Ethics), together with the ethical requirements that are relevant to our audit of the financial statements in the Philippines, and we have fulfilled our other ethical responsibilities in accordance with these requirements and Code of Ethics.

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Emphasis of Matter - Basis of Accounting and Restriction on Use

We draw attention to Note 10 to the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the reporting guidelines prescribed by the Bangko Sentral ng Pilipinas. As a result, the financial statements may not be suitable for other purpose. Our report is intended solely for the information and use of the management of the Bank, and for the purposes of submission to the Bangko Sentral ng Pilipinas and the Bureau of Internal Revenue and is not for any other purpose. Our opinion is not modified in respect of this matter.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the reporting guidelines of the Bangko Sentral ng Pilipinas, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with PSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with PSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Isla Lipana & Co.

Ruth F. Blasco
Partner
CPA Cert. No. 112595
P.T.R. No. 0018519, issued on January 5, 2021, Makati City
SEC A.N. (individual) as general auditors 112595-SEC; Category A, valid to audit 2020 to 2024 financial statements
SEC A.N. (firm) as general auditors 0142-SEC, Category A; valid to audit 2020 to 2024 financial statements
TIN 235-725-236
BIR A.N. 08-000745-133-2020, issued on June 5, 2020; effective until June 4, 2023
BOA/PRC Reg. No. 0142, effective until January 21, 2023

Makati City
March 24, 2021

BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
Foreign Currency Deposit Unit

Statements of Condition
December 31, 2020 and 2019
(All amounts in Philippine Peso)

	Notes	2020	2019
RESOURCES			
Due from other banks	2,7	223,481,234	231,868,773
Other resources		3,414	130,497
Total resources		223,484,648	231,999,270
LIABILITIES AND DUE (FROM) TO REGULAR BANKING UNIT			
Deposit liabilities	3	205,215,211	207,922,425
Accrued interest payable		283	45,866
Other liabilities		19,012,378	23,687,948
Total liabilities		224,227,872	231,656,239
Due (from) to regular banking unit		(743,224)	343,031
Total liabilities and due to regular banking unit		223,484,648	231,999,270

(The notes on pages 1 to 14 are an integral part of these financial statements.)

BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
Foreign Currency Deposit Unit

Statements of Income
For the years ended December 31, 2020 and 2019
(All amounts in Philippine Peso)

	Notes	2020	2019
Interest income on deposits with banks	2	680,363	2,525,624
Interest expense on deposit liabilities	3	(507,229)	(564,724)
Net interest income		173,134	1,960,900
Service fee income	4	672,133	720,229
Miscellaneous expenses	5	(1,477,028)	(1,943,627)
(Loss) income before income tax		(631,761)	737,502
Income tax expense	6	(111,463)	(394,471)
Net (loss) income for the year		(743,224)	343,031

(The notes on pages 1 to 14 are an integral part of these financial statements.)

BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
Foreign Currency Deposit Unit

Statements of Comprehensive Income
For the years ended December 31, 2019 and 2018
(All amounts in Philippine Peso)

	2020	2019
Net (loss) income for the year	(743,224)	343,031
Other comprehensive income	-	-
Total comprehensive (loss) income for the year	(743,224)	343,031

(The notes on pages 1 to 14 are an integral part of these financial statements.)

BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
Foreign Currency Deposit Unit

Statements of Changes in Due (from) to Regular Banking Unit
For the years ended December 31, 2020 and 2019
(All amounts in Philippine Peso)

	2020	2019
Balances at January 1	343,031	47,841
Comprehensive income		
Net (loss) income for the year	(743,224)	343,031
Other comprehensive income	-	-
Total comprehensive (loss) income for the year	(743,224)	343,031
Transfers to regular banking unit	(343,031)	(47,841)
Balances at December 31	(743,224)	343,031

(The notes on pages 1 to 14 are an integral part of these financial statements.)

BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
Foreign Currency Deposit Unit

Statements of Cash Flows
For the years ended December 31, 2020 and 2019
(All amounts in Philippine Peso)

	Notes	2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES			
(Loss) income before income tax		(631,761)	737,502
Adjustments for:			
Interest income on deposits with banks	2	(680,363)	(2,525,624)
Interest received on deposits with banks		807,402	2,581,118
Interest expense on deposit liabilities	3	507,229	564,724
Interest paid on deposit liabilities		(552,812)	(569,745)
Changes in operating assets/liabilities			
Decrease in other resources		44	200
(Decrease) increase in:			
Deposit liabilities		(2,707,214)	(117,019,928)
Other liabilities		(4,675,570)	9,424,419
Net cash used in operations		(7,933,045)	(106,807,334)
Income taxes paid	6	(111,463)	(394,471)
Net cash used in operating activities		(8,044,508)	(107,201,805)
CASH FLOWS USED IN FINANCING ACTIVITY			
Transfer to regular banking unit		(343,031)	(47,841)
NET DECREASE IN CASH		(8,387,539)	(107,249,646)
CASH	2		
January 1		231,868,773	339,118,419
December 31		223,481,234	231,868,773

(The notes on pages 1 to 14 are an integral part of these financial statements.)

BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
Foreign Currency Deposit Unit

Notes to the Financial Statements
As at and for the years ended December 31, 2020 and 2019
(In the notes, all amounts are shown in Philippine Peso unless otherwise stated)

Note 1 - General information

1.1 Business information

BPI Direct BanKo, Inc., A Savings Bank (the "Bank") was incorporated in the Philippines and registered with the Securities and Exchange Commission (SEC) on September 26, 1986 primarily to engage in and carry on the general business of savings and mortgage banking.

The Foreign Currency Deposit Unit (FCDU) license was granted to the Bank on October 31, 2008.

The Bank is a wholly-owned subsidiary of Bank of the Philippine Islands ("BPI" or the "Parent Bank"), a domestic commercial bank with an expanded banking license, which is also its ultimate parent.

The Bank's registered office address, which is also its principal place of business, is BanKo Center Building, Ortigas Avenue, North Greenhills, San Juan, Metro Manila. The Bank has 2,094 regular employees as at December 31, 2020 (2019 - 2,823).

Coronavirus pandemic

On March 16, 2020, the Philippine Government declared the entire island of Luzon under an Enhanced Community Quarantine (ECQ) due to the increasing coronavirus disease (COVID-19) cases in the country. The ECQ mandated the closure of non-essential businesses and strict home quarantine which resulted in the slowdown of the economy. Measures have been implemented to protect the health and safety of the Bank's employees, clients and partners, to support business continuity and to manage financial impact to a minimum. These measures have caused disruptions to businesses and economic activities, and its impact on businesses continue to evolve. While banks are authorized to operate during the ECQ period, branch operations were sorely impacted by COVID-19, with 44% of the branches operating on a skeletal basis during the beginning of the lockdown. With the transition to general community quarantine (GCQ) on June 1, 2020, branch operations have been back to 100%. At this stage, the Bank deems it prudent to review its branch network strategy given the acceleration in digital adoption by its clients and other considerations.

While quarantine measures over highly urbanized cities in the National Capital Region (NCR) were relaxed following the proclamation of a modified enhanced community quarantine (MECQ) effective May 16, 2020, and subsequently, a GCQ effective June 1, 2020, operations across various industries remain below full capacity in these areas.

The FCDU of the Bank has considered the market conditions, including the impact of COVID-19, as at the reporting date. Management assessed that there is no material impact in the estimates and judgements on the recoverability of assets as at December 31, 2020.

1.2 Approval of the Bank's financial statements

These financial statements have been approved and authorized for issuance by the Board of Directors on March 24, 2021.

Note 2 - Due from other banks

The account consists of deposits with the Parent Bank and a fellow subsidiary amounting to P223,481,234 at December 31, 2020 (2019 - P231,868,773).

Interest income recognized on deposits with banks amounts to P680,363 for the year ended December 31, 2020 (2019 - P2,525,624).

Note 3 - Deposit liabilities

The account consists of savings deposits amounting to P205,215,211 at December 31, 2020 (2019 - P207,922,425). All of which are payable on demand.

