

MAPFRE INSULAR INSURANCE CORPORATION  
*(Formerly Mapfre Asian Insurance Corporation)*

Financial Statements  
December 31, 2006 and 2005

and

Independent Auditors' Report

## **INDEPENDENT AUDITORS' REPORT**

The Stockholders and the Board of Directors  
Mapfre Insular Insurance Corporation

We have audited the accompanying financial statements of Mapfre Insular Insurance Corporation (formerly Mapfre Asian Insurance Corporation), which comprise the balance sheets as of December 31, 2006 and 2005, and the related statements of income, statements of changes in stockholders' equity and statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory notes.

### **Management's Responsibility for the Financial Statements**

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

### **Auditors' Responsibility**

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

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

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

**Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of Mapfre Insular Insurance Corporation as of December 31, 2006 and 2005, and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards.

SYCIP GORRES VELAYO & CO.

Lucy L. Chan  
Partner  
CPA Certificate No. 88118  
SEC Accreditation No. 0114-A  
Tax Identification No. 152-884-511  
PTR No. 0266535, January 2, 2007, Makati City

January 25, 2007

## **INDEPENDENT AUDITORS' REPORT**

The Stockholders and the Board of Directors  
Mapfre Insular Insurance Corporation

We have audited the accompanying financial statements of Mapfre Insular Insurance Corporation (formerly Mapfre Asian Insurance Corporation), which comprise the balance sheets as of December 31, 2006 and 2005, and the related statements of income, statements of changes in stockholders' equity and statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory notes.

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January 25, 2007

## INDEPENDENT AUDITORS' REPORT

The Stockholders and the Board of Directors  
Mapfre Insular Insurance Corporation  
Mapfre Asian Corporate Center  
Acacia Avenue, Madrigal Business Park  
Ayala Alabang, Muntinlupa City

We have audited the financial statements of Mapfre Insular Insurance Corporation (formerly Mapfre Asian Insurance Corporation) for the year ended December 31, 2006, on which we have rendered the attached report dated January 25, 2007.

In compliance with SRC Rule 68, we are stating that the above Company has 16 stockholders owning one hundred (100) or more shares.

SYCIP GORRES VELAYO & CO.

Lucy L. Chan  
Partner  
CPA Certificate No. 88118  
SEC Accreditation No. 0114-A  
Tax Identification No. 152-884-511  
PTR No. 0266535, January 2, 2007, Makati City

January 25, 2007

**MAPFRE INSULAR INSURANCE CORPORATION**  
**(Formerly Mapfre Asian Insurance Corporation)**

**BALANCE SHEETS**

	<b>December 31</b>	
	<b>2006</b>	2005 (As restated - Note 2)
<b>ASSETS</b>		
<b>Cash and Cash Equivalents</b> (Notes 5 and 7)	<b>₱ 262,752,672</b>	₱ 187,385,782
<b>Insurance Receivables - net</b> (Notes 6, 29 and 31)	<b>153,664,719</b>	321,847,778
<b>Financial Assets</b> (Note 7)		
Held to maturity financial assets	<b>876,445,791</b>	676,474,858
Available-for-sale financial assets	<b>148,760,222</b>	48,690,000
Loans and receivables - net	<b>78,846,390</b>	95,296,795
<b>Prepayments and Accrued income</b> (Note 8)	<b>24,610,871</b>	17,169,363
<b>Reinsurance Assets</b> (Notes 9, 15 and 17)	<b>544,477,936</b>	278,358,907
<b>Deferred Acquisition Costs - net</b> (Notes 10 and 31)	<b>114,336,620</b>	73,913,832
<b>Deferred Tax Asset - net</b> (Note 27)	<b>–</b>	9,054,041
<b>Investment Property - net</b> (Note 11)	<b>27,072,767</b>	27,663,356
<b>Property and Equipment - net</b> (Notes 12 and 31)	<b>105,233,257</b>	101,145,509
<b>Goodwill</b> (Note 2)	<b>33,794,284</b>	33,794,284
<b>Other Assets</b> (Notes 13 and 31)	<b>28,733,367</b>	12,177,438
	<b>₱2,398,728,896</b>	₱1,882,971,943
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Trade and other liabilities (Note 14)	<b>₱ 63,693,952</b>	₱ 73,887,293
Insurance contract liabilities (Notes 15 and 17)	<b>1,150,224,187</b>	766,850,638
Other insurance contract liabilities (Notes 16, 17 and 29)	<b>122,555,004</b>	115,740,952
Pension benefit obligation (Note 25)	<b>11,032,944</b>	6,990,396
Deferred tax liability - net (Note 27)	<b>2,960,277</b>	–
	<b>1,350,466,364</b>	963,469,279
<b>Stockholders' Equity</b>		
Capital stock (Notes 2 and 18)	<b>400,000,000</b>	398,604,450
Additional paid-in capital (Note 2)	<b>200,446,070</b>	197,684,277
Contributed surplus	<b>100,000,000</b>	100,000,000
Revaluation reserve for available-for-sale financial assets (Note 7)	<b>13,231,915</b>	(852,349)
Retained earnings	<b>334,584,547</b>	224,066,286
	<b>1,048,262,532</b>	919,502,664
	<b>₱2,398,728,896</b>	₱1,882,971,943