Interest expense recognized on deposit liabilities amounts to P507,229 for the year ended December 31, 2020 (2019 - P564,724).

Note 4 - Service fee income

The account consists of service charges on deposit accounts for failure to meet minimum balance requirements which amount to P672,133 for the year ended December 31, 2020 (2019 - P720,229).

Note 5 - Miscellaneous expenses

The account mainly includes allocated costs from the Bank's regular banking unit (RBU) which amounts to P1,477,028 for the year ended December 31, 2020 (2019 - P1,943,627).

Note 6 - Income taxes

Income subject to tax for the year ended December 31 consists of revenue generated from on-shore transactions of the FCDU.

A reconciliation between the income tax expense at the statutory income tax rate to the actual income tax expense for the years ended December 31 are as follows:

	2020		2019	
	Amount	Rate (%)	Amount	Rate (%)
Statutory income tax	(189,528)	(30.00)	221,251	30.00
Effects of items not subjected to statutory tax rate				
Non-deductible expenses	407,633	64.52	560,363	75.98
Income subjected to lower tax rates	(106,642)	(16.88)	(387,143)	(52.49)
Income tax expense	111,463	17.64	394,471	53.49

Note 7 - Related party transactions

In the ordinary course of business, the Bank has transactions with the Parent Bank and other related entities which are recognized in the FCDU books. These transactions usually arise from normal banking activities such as deposit arrangements and outsourcing of certain services primarily loans operations, branch operations and human resource-related functions. These transactions are done on an arm's length basis and are made substantially on the same terms and conditions as transactions with unaffiliated individuals and businesses of comparable risks under the same or similar circumstance.

Significant related party transactions at December 31, 2020 of the FCDU pertain to deposits with the Parent Bank and a fellow subsidiary amounting to P223,481,234 (2019 - P231,868,773).

Note 8 - Other commitments and contingent liabilities

There are no outstanding commitments and contingent liabilities involving the Bank's FCDU as at December 31, 2020 and 2019.

Note 9 - Financial risk and capital management

Risk management in the Bank, including the FCDU, 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 foreign exchange risk, interest rate risk, credit risk, equity risk, and contingency risk, among others.

The primary objective of the Bank is the generation of recurring acceptable returns to shareholder's 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 shareholder's 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 Risk Management Office is responsible for the management of market and liquidity risks. Its objective is to minimize adverse impacts on the Bank's financial performance due to the unpredictability of financial markets. Market and credit risks management in the Bank is carried out through policies approved by the Risk Management Committee and the Board of Directors. In addition, Internal Audit is responsible for the independent review of risk assessment measures and procedures and the control environment. For risk management purposes, risks emanating from Treasury activities are managed independently.

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

9.1 Credit risk

The Bank, including the FCDU, takes on exposure to credit risk, which is the risk that may arise if a borrower or counterparty fails to meet its obligations in accordance with agreed terms. Credit risk is the single largest risk for the Bank's business; management therefore carefully manages its exposure to credit risk as governed by relevant regulatory requirements and international benchmarks.

Credit exposure in the FCDU arises principally from financial assets at amortized cost consisting of Due from other banks. The Credit Policy Group works with the Credit Committee in managing credit risks, and reports are regularly provided to the Board of Directors.

The maximum credit risk exposure relates to Due from other banks which amounts to P223,481,234 at December 31, 2020 (2019 - P231,868,773), which are deposited in a universal and a thrift bank and are considered fully performing (Note 2). Deposits are made in the reputable banks with good credit ratings. Management has determined that there is a low risk of default on these deposits and has assessed that the said counterparties have strong capacity to meet its contractual cash flow obligations in the near term. Low credit risk assets are at a minimum subject to 12-month expected credit loss (ECL). Based on its assessment, management has ascertained that the corresponding 12-month ECL is not material for financial reporting purposes as at December 31, 2020 and 2019.

9.2 Market risk

The Bank, including the FCDU, 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 management is incumbent on the Board of Directors through its Risk Management Committee.

9.2.1 Interest rate risk

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, including the FCDU, takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates. 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 Risk Management Office.

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.

The FCDU's financial assets and liabilities as at December 31 are all non-repricing and are broken down as follows:

	2020	2019
Financial assets		
Due from other banks	223,481,234	231,868,773
Other resources	3,414	130,497
Total financial assets	223,484,648	231,999,270
Financial liabilities		
Deposit liabilities	205,215,211	207,922,425
Accrued interest payable	283	45,866
Total financial liabilities	205,215,494	207,968,291
Total interest repricing gap	18,269,154	24,030,979

9.2.2 Foreign currency exchange risk

Foreign currency exchange risk is being managed on a Bank-wide basis. As at December 31, 2020 and 2019, the FCDU of the Bank is not engaged in transactions denominated in currencies other than its functional currency, US Dollar. Accordingly, it has no exposure to foreign currency exchange risk.

9.3 Liquidity risk

Liquidity risk is the risk that the Bank, including the FCDU, 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 management process, as carried out within the Bank and monitored by the Risk Management Committee and the Risk Management Office includes:

- day-to-day funding, which includes replenishment of funds as they mature or are borrowed by customers, managed by monitoring future cash flows to ensure that requirements can be met;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- monitoring balance sheet liquidity ratios against internal and regulatory requirements;
- managing the concentration and profile of debt maturities; and
- performing periodic liquidity stress testing on the Bank's liquidity position by assuming a faster rate of withdrawals in its deposit base.

Monitoring and reporting take the form of cash flow measurement and projections for the next days, weeks and months as these are key periods for liquidity management. The starting point for those projections is an analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets.

Sources of liquidity are regularly reviewed by the Bank to maintain a wide diversification by currency, geography, counterparty, product and term. Assets available to meet all of the liabilities include due from other banks. The Bank would also be able to meet unexpected net cash outflows by accessing additional funding sources.

The FCDU's financial liabilities at December 31, 2020, which consist of savings deposits and accrued interest payable amounting to P205,215,211 and P283, respectively, (2019 - P207,922,425 and P45,866, respectively), have no stated maturity and are repayable on demand.

The Bank has sufficient liquid assets (mainly Due from other banks) to meet its obligations as at December 31, 2020 and 2019.

Liquidity Coverage Ratio (LCR)

Pursuant to Bangko Sentral ng Pilipinas (BSP) Circular No. 905 issued in 2016, the Bank is required to hold and maintain an adequate level of unencumbered High Quality Liquid Assets (HQLA) that are sufficient to meet its estimated total cash outflows over a 30 calendar-day period of liquidity stress. The LCR is the ratio of HQLAs to total net cash outflows which should be no lower than 100% on a daily basis. It is designed to promote short-term resilience of the Bank's liquidity risk profile to withstand significant liquidity shocks that may last over 30 calendar days. HQLA represent the Bank's stock of liquid assets that qualify for inclusion in the LCR which consist mainly of cash, regulatory reserves and unencumbered high-quality liquid securities. HQLAs therefore, serve as defense against potential stress events.

The main drivers of the Bank's LCR comprise the changes in the total stock of HQLA as well as changes in net cash outflows related to deposits, unsecured borrowings and commitment facilities, if any.

9.4 Fair values of financial assets and liabilities

The table below summarizes the carrying amounts and fair values of those financial assets and liabilities at December 31 not presented in the statement of condition at fair value.

	Carrying Value		Fair Value	
	2020	2019	2020	2019
Financial assets				
Due from other banks	223,481,234	231,868,773	223,481,234	231,868,773
Other resources	3,414	130,497	3,414	130,497
Financial liabilities				
Deposit liabilities	205,215,211	207,922,425	205,215,211	207,922,425
Accrued interest payable	283	45,866	283	45,866

Due from other banks

The fair value of floating rate placements and overnight deposits approximates their carrying amount. The estimated fair value of fixed interest-bearing deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity.

Deposit liabilities

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The carrying amount of deposit liabilities approximates their fair value due to the short-term nature of these instruments.

Other resources/liabilities

Carrying amounts of other resources/liabilities which have no definite repayment dates are assumed to be their fair values.