*See accompanying Notes to Financial Statements.*

**MAPFRE INSULAR INSURANCE CORPORATION**  
**(Formerly Mapfre Asian Insurance Corporation)**

**STATEMENTS OF INCOME**

	<b>Years Ended December 31</b>	
	<b>2006</b>	<b>2005</b>
<b>Revenues</b>		
Gross earned premiums on insurance contracts (Notes 15 and 19)	<b>₱1,163,104,730</b>	₱787,499,295
Reinsurers' share of gross premiums on insurance contracts (Notes 15 and 19)	<b>380,516,045</b>	292,385,205
<b>Net insurance revenue</b>	<b>782,588,685</b>	495,114,090
Commission income (Note 29)	<b>67,531,574</b>	32,460,079
Investment income - net (Note 20)	<b>98,436,842</b>	60,102,490
Realized gains (Note 21)	<b>3,045,835</b>	14,612,654
<b>Other revenue</b>	<b>169,014,251</b>	107,175,223
<b>Total revenue</b>	<b>951,602,936</b>	602,289,313
Gross insurance benefits and claims paid (Notes 15 and 22)	<b>325,056,770</b>	309,323,214
Reinsurers' share of gross insurance benefits and claims paid (Notes 15 and 22)	<b>(66,074,094)</b>	(99,198,926)
Gross change in insurance contract liabilities (Note 15)	<b>357,479,282</b>	(31,861,385)
Reinsurers' share of change in insurance contract liabilities (Note 15)	<b>(304,136,021)</b>	71,101,788
<b>Net insurance benefits and claims</b>	<b>312,325,937</b>	249,364,691
Commission expense	<b>288,110,413</b>	151,608,573
General and administrative expenses (Note 24)	<b>196,247,220</b>	145,984,437
Finance costs (Note 23)	<b>1,718,008</b>	2,265,204
Others	<b>11,661,210</b>	5,308,483
<b>Expenses</b>	<b>497,736,851</b>	305,166,697
<b>Total benefits, claims and expenses</b>	<b>810,062,788</b>	554,531,388
<b>Income before income tax</b>	<b>141,540,148</b>	47,757,925
Current income tax	<b>19,007,569</b>	9,715,096
Deferred income tax (Note 27)	<b>12,014,318</b>	(4,222,978)
<b>Income tax expense</b>	<b>31,021,887</b>	5,492,118
<b>NET INCOME</b> (Note 30)	<b>₱ 110,518,261</b>	₱ 42,265,807

*See accompanying Notes to Financial Statements.*

**MAPFRE INSULAR INSURANCE CORPORATION**  
**(Formerly Mapfre Asian Insurance Corporation)**

**STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

	Capital Stock	Additional Paid - in Capital	Contributed Surplus	Revaluation Reserve for Available-for-Sale Financial Assets	Retained Earnings	Total
As of January 1, 2006	₱398,604,450	₱197,684,277	₱100,000,000	(₱ 852,349)	₱224,066,286	₱ 919,502,664
Issuance during the period (Note 18)	1,395,550	2,761,793	–	–	–	4,157,343
Changes in fair value of available-for-sale financial assets (Note 7)	–	–	–	20,085,003	–	20,085,003
Transferred to income and expense for the year	–	–	–	(6,000,739)	–	(6,000,739)
Income recognized directly in equity	–	–	–	14,084,264	–	14,084,264
Net income for the period	–	–	–	–	110,518,261	110,518,261
Total recognized income for the period	–	–	–	14,084,264	110,518,261	124,602,525
<b>As of December 31, 2006</b>	<b>₱400,000,000</b>	<b>₱200,446,070</b>	<b>₱100,000,000</b>	<b>₱ 13,231,915</b>	<b>₱334,584,547</b>	<b>₱1,048,262,532</b>
As of January 1, 2005, as previously reported	₱300,000,000	₱ 2,805,850	₱100,000,000	(₱ 20,567,048)	₱201,966,679	₱ 584,205,481
Effect of changes in accounting policies	–	–	–	–	(6,315,979)	(6,315,979)
Cumulative effect of change in accounting policy for financial instruments and insurance contracts as of January 1, 2005	–	–	–	11,894,151	(13,850,221)	(1,956,070)
As of January 1, 2005, as restated	300,000,000	2,805,850	100,000,000	(8,672,897)	181,800,479	575,933,432
Issuance during the period (Note 18)	98,604,450	194,878,427	–	–	–	293,482,877
Changes in fair value of available-for-sale financial assets (Note 7)	–	–	–	2,053,534	–	2,053,534
Transferred to income and expense for the year	–	–	–	5,767,014	–	5,767,014
Income recognized directly in equity	–	–	–	7,820,548	–	7,820,548
Net income for the period	–	–	–	–	42,265,807	42,265,807
Total recognized income for the period	–	–	–	7,820,548	42,265,807	50,086,355
As of December 31, 2005	₱398,604,450	₱197,684,277	₱100,000,000	(₱ 852,349)	₱224,066,286	₱ 919,502,664

See accompanying Notes to Financial Statements.

**MAPFRE INSULAR INSURANCE CORPORATION**  
**(Formerly Mapfre Asian Insurance Corporation)**

**STATEMENTS OF CASH FLOWS**

	<b>Years Ended December 31</b>	
	<b>2006</b>	<b>2005</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Income before income tax	<b>₱141,540,148</b>	₱47,757,925
Adjustments for:		
Increase in reserve for unearned premiums - net of deferred reinsurance premiums (Notes 15 and 19)	<b>63,911,259</b>	62,583,888
Net benefit expense (Note 25)	<b>13,242,548</b>	4,189,013
Provision for incurred but not reported losses (Note 15)	<b>7,735,152</b>	1,115,637
Depreciation and amortization (Notes 11, 12 and 24)	<b>15,541,002</b>	15,049,385
Loss on impairment of AFS financial assets (Note 20)	<b>2,931,229</b>	5,767,015
Interest expense (Note 23)	<b>1,437,957</b>	1,952,047
Gain on sale of:		
Investments in AFS financial assets (Note 21)	<b>(8,931,968)</b>	(12,581,908)
Property and equipment (Note 21)	-	(1,171,819)
Gain on maturities of fair value through profit or loss financial assets (Note 21)	-	(644,777)
Dividend income (Note 20)	<b>(4,795,899)</b>	(2,881,140)
Interest income (Note 20)	<b>(95,597,853)</b>	(60,778,605)
Operating income before working capital changes	<b>137,013,575</b>	60,356,661
Decrease (increase) in:		
Insurance receivables (Note 6)	<b>168,183,059</b>	(38,596,937)
Reinsurance assets (Note 15)	<b>(311,871,173)</b>	45,141,225
Prepayments (Note 8)	<b>187,432</b>	298,220
Deferred acquisition costs - net of deferred reinsurance commissions (Note 10)	<b>(40,422,788)</b>	(7,064,626)
Increase (decrease) in:		
Trade and other liabilities (Note 14)	<b>(12,489,896)</b>	12,082,031
Insurance contract liabilities (Note 15)	<b>357,479,282</b>	(38,487,483)
Other insurance contract liabilities (Note 16)	<b>6,814,052</b>	10,365,597
Net cash generated from operations	<b>304,893,543</b>	44,094,688
Payments for:		
Contributions for retirement fund	<b>(9,200,000)</b>	(4,800,000)
Interest expense	<b>(1,437,957)</b>	(1,952,047)
Income taxes	<b>(16,711,014)</b>	(9,715,096)
Net cash provided by operating activities	<b>277,544,572</b>	27,627,545