9.5 Capital management

Capital management is understood to be a facet of risk management. The primary objective of the Bank, including the FCDU, is the generation of recurring acceptable returns to shareholder's capital. To this end, the Bank's policies, business strategies and 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 funders and stakeholders.

Cognizant of its exposure to risks, the Bank understands that it must maintain sufficient capital to absorb unexpected losses, to stay in business for the long haul, and to satisfy regulatory requirements. The Bank further understands that its performance, as well as the performance of its various units, should be measured in terms of returns generated vis-à-vis allocated capital and the amount of risk borne in the conduct of business.

Effective January 1, 2014, the BSP, through its Circular 781, requires each bank and its financial affiliated subsidiaries to adopt new capital requirements in accordance with the provisions of Basel III. The new guidelines are meant to strengthen the composition of the Bank's capital by increasing the level of core capital and regulatory capital. The Circular sets out minimum Common Equity Tier 1 (CET1) ratio and Tier 1 Capital ratios of 6% and 7.5%, respectively. A capital conservation buffer of 2.5%, comprised of CET1 capital, was likewise imposed. The minimum required capital adequacy ratio (CAR) remains at 10% which includes the capital conservation buffer.

The table below summarizes the Bank's CAR (combined FCDU and regular banking books) under the Basel III framework for the years ended December 31:

	2020	2019
Tier 1 capital	2,317,412,934	2,601,981,668
Tier 2 capital	108,538,715	127,967,043
Gross qualifying capital	2,425,951,649	2,729,948,711
Less: Required deductions	745,563,606	354,936,540
Total qualifying capital	1,680,388,043	2,375,012,171
Risk weighted assets	14,250,760,748	14,795,700,780
CET1	11.03%	15.19%
CAR (%)	11.79%	16.05%

The Bank has fully complied with the CAR requirement of the BSP as at December 31, 2020 and 2019.

Note 10 - Summary of significant accounting policies

The accompanying financial statements reflect the accounts maintained by the FCDU of the Bank. The principal accounting policies applied in the preparation of the financial statements of the FCDU of the Bank are set out below. These policies have been consistently applied to both years presented, unless otherwise stated.

10.1 Basis of preparation

The financial statements of the FCDU have been prepared in accordance with the reporting guidelines of the BSP. In general, the said guidelines as they relate to the preparation and presentation of the FCDU financial statements of banks, include all applicable Philippine Financial Reporting Standards (PFRSs), Philippine Accounting Standards (PAS), and interpretations approved by the Financial Reporting Standards Council (FRSC) and adopted by the SEC, except with respect to the determination and translation of functional currency as discussed in Note 10.8.

The financial statements of the FCDU of the Bank have been prepared under the historical cost convention.

The preparation of financial statements in conformity with PFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Bank's accounting policies. Changes in assumptions may have a significant impact on the financial statements in the period the assumptions changed. Management believes that the underlying assumptions are appropriate and that the Bank's financial statements therefore present the financial position and results fairly. There are no areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements.

10.1.1 Changes in accounting policy and disclosures

(a) Amendments to existing standards adopted by the Bank's FCDU

The Bank's FCDU has adopted the following amendments to existing standards and the revised Conceptual Framework effective January 1, 2020:

- Amendments to PAS 1, *'Presentation of Financial Statements'*, and PAS 8, *'Accounting Policies, Changes in Accounting Estimates and Errors'*

  The amendments clarify that the reference to obscuring information addresses situations in which the effect is similar to omitting or misstating that information, and that an entity assesses materiality in the context of the financial statements as a whole, and; the meaning of 'primary users of general purpose financial statements' to whom those financial statements are directed, by defining them as 'existing and potential investors, lenders and other creditors' that must rely on general purpose financial statements for much of the financial information they need.

  The adoption of the above amendments did not have a material impact on the financial statements of the Bank's FCDU as its materiality assessment is already made in the context of the financial statements as a whole.