(Forward)

	<b>Years Ended December 31</b>	
	<b>2006</b>	<b>2005</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Cash received due to merger (Note 2)	₱ –	₱ 30,639,439
Interest received	<b>87,968,913</b>	58,990,015
Dividends received (Note 20)	<b>4,795,899</b>	2,881,140
Proceeds from sale/maturities of:		
Investments in:		
Held-to-maturity financial assets	<b>203,360,130</b>	30,002,040
Available-for-sale financial assets	<b>85,706,117</b>	106,267,897
Fair value through profit and loss	–	42,243,309
Property and equipment (Notes 12 and 21)	–	1,171,819
Acquisitions of:		
Investments in:		
Held-to-maturity financial assets	<b>(403,331,063)</b>	(194,808,245)
Available-for-sale financial assets	<b>(165,691,336)</b>	(69,919,875)
Property and equipment (Note 12)	<b>(19,038,161)</b>	(17,763,323)
Decrease (increase) in:		
Loans and receivables (Note 7)	<b>16,450,405</b>	22,248,710
Other assets	<b>(16,555,929)</b>	(4,466,675)
Net cash provided by (used in) investing activities	<b>(206,335,025)</b>	7,486,251
<b>CASH FLOW FROM FINANCING ACTIVITY</b>		
Cash received from issuance of shares of stock	<b>4,157,343</b>	–
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>75,366,890</b>	35,113,796
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b>187,385,782</b>	152,271,986
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b>₱262,752,672</b>	<b>₱187,385,782</b>

*See accompanying Notes to Financial Statements.*

**MAPFRE INSULAR INSURANCE CORPORATION**  
**(Formerly Mapfre Asian Insurance Corporation)**

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**NOTES TO FINANCIAL STATEMENTS**

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**1. Corporate Information**

Mapfre Insular Insurance Corporation (formerly Mapfre Asian Insurance Corporation) (the Company) was incorporated in the Philippines and is a subsidiary of Mapfre Internacional of Spain. The Company is engaged in the business of motor car, fire, marine, fidelity and surety insurance, and on all other kinds of insurance business of any nature. The registered office address of the Company is Mapfre Asian Corporate Center, Acacia Avenue, Madrigal Business Park, Ayala Alabang, Muntinlupa City.

The accompanying financial statements of the Company for the year ended December 31, 2006 were authorized for issue by the Board of Directors (BOD) on January 25, 2007.

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**2. Business Combination**

In 2005, the Company, with its shareholders, entered into a Memorandum of Understanding (MOU) with Insular General Insurance Co., Inc. (Insular General) and its shareholders. Under the MOU, the parties agreed to pursue a merger between the Company and Insular General, with the Company as the surviving entity.

The Articles and Plan of Merger were approved by the respective BOD and stockholders of the Company and Insular General on October 14, 2005 and October 13, 2005, respectively. On the same date, the Company's BOD approved the change in name of the Company from Mapfre Asian Insurance Corporation to Mapfre Insular Insurance Corporation. The merger was approved by the Insurance Commission (IC) on November 8, 2005. The Philippine Securities and Exchange Commission (SEC) approved the merger and the application for the change in the Company's name on December 29, 2005.

The merger was accounted for using the purchase method in accordance with Philippine Financial Reporting Standards (PFRS) 3, *Business Combinations*. Since the effective date of the merger is on December 29, 2005, only the assets and liabilities of Insular General have been included in the 2005 financial statements. No part of the net income earned by Insular General in 2005 has been included in the Company's 2005 results of operations. If the merger had taken place at the beginning of the year, the 2005 net income of the Company would have been ₱43,044,895 and 2005 premiums earned, net of reinsurance, would have been ₱622,151,941.

The merger was effected through a swap of shares at an exchange ratio agreed upon by both parties. The Company issued 1,972,089 common shares at ₱148.95 per share for the net assets of Insular General (see Note 18). The fair values of the assets and liabilities of Insular General as of December 31, 2005 are as follows:

Cash and cash equivalents	₱30,639,439
Insurance balances receivable - net of allowance for doubtful accounts amounting to ₱2,593,542	169,432,094

(Forward)

Financial assets:	
Available-for-sale	₱ 20,430,610
Held-to-maturity	187,223,059
Loans and receivables	2,234,796
Accrued income	4,358,324
Reinsurance assets	67,010,946
Deferred acquisition costs - net	13,179,044
Property and equipment - net	1,345,186
Other assets	468,604
	<hr/>
	496,322,102
Trade and other liabilities	26,585,701
Insurance contract liabilities	161,302,368
Other insurance liabilities	52,624,538
Deferred tax liability - net	1,376,567
	<hr/>
	241,889,174
	<hr/>
	₱254,432,928

Goodwill arising on the business combination with Insular General amounted to ₱41,786,263. Legal and consultancy fees directly attributable to the combination amounting to ₱2,476,534 were included in the cost of the business combination.

Included under "Trade and other liabilities" assumed by the Company from Insular General is the latter's retirement liability to its employees amounting to ₱7,991,979. In 2006, however, the former shareholders of Insular General assumed payment of this liability. Consequently, the Company derecognized the liability previously booked and reduced goodwill to ₱33,794,284. The 2005 balances were restated to reflect this reduction.

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### 3. Summary of Significant Accounting Policies

#### Basis of Preparation

The accompanying financial statements have been prepared on a historical cost basis, except for available-for-sale (AFS) financial assets which have been measured at fair value.

The financial statements are presented in Philippine Pesos.

#### Statement of Compliance

The accompanying financial statements, which have been prepared for submission to the Securities and Exchange Commission (SEC) and the Bureau of Internal Revenue, have been prepared in compliance with Philippine Financial Reporting Standards (PFRS) as adopted by the Philippine SEC.

### Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year except as follows:

The Company has adopted the following new and amended PFRS and Philippine Interpretations during the period. Adoption of these revised standards and interpretations did not have any effect on the Company except for the additional disclosures on the financial statements.

- PAS 19 *Amendment - Employee Benefits*
- PAS 21 *Amendment - The Effects of Changes in Foreign Exchange Rates*
- PAS 39 *Amendments - Financial Instruments: Recognition and Measurement*
- Philippine Interpretation IFRIC 4 *Determining whether an Arrangement contains a Lease*

The Company has also early adopted the following IFRIC interpretations. Adoption of these interpretations did not have any effect on the financial position of the Company. These, however, require additional disclosures on the financial statements.

- Philippine Interpretation IFRIC 8 *Scope of IFRS 2*
- Philippine Interpretation IFRIC 9 *Reassessment of Embedded Derivatives*

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

#### *PAS 19, Employee Benefits*

*Amendment for actuarial gains and losses, group plans and disclosures.* As of January 1, 2006, the Company adopted the amendments to PAS 19. As a result, additional disclosures are made, starting in 2006, to provide information about trends in the assets and liabilities in the defined benefit plan and assumptions underlying the components of the defined benefit cost. This change has neither recognition nor measurement impact as the Company chose not to apply the new option offered to recognize actuarial gains and losses outside of the statement of income.

#### *PAS 21, Effects of Changes in Foreign Exchange Rates*

*Amendment for net investment in a foreign operation.* As of January 1, 2006, the Company adopted the amendments to PAS 21. This amendment states that all exchange differences arising from a monetary item that forms part of an entity's net investment in a foreign operation are recognized in a separate component of equity in the financial statements regardless of the currency in which the monetary item is denominated. As the Company currently has no investment in a foreign operation, the amendment did not have an effect on the financial statements.

#### *PAS 39, Financial Instrument: Recognition and Measurement*

*Amendment for financial guarantee contracts* (issued August 2005). This amended the scope of PAS 39 to require financial guarantee contracts that are not considered to be insurance contracts to be recognized initially at fair value and to be remeasured at the higher of the amount determined in accordance with PAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with PAS 18, *Revenue*. This amendment did not have an effect on the financial statements.

*Amendment for hedges of forecast intra-group transactions* (issued April 2005). This amended PAS 39 to permit the foreign currency risk of a highly probable intra-group forecast transaction to qualify as the hedged item in a cash flow hedge, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and that the foreign currency risk will affect the consolidated income statement. As the Company currently has no such transactions, the amendment did not have an effect on the financial statements.

*Amendment for the fair value option* (issued June 2005). This amendment to PAS 39 prescribes the conditions under which the fair value option on classification of financial instruments at fair value through profit or loss (FVPL) may be used. The Company had not previously used this option, hence the amendment did not have an effect on the financial statements.

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

Philippine Interpretation *IFRIC 8 Scope of PFRS 2*

The Company early adopted IFRIC Interpretation 8 which becomes effective for financial years beginning on or after May 1, 2006. IFRIC Interpretation 8 which requires IFRS 2 to be applied to any arrangements where equity instruments are issued for consideration which appears to be less than fair value. The interpretation has no impact on the financial position of the Company.

Philippine Interpretation *IFRIC 9 Reassessment of Embedded Derivatives*

This Interpretation was issued in March 2006 and becomes effective for financial years beginning on or after June 1, 2006. The Company early adopted IFRIC Interpretation 9 which establishes that the date to assess the existence of an embedded derivative is the date an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. The Company assessed that adoption of this interpretation has no impact on the financial statements.

#### Use of Estimates, Assumptions and Judgments

The preparation of the financial statements necessitates the use of estimates, assumptions and judgments. These estimates and assumptions affect the reported amounts of assets and liabilities and contingent liabilities at the balance sheet date as well as affecting the reported income and expenses for the year. Although the estimates are based on management's best knowledge and judgment of current facts as at the balance sheet date, the actual outcome may differ from these estimates, possibly significantly. For further information on critical estimates and judgments, refer to Note 4.

#### Cash and Cash Equivalents

Cash includes cash on hand and in banks. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less and that are subject to an insignificant risk of changes in value.

### Insurance Receivables

Insurance receivables are recognized when due. The carrying values of insurance receivables are reviewed for impairment whenever events or circumstances indicate that the carrying amounts may not be recoverable, with the impairment loss recorded in the statement of income.

### Financial Assets and Financial Liabilities

#### *Date of recognition*

The Company recognizes a financial asset or a financial liability in the balance sheets when it becomes a party to the contractual provisions of the instrument. In the case of a regular way purchase or sale of financial assets, recognition and derecognition, as applicable, is done using settlement date accounting.

#### *Initial recognition of financial instruments*

Financial instruments are initially recognized at fair value, which is the fair value of the consideration given (in the case of an asset) or received (in the case of a liability). The fair values of the consideration given or received are determined by reference to the transaction price or other market prices. If such market prices are not reliably determinable, the fair value of the consideration is estimated as the sum of all future cash payments or receipts, discounted using the prevailing market rates of interest for similar instruments with similar maturities. The initial measurement of financial instruments, except for those designated as at FVPL, includes transaction costs.

Subsequent to initial recognition, the Company classifies its financial assets in the following categories: held-to-maturity (HTM) financial assets, AFS financial assets, FVPL financial assets, and loans and receivables. The classification depends on the purpose for which the investments were acquired and whether they are quoted in an active market. Management determines the classification of its financial assets at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

#### *Determination of fair value*

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

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

*Day 1 profit*

Where the transaction price in a non-active market is different to the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Company recognizes the difference between the transaction price and fair value (a 'Day 1' profit) in the statements of income unless it qualifies for recognition as some other type of asset. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognized in the statements of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Company determines the appropriate method of recognizing the 'Day 1' profit amount.

*HTM financial assets*

HTM investments are quoted nonderivative financial assets with fixed or determinable payments and fixed maturities for which the Company's management has the positive intention and ability to hold to maturity. Where the Company sells other than an insignificant amount of HTM investments, the entire category would be tainted and reclassified as AFS securities. After initial measurement, these investments are subsequently measured at amortized cost using the effective interest rate method, less impairment in value. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. Gains and losses are recognized in income when the HTM investments are derecognized and impaired, as well as through the amortization process.

*AFS financial assets*

AFS financial assets are nonderivatives that are either designated in this category or not classified in any of the other categories. Subsequent to initial recognition, AFS assets are carried at fair value in the balance sheets. Changes in the fair value of such assets are reported as revaluation reserve for AFS financial assets in the equity section of the balance sheet until the investment is derecognized or the investment is determined to be impaired. On derecognition or impairment, the cumulative gain or loss previously reported in equity is transferred to the statement of income.

*FVPL financial assets*

A financial asset is classified in this category if acquired principally for the purpose of selling or repurchasing in the near term or upon initial recognition, it is designated by management as at FVPL. Assets classified under this category are carried at fair value in the balance sheets. Changes in fair value are accounted for in earnings.

*Loans and Receivables*

Loans and receivables are nonderivative financial assets with fixed or determinable maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as financial assets held for trading, designated as AFS or as at FVPL. Loans and receivables are carried at cost or amortized cost, less impairment in value. Amortization is determined using the effective interest rate method.

#### Classification of Financial Instruments Between Debt and Equity

A financial instrument is classified as debt if it provides for a contractual obligation to:

- Deliver cash or another financial asset to another entity or
- Exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the Company.

If the Company does not have an unconditional right to avoid delivering cash or another financial asset to settle its contractual obligation, the obligation meets the definition of a financial liability.

#### Derecognition of Financial Assets and Liabilities

##### *Financial Asset*

A financial asset (or, where applicable a part of a financial asset or part of a group of financial assets) is derecognized where:

1. the rights to receive cash flows from the asset have expired;
2. the Company retains the right to receive cash flows from the asset, but has assumed as obligation to pay them in full without material delay to a third party under a “pass-through” arrangement; or
3. the Company has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risk and rewards of the asset, but has transferred the control of the asset.

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

##### *Financial Liability*

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

#### Impairment of Financial Assets

The Company assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired.

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

*Loan and Receivables and HTM Financial Assets*

For loans and other receivables and HTM financial assets, carried at amortized cost, the amount of the impairment loss is measured as the difference between the financial asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced by the impairment loss and the loss is recorded in the income statement.

The Company assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

If in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the statement of income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

*AFS Financial Assets carried at fair value*

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

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

In the case of debt instruments classified as AFS, impairment is based on the same criteria as loans and receivables and HTM financial assets. Interest continues to be accrued at the original effective interest rate on the reduced carrying amount of the asset. If, in the subsequent year, the fair value of a debt instrument can be objectively related to an asset occurring after the impairment loss was recognized in the statement of income, the impairment loss is reversed through the statement of income.

#### Offsetting Financial Instruments

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

#### Reinsurance Assets

The Company assumes and cedes reinsurance in the normal course of business. Reinsurance assets primarily include balances due from both insurance and reinsurance companies for ceded insurance liabilities. Premiums on reinsurance assumed are recognized as revenue in the same manner as they would be if the reinsurance were considered direct business, taking into account the product classification of the reinsured business. Amounts due to reinsurers are estimated in a manner consistent with the associated reinsured policies and in accordance with the reinsurance contracts. Premiums ceded and claims reimbursed are presented on a gross basis.

An impairment review is performed on all reinsurance assets when an indication of impairment occurs. Reinsurance assets are impaired only if there is an objective evidence that the Company may not receive all amounts due to it under the terms of the contract and that this can be measured reliably.

Gains or losses on buying reinsurance, if any, are recognized in the statement of income immediately at the date of purchase and are not amortized.

Ceded reinsurance arrangements do not relieve the Company from its obligation to policyholders.

The Company also assumed reinsurance risk in the normal course of business for insurance contracts. Premiums and claims on assumed reinsurance are recognized as income and expense in the same manner as they would be if the reinsurance were considered direct business, taking into account the product classification of the reinsured business. Reinsurance liabilities represent balances due to reinsurance companies. Amounts payable are estimated in a manner consistent with the associated reinsurance contract.

Premiums and claims are presented on a gross basis for both ceded and assumed reinsurance.

Reinsurance assets and liabilities are derecognized when the contractual right is extinguished or expired or when the contract is transferred to another party.

Ceding contracts that do not transfer significant insurance risk are accounted for directly through the balance sheet. These are deposit assets or financial liabilities that are recognized based on the consideration paid or received less any explicit identified premiums or fees to be retained by the reinsured. Investment income on these contracts is accounted for using the effective interest rate method when accrued.

#### Deferred Acquisition Costs (DAC)

Commissions and other acquisition costs incurred during the financial period that vary with and are related to securing new insurance contracts and or renewing existing insurance contracts, but which relates to subsequent financial periods, are deferred to the extent that they are recoverable out of future revenue margins. DAC are capitalized and amortized on a straight-line basis over the life of the contract. All other acquisition costs are recognized as expense when incurred.

An impairment review is performed at each reporting date or more frequently when an indication of impairment arises. The carrying value is written down to the recoverable amount and the impairment loss is charged to the statements of income. The deferred acquisition cost is also considered in the liability adequacy test for each reporting period.

#### Income Taxes

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

Deferred tax liabilities are recognized for all taxable temporary differences including asset revaluation, if any. Deferred tax assets are recognized for all deductible temporary differences, carry-forward of unused tax credit from the excess of minimum corporate income tax (MCIT) over regular corporate income tax and unused net operating loss carryover (NOLCO), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carry-forward of unused tax credit from MCIT and unused NOLCO can be utilized.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax assets to be utilized.

Deferred tax assets and liabilities are measured at the tax rate that is expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

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

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

Investment Property

Property held for long term rental yields or for capital appreciation or for both, is classified as investment property. These properties are initially measured at cost, which includes transaction cost, but excludes day to day service cost. Replacement cost is capitalized if it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be reliably measured. Subsequently, at each balance sheet date, such properties are carried at cost less accumulated depreciation and impairment in value if any.

Depreciation is computed using the straight-line method over the estimated useful life of 50 years of the investment property, regardless of utilization. The estimated useful life and depreciation method are reviewed periodically to ensure that the period and method of depreciation are consistent with the expected pattern of economic activity.