- Revised Conceptual Framework for Financial Reporting

  The revised Framework includes the following changes:
  - increasing the prominence of stewardship in the objective of financial reporting;
  - reinstating prudence as a component of neutrality;
  - defining a reporting entity, which may be a legal entity, or a portion of an entity;
  - revising the definitions of an asset and a liability;
  - removing the probability threshold for recognition and adding guidance on derecognition;
  - adding guidance on different measurement basis; and
  - stating that profit or loss is the primary performance indicator and that, in principle, income and expenses in other comprehensive income should be recycled where this enhances the relevance or faithful representation of the financial statements.

No changes will be made to any of the current accounting standards. However, entities that rely on the Framework in determining their accounting policies for transactions, events or conditions that are not otherwise dealt with under the accounting standards will need to apply the revised Framework from January 1, 2020.

The adoption of the revised framework did not have a material impact on the financial statements of the Bank's FCDU as the accounting policies of the Bank are still the same and appropriate under the revised framework.

- Amendments to PFRS 16, *"Leases"*

  The amendment provides lessees with an option to treat qualifying rent concessions in the same way as they would if they were not lease modifications. In many cases, this will result in accounting for the concessions as variable lease payments in the period in which they are granted.

  The adoption of the above amendment did not have a material impact on the financial statements of the Bank's FCDU.

There are no other standards, amendments to existing standards and interpretations effective January 1, 2020 that are considered relevant to the financial statements of the Bank's FCDU.

(b) Amendments to existing standards not yet effective and not yet adopted by the Bank's FCDU

The following amendments to existing standards are not mandatory for December 31, 2020 reporting period and have not been early adopted by the Bank's FCDU:

- Amendments to PAS 1, *"Presentation of Financial Statements"*

  The amendments to PAS 1 clarify that liabilities are classified as either current or non-current, depending on the rights that exist at the end of the reporting period. Classification is unaffected by the expectations of the entity or events after the reporting date (e.g. the receipt of a waiver or a breach of covenant).

- Amendments to PAS 16, "Property, Plant and Equipment"

  The amendment prohibits an entity from deducting from the cost of an item of property, plant and equipment any proceeds received from selling items produced while the entity is preparing the asset for its intended use. It also clarifies that an entity is 'testing whether the asset is functioning properly' when it assesses the technical and physical performance of the asset.

- PAS 37, *"Provisions, Contingent Liabilities and Contingent Assets"*

  The amendment clarifies that the direct costs of fulfilling a contract include both the incremental costs of fulfilling the contract and an allocation of other costs directly related to fulfilling the contract. Before recognizing a separate provision for an onerous contract, the entity recognizes any impairment loss that has occurred on assets used in fulfilling the contract.

- Annual Improvements to PFRS Standards 2018-2020

  The following improvements were finalized in May 2020:
  i. PFRS 9, "*Financial Instruments*", clarifies which fees should be included in the 10% test for derecognition of financial liabilities.
  ii. PFRS 16, "*Leases*", amendment to remove the illustration of payments from the lessor relating to leasehold improvements, to remove any confusion about the treatment of lease incentives.

The adoption of the above amendments is not expected to have a material impact on the financial statements of the Bank's FCDU. There are also no new standards effective after December 31, 2020 that are expected to be relevant or would have a material impact on the financial statements of the Bank's FCDU.

10.2 Business combination between entities under common control

Business combinations under common control are accounted for using the predecessor cost method following the guidance under PIC Q&A No. 2011-02 and PIC Q&A 2012-01. Under this method, the Bank does not restate the acquired businesses or assets and liabilities to their fair values. The net assets of the combining entities or businesses are combined using the carrying amounts of assets and liabilities of the acquired entity. No amount is recognized in consideration for goodwill or the excess of acquirer's interest in the net fair value of acquired identifiable assets, liabilities and contingent liabilities over their cost at the time of the common control combination.

The financial statements incorporated the net assets and results of operations of the combining entities or businesses at the date of acquisition.

10.3 Financial assets

10.3.1 Classification

The Bank, including the FCDU, classifies its financial assets in the following measurement categories:

- those to be measured subsequently at fair value through profit or loss (FVTPL);
- those to be measured subsequently at fair value through other comprehensive income (FVOCI); and
- those to be measured at amortized cost.

The classification depends on the Bank's business model for managing the financial assets and the contractual terms of the cash flows.