Investment property is derecognized when it has either been disposed of or the investment property is permanently withdrawn from use and no future benefit is expected from its disposal. Any gain or loss from derecognition of an investment property is recognized in the statement of income in the year of derecognition.

Rental income from investment property is recognized in the statement of income on a straight-line basis over the term of the lease. Lease incentives are recognized as an integral part of the total rental income.

Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation and amortization and any impairment in value.

The initial cost of property and equipment comprises its purchase price, including any directly attributable costs of bringing the asset to its working condition and location for its intended use. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance expenses are charged to the statement of income during the financial period in which they are incurred.

Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the property and equipment as follows:

	<u>Years</u>
Building and building improvements	50
Office furniture and equipment	5
Transportation equipment	5
Leasehold improvements	5

Leasehold improvements are amortized over the estimated useful lives of the improvements or the term of the lease, whichever is shorter.

The assets' residual values, useful lives and depreciation and amortization method are reviewed periodically to ensure that the residual value, period and method of depreciation and amortization are consistent with the expected pattern of economic benefits from items of property and equipment.

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

#### *Impairment of Non-Financial Assets*

The carrying values of assets (i.e., investment property and property and equipment) are reviewed for impairment when events or changes in circumstances indicate that the carrying values may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amounts, the assets or cash-generating units are written down to their recoverable amounts. The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in the statement of income.

For non-financial assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the statement of income unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal, the depreciation expense is adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining life.

#### Goodwill

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Company's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquired entity at the date of acquisition.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment, annually or more frequently, if events or changes in circumstances indicate that the carrying value may be impaired.

Impairment is determined by assessing the recoverable amount of the cash generating unit to which the goodwill relates. Where the recoverable amount of the cash generating unit is less than the carrying amount, an impairment loss is recognized. A previously recorded impairment loss for goodwill can never be reversed.

### Product Classification

#### *Insurance Contracts*

Insurance contracts are defined as those contracts under which the Company (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder. As a general guideline, the Company defines significant insurance risk, by comparing benefits paid with benefits payable if the insured event did not occur. Insurance contracts can also transfer financial risk. Financial risk is the risk of a possible future change in one or more of a specified interest rate, security price, commodity price, foreign exchange rate, index of price or rates, a credit rating or credit index or other variable.

Investment contracts mainly transfer financial risk but can also transfer insignificant insurance risk.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire. Investment contracts can however be reclassified as insurance contracts after inception if the insurance risk becomes significant.

### Insurance Contract Liabilities

#### *Short-term Insurance Contract Liabilities*

Insurance contract liabilities are based on the estimated ultimate cost of all claims incurred but not settled at the balance sheet date, whether reported or not, together with related claims handling costs and reduction for expected value of salvage and other recoveries. Significant delays can be experienced in the notification and settlement of certain type of insurance claims, particularly in respect of liability business, therefore the ultimate cost of which cannot be known with certainty at the balance sheet date.

#### *Provision for Unearned Premiums*

The proportion of written premiums, gross of commissions payable to intermediaries, attributable to subsequent periods is deferred as unearned premiums. The change in the provision for unearned premiums is taken to the statement of income in the order that revenue is recognized over the period of risk. Further provisions are made to cover claims under unexpired insurance contracts which may exceed the unearned premiums and the premiums due in respect of these contracts.

#### *Liability Adequacy Test*

At each balance sheet date, liability adequacy tests are performed, to ensure the adequacy of insurance contract liabilities. In performing the test, current best estimates of future cash flows, claims handling and policy administration expenses, as well as investment income from assets backing such liabilities, are used. Any inadequacy is immediately charged to the statement of income by establishing an unexpired risk provision for losses arising from the liability adequacy tests.

#### Provisions

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

#### Pension Cost

Pension cost is actuarially determined using the projected unit credit method. This method reflects services rendered by employees up to the date of valuation and incorporates assumptions concerning employees' projected salaries. Actuarial valuations are conducted with sufficient regularity, with option to accelerate when significant changes to underlying assumptions occur. Pension cost includes current service cost, interest cost, expected return on any plan assets, actuarial gains and losses, past service cost and the effect of any curtailment or settlement.

The pension benefit obligation recognized by the Company in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the balance sheet date less the fair value of the plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs that shall be recognized in later periods. The defined benefit obligation is calculated by an independent actuary using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using risk-free interest rates of government bonds that have terms to maturity approximating to the terms of the related pension liabilities. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are credited to or charged against income when the net cumulative unrecognized actuarial gains and losses at the end of the previous period exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plan.

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

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

### Revenue Recognition

#### *Premiums Revenue*

Premiums from short duration insurance contracts are recognized as revenue over the period of the contracts using the 24th method. The portion of the premiums written that relate to the unexpired periods of the policies at balance sheet dates is accounted for as Reserve for unearned premiums and presented in the liabilities section of the balance sheets. The related reinsurance premiums that pertain to the unexpired periods at balance sheet date are accounted for as reinsurance premiums reserve presented in the assets section of the balance sheets. The net changes in these accounts between balance sheet date are credited or charged to current operations.

#### *Interest income*

Interest income and expense are recognized in the statement of income as it accrues, taking into account the effective yield of the asset or liability or an applicable floating rate. Interest income and expense includes the amortization of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

#### *Dividend income*

Dividend income is recognized when the shareholders' right to receive the payment is established.

#### *Rental Income*

Rental income from investment property, which is accounted for on a straight-line basis over the lease term on an ongoing basis, is also recognized in investment income.

#### *Realized Gains and Losses*

Realized gains and losses on the sale of property and equipment are calculated as the difference between net sales proceeds and the net book value. Realized gains and losses on the sale of AFS financial assets are calculated as the difference between net sales proceeds and the original cost net of accumulated impairment losses. Realized gains and losses are recognized in the statement of income when the sale transaction occurred.

#### *Benefits and Claims*

Benefits and claims consist of benefits and claims paid to policyholders, which includes changes in the valuation of Insurance contract liabilities, except for changes in the Unearned premium provision which are recorded in premium income. It further includes internal and external claims handling costs that are directly related to the processing and settlement of claims. General insurance claims are recorded on the basis of notifications received.

### Leases

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

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

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

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

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

### Foreign Exchange Transactions

The functional and presentation currency of the Company is the Philippine Peso (₱). Transactions in foreign currencies are initially recorded in the exchange rate ruling at the date of the transaction. Foreign currency-denominated monetary assets and liabilities are translated at the rate of exchange ruling at the balance sheet date. Foreign currency exchange gains and losses are credited to or charged against current operations.

### Contingencies

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

### Events after Balance Sheet date

Post year-end events that provide additional information about the Company's position at the balance sheet date (adjusting events) are reflected in the financial statements. Post year-end events that are non-adjusting events are disclosed in the notes when material.

#### Future Changes in Accounting Policies

The Company has not yet adopted PFRS 7, *Financial Instruments: Disclosures* and complementary amendment to PAS 1, *Presentation of Financial Statements*. PFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, as well as sensitivity analysis to market risk. It replaces PAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, and the disclosure requirements in PAS 32, *Financial Instruments: Disclosure and Presentation*. It is applicable to all entities that report under PFRS.

The amendment to PAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Company is currently assessing the impact of PFRS 7 and the amendment to PAS 1 and expects that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by PFRS 7 and the amendment to PAS 1. The Company will apply PFRS 7 and the amendment to PAS 1 in 2007.

Philippine Interpretation IFRIC 11 IFRS 2 - *Company and Treasury Share Transactions*, will be effective January 1, 2008 for the Company. This interpretation requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme by the entity even if (a) the entity chooses or is required to buy those equity instruments (e.g., treasury shares) from another party, or (b) the shareholder(s) of the entity provide the equity instruments needed. It also provides guidance on how subsidiaries, in their separate financial statements, account for such schemes when their employees receive rights to the equity instruments of the parent. The Company currently does not have any stock option plan and therefore, does not expect this interpretation to have significant impact to its financial statements.

Philippine Interpretation IFRIC 12, *Service Concession Arrangements*, will become effective January 1, 2008. This interpretation, which covers contractual arrangements arising from entities providing public services, is not relevant to the Company's current operations.

PFRS 8, *Operating Segments*, will be effective January 1, 2009 and will replace PAS 14, *Segment Reporting*, and adopts a management approach to reporting segment information. PFRS 8 is required for adoption only by entities whose debt or equity instruments are publicly traded, or are in the process of filing with the SEC for purposes of issuing any class of instruments in a public market. The Company is not required and will not adopt PFRS 8.

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#### **4. Critical Accounting Estimates and Judgments**

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

Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

### Judgments

#### *(a) Impairment of AFS Financial Assets*

The Company determines that AFS investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment. In making this judgment, the Company evaluates among other factors, the normal volatility in price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance.

#### *(b) Held-to-Maturity (HTM) Investments*

The Company classifies nonderivative financial assets with fixed or determinable payments and fixed maturity as HTM. This classification requires significant judgment. In making this judgment, the Company evaluates its intention and ability to hold such investments to maturity. If the Company fails to keep these investments to maturity other than in certain specific circumstances - for example, sales that are so close to maturity - it will be required to reclassify the entire portfolio as AFS. The investment would therefore be measured at fair value and not at amortized cost.

### Estimates

#### *(a) Claims Liability Arising from Insurance Contracts*

For nonlife insurance contracts, estimates have to be made both for the expected ultimate cost of claims reported at the balance sheet date and for the expected ultimate cost of the claims incurred but not yet reported (IBNR) as of balance sheet date. It can take a significant period of time before the ultimate claim costs can be established with certainty and for some type of policies, IBNR claims form the majority of the balance sheet claims provision. The primary technique adopted by management in estimating the cost of notified and IBNR claims is that of using past claims settlement trends to predict future claims settlement trends. At each reporting date, prior year claims estimates are assessed for adequacy and changes made are charged to provision. Nonlife insurance claims provisions are not discounted for the time value of money.

The main assumption underlying the estimation of the claims provision is that a company's past claims development experience can be used to project future claims development and hence ultimate claims costs. As such, these methods extrapolate the development of paid and incurred losses, average costs per claim and claim numbers based on the observed development of earlier years and expected loss ratios. Historical claims development is mainly analyzed by accident years, but can also be further analyzed by geographical area, as well as by significant business lines and claim types. Large claims are usually separately addressed, either by being reserved at the face value of loss adjuster estimates or separately projected in order to reflect their future development. In most cases, no explicit assumptions are made regarding future rates of claims inflation or loss ratios. Instead, the assumptions used are those implicit in the historic claims development data on which the projections are based. Additional qualitative judgment is used to

assess the extent to which past trends may not apply in future, (for example to reflect one-off occurrences, changes in external or market factors such as public attitudes to claiming, economic conditions, levels of claims inflation, judicial decisions and legislation, as well as internal factors such as portfolio mix, policy conditions and claims handling procedures) in order to arrive at the estimated ultimate cost of claims that present the likely outcome from the range of possible outcomes, taking account of all the uncertainties involved. A margin for adverse deviation may also be included in the liability valuation.

The carrying value of insurance contract liabilities amounted to ₱1,150,224,187 and ₱766,850,638 as of December 31, 2006 and 2005, respectively.

(b) Estimated Allowance for Doubtful Accounts

The Company maintains the allowance for doubtful accounts at a level considered adequate to provide for potential uncollectible receivables. The level of this allowance is evaluated by management on the basis of factors that affect the collectibility of the accounts. The Company reviews the age and status of receivables, and identifies accounts that are to be provided with allowances on a regular basis.

The amount and timing of recorded expenses for any period would differ if the Company made different judgments or utilized different estimates. An increase in allowance for doubtful accounts would increase recorded expenses and decrease net income.

Provision for doubtful accounts amounted to ₱5,338,604 and ₱823,740 in 2006 and 2005, respectively (see Note 24). As of December 31, 2006 and 2005, loans and receivables, net of allowance for doubtful accounts, amounted to ₱78,846,390 and ₱95,296,795, respectively (see Note 7). Insurance receivables, net of allowance for doubtful accounts, amounted to ₱153,664,719 and ₱321,847,778 as of December 31, 2006 and 2005, respectively (see Note 6).