For assets measured at fair value, gains and losses will either be recorded in profit or loss or other comprehensive income. For investments in equity instruments that are not held for trading, this will depend on whether the Bank, including the FCDU, has made an irrevocable election at the time of initial recognition to account for the equity investment at FVOCI.

10.3.2 Recognition and derecognition

Regular way purchases and sales of financial assets are recognized on trade date, the date on which the Bank commits to purchase or sell the asset. Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or have been transferred and the Bank has transferred substantially all the risks and rewards of ownership.

10.3.3 Measurement

The classification requirements for debt and equity instruments are described below:

At initial recognition, the Bank, including the FCDU, measures a financial asset at its fair value plus, in the case of a financial asset not at FVTPL, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVTPL are expensed in profit or loss.

Based on these factors, the Bank, including the FCDU, classifies its debt instruments into one of the following three measurement categories:

Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds and trade receivables purchased from clients in factoring arrangements without recourse. Subsequent measurement of debt instruments depends on the FCDU's business model for managing the asset and the cash flow characteristics of the asset. The FCDU only has debt instrument measured at amortized cost. The FCDU does not hold any debt instruments measured at FVOCI and FVTPL as at December 31, 2020 and 2019.

- *Amortized cost*

  Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at fair value through profit or loss, are measured at amortized cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognized and measured. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

  Amortized cost financial assets of the FCDU as at December 31, 2020 and 2019 include due from other banks (Note 2) and other resources.

  Cash and cash equivalents consist of deposits with the Parent Bank and with a fellow subsidiary.

Business model: The business model reflects how the Bank, including the FCDU, manages the assets in order to generate cash flows. That is, whether the Bank's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable, then the financial assets are classified as part of 'other' business model and measured at FVTPL. Factors considered by the Bank, including the FCDU, in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated.

SPPI: Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Bank, including the FCDU, assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Bank, including the FCDU, considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

The FCDU reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

Equity instruments

Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets.

The FCDU does not hold equity instruments as at December 31, 2020 and 2019.

10.3.4 Impairment and write-off

The Bank, including the FCDU, assesses on a forward-looking basis the expected credit losses (ECL) associated with its debt instrument assets carried at FVOCI and amortized cost. The Bank, including the FCDU, recognizes a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions

The FCDU's financial assets pertain to due from other banks and other resources. The FCDU applies the simplified approach, as permitted by PFRS 9, in measuring ECL which uses a lifetime expected loss allowance for other financial assets.

To measure the expected credit losses, other financial assets have been grouped based on shared credit risk characteristics and the days past due. The expected loss rates are based on the payment profiles of receivables over a period of 36 months and corresponding historical credit losses experienced within this periods. The forward-looking information on macroeconomic factors are considered insignificant in calculating impairment of the FCDU's financial assets.

Write-off

Financial assets are written-off when there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, the failure of a debtor to engage in a repayment plan with the FCDU and a failure to make contractual payments for a period of greater than 120 days past due.

10.4 Financial liabilities

10.4.1 Classification

The Bank, including the FCDU, classifies its financial liabilities in the following categories: financial liabilities at FVTPL, and financial liabilities at amortized cost. As at December 31, 2020 and 2019, the Bank has no financial liabilities classified at FVTPL.

Financial liabilities measured at amortized cost include deposit liabilities and accrued interest payable.

10.4.2 Recognition and measurement

Initial recognition and measurement

Financial liabilities at amortized cost are initially recognized at fair value less transaction costs.

Subsequent measurement

Financial liabilities at amortized cost are subsequently measured at amortized cost using the effective interest rate method.

10.4.3 Derecognition

A financial liability is removed from the statement of condition when it is extinguished, i.e., when the obligation is discharged or is canceled or expires.

10.5 Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The fair value of a non-financial asset is measured based on its highest and best use. The asset's current use is presumed to be its highest and best use.

The fair value of financial and non-financial liabilities takes into account non-performance risk, which is the risk that the entity will not fulfill an obligation.