(c) Fair Values of Financial Assets

The Company carries certain financial assets at fair value, which requires use of accounting estimates and judgments. Fair value determinations for financial assets are based generally on listed or quoted market prices. If prices are not readily determinable or if liquidating the positions is reasonably expected to affect market prices, fair value is based on either internal valuation models or management's estimate of amounts that could be realized under current market conditions, assuming an orderly liquidation over a reasonable period of time. While significant components of fair value measurement were determined using verifiable objective evidence (i.e., foreign exchange rates, interest rates, volatility rates), the amount of changes in fair value of these financial assets would affect profit and loss and equity. As of December 31, 2006 and 2005, AFS financial assets amounted to ₱148,760,222 and ₱48,690,000, respectively (see Note 7).

(d) Estimated Useful Lives of Property and Equipment and Investment Property

The Company reviews annually the estimated useful lives of property and equipment and investment property based on the period over which the assets are expected to be available for use. It is possible that future results of operations could be materially affected by changes in these estimates. A reduction in the estimated useful lives of property and equipment and investment property would increase recorded depreciation and amortization expense and decrease the related asset accounts.

As of December 31, 2006 and 2005, property and equipment and investment property aggregated to ₱132,306,024 and ₱128,808,865, respectively (see Note 11 and 12).

*(e) Pension and Other Employee Benefits*

The determination of obligation and cost of pension and other employee benefits is dependent on the selection of certain assumptions used in calculating such amounts. Those assumptions include, among others, discount rate, expected return on plan assets and salary increase rate. In accordance with PFRS, actual results that differ from the Company's assumptions are accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods. While the Company believes that the assumptions are reasonable and appropriate, significant differences in the actual experience or significant changes in the assumptions may materially affect the pension obligations.

As of December 31, 2006 and 2005, the Company has unrecognized actuarial gains (losses) of ₱8,073,507 and (₱1,226,549) (see Note 25), respectively.

The Company also estimates other employee benefit obligations and expenses, including costs of paid leaves based on historical leave availments of employees subject to the Company's policies. These estimates may vary depending on the future changes in salaries and actual experiences during the year.

The accrued balance of other employee benefits as of December 31, 2006 and 2005 amounted to ₱3,976,522 and ₱2,505,030, respectively.

Contingencies

The Company is currently involved in various legal proceedings. The estimate of the probable costs for the resolution of these claims has been developed in consultation with the legal counsels and based upon an analysis of potential results. The Company currently does not believe these proceedings will have a material adverse effect on the Company's financial position. It is possible, however, that the results of operations could be materially affected by changes in the estimates.

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5. **Cash and Cash Equivalents**

This account consists of:

	<b>2006</b>	2005
Cash on hand and in banks	<b>₱125,762,010</b>	₱109,603,404
Short-term deposits	<b>136,990,662</b>	77,782,378
	<b>₱262,752,672</b>	₱187,385,782

Cash in banks earns interest at the prevailing bank deposit rates. Short-term deposits are made for varying periods of between one day and one month depending on the immediate cash requirements of the Company and earn interest at the prevailing short-term deposit rates.

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## 6. Insurance Receivables

This account consists of:

	2006	2005
Premiums receivable	P 87,287,330	P116,344,952
Due from brokers	40,271,654	73,191,376
Due from ceding companies	37,305,133	139,265,855
	<b>164,864,117</b>	328,802,183
Less allowance for doubtful accounts	11,199,398	6,954,405
	<b>P153,664,719</b>	P321,847,778

Included in the Company's insurance receivables as of December 31, 2005 are insurance receivables acquired from Insular General which are as follows:

	2005
Premiums receivable	P 38,726,534
Due from brokers	6,787,645
Due from ceding companies	126,511,457
	172,025,636
Less allowance for doubtful accounts	2,593,542
	<b>P169,432,094</b>

The carrying amounts disclosed above reasonably approximate fair values at year end.

Insurance receivables are all due within one year or less.

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## 7. Financial Assets

The Company's financial assets are summarized by measurement categories as follows:

	2006	2005
HTM financial assets	P 876,445,791	P676,474,858
AFS financial assets	148,760,222	48,690,000
Loans and receivables - net	78,846,390	95,296,795
	<b>P1,104,052,403</b>	P820,461,653

The assets included in each of the categories above are detailed below:

a) *HTM financial assets*

	<b>2006</b>	2005
Amortized cost	<b>₱876,445,791</b>	₱676,474,858
Fair value	<b>939,110,218</b>	694,370,434

The following presents the breakdown of HTM financial assets consisting of investments in bonds, government and other securities by contractual maturity dates as of December 31, 2006 and 2005:

	2006			2005		
	Due Within One Year	Due Beyond One Year	Total	Due Within One Year	Due Beyond One Year	Total
Government securities	<b>₱80,611,173</b>	<b>₱510,122,192</b>	<b>₱590,733,365</b>	₱183,023,041	₱376,669,321	₱559,692,362
Bonds and notes	<b>10,000,000</b>	<b>94,679,535</b>	<b>104,679,535</b>	-	45,353,876	45,353,876
Other securities	<b>2,451,234</b>	<b>178,581,657</b>	<b>181,032,891</b>	6,892,867	64,535,753	71,428,620
	<b>₱93,062,407</b>	<b>₱783,383,384</b>	<b>₱876,445,791</b>	₱189,915,908	₱486,558,950	₱676,474,858

As of December 31, 2006 and 2005, government securities totaling ₱65,400,000 are deposited with the IC in accordance with the provisions of the Insurance Code (the Code) as security for the benefit of policyholders and creditors of the Company.

b) *AFS financial assets*

	<b>2006</b>	2005
<b>At fair value:</b>		
Equity securities		
Listed and club shares	<b>₱144,931,242</b>	₱45,999,444
Unlisted	<b>3,828,980</b>	2,690,556
AFS recognized in the balance sheets	<b>₱148,760,222</b>	₱48,690,000

The costs of AFS financial assets are as follows:

	<b>2006</b>	2005
<b>At cost:</b>		
Equity securities		
Listed and club shares	<b>₱132,955,865</b>	₱42,743,971
Unlisted	<b>2,572,442</b>	6,798,378
Total AFS financial assets at cost	<b>₱135,528,307</b>	₱49,542,349

The unrealized