The Bank, including the FCDU, classifies its fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example, Philippine Stock Exchange, Inc., Philippine Dealing and Exchange Corp., etc.).
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).
- Level 3 - Inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components. This hierarchy requires the use of observable market data when available. The Bank considers relevant and observable market prices in its valuations where possible. The FCDU has no assets or liabilities classified under Level 3 as at December 31, 2020 and 2019.

The appropriate level is determined on the basis of the lowest level input that is significant to the fair value measurement.

10.6 Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of condition when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy of the entity or the counterparty.

As at December 31, 2020 and 2019, there are no financial assets and liabilities that have been offset in FCDU books.

10.7 Interest income and expense

Interest income and expense are recognized in the statement of income for all interest-bearing financial instruments using the effective interest rate method.

When calculating the effective interest rate, the Bank, including the FCDU, estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognized using the rate of interest used to discount future cash flows for the purpose of measuring impairment loss.

10.8 Foreign currency translation

Functional and presentation currency

Items in the financial statements are measured using the currency of the primary economic environment in which the FCDU operates (the functional currency). In accordance with BSP Circular 601, series of 2008, the functional currency of the FCDU is US Dollar while the financial statements are presented in Philippine Peso (the presentation currency).

For financial reporting purposes and following the requirements under Section 84 of the Manual of Regulations on Foreign Exchange Transactions (MORFXT), the functional currency of the Bank's FCDU is the US Dollar. The FCDU accounts are translated into their equivalent amounts in Philippine Peso. In determining the presentation currency of the FCDU, the Bank's management considered the primary users of these financial statements. These financial statements are prepared mainly for submission to the BSP and for filing with the Bureau of Internal Revenue along with the annual income tax return of the FCDU, which is also presented in Philippine Peso. Consistent with the provision of PAS 21, *The Effects of Changes in Foreign Exchange Rates*, the Bank's FCDU adopts Philippine Peso as its presentation currency.

The results and financial position of the FCDU are translated into Philippine Peso as follows:

- resources and liabilities are translated at closing rate at year-end;
- income and expenses are translated at exchange rates at the dates of the transactions; and
- all resulting exchange differences are taken to statement of comprehensive income under cumulative translation adjustment.

Management assessed that the impact of the translation adjustment is insignificant and decided not to present the cumulative translation adjustment separately in the FCDU's financial statements as at December 31, 2020 and 2019.

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit or loss.

10.9 Service fee income

The Bank, including the FCDU, recognizes revenue when (or as) the Bank satisfies a performance obligation by transferring a promised good or service to a customer (i.e. an asset). An asset is transferred when (or as) the customer obtains control of that asset.

Fees and commissions are generally recognized over time when the service has been provided and the control over the service is transferred to the customer. The service being rendered by the Bank represents a single performance obligation.

Fees and commissions, mainly representing service fees, are recognized on an accrual basis when the service has been provided. Fees and commission arising from loans, deposits and other banking transactions are recognized as income based on agreed terms and conditions.

10.10 Income taxes

Income earned by the FCDU is taxed as follows: (a) offshore income is tax-exempt, (b) gross onshore income is taxed at 10%, and (c) all other income not classifiable as onshore or offshore subject to the regular corporate tax rate of 30% of net taxable income.

Income derived by the FCDU from foreign currency transactions with local commercial banks, including branches of foreign banks authorized by the BSP to transact business with the FCDU is subject to 10% final tax. Also, interest earned on deposits with foreign currency denominated units of other banks is subject to 15% final tax.

10.11 Transfer to RBU

Transfer to RBU comprises actual transfer of net income of FCDU to the RBU, excluding unrealized foreign exchange gains and losses.

10.12 Expense allocation

Certain expenses of the Bank are allocated to the FCDU which takes into consideration the specific transactions of the FCDU.

10.13 Related party relationships and transactions

Related party relationship exists when one party has the ability to control, directly, or indirectly through one or more intermediaries, the other party or exercises significant influence over the other party in making financial and operating decisions. Such relationship also exists between and/or among entities which are under common control with the reporting enterprise, or between and/or among the reporting enterprise and its key management personnel, directors, or its shareholders. In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

10.14 Events after the reporting date

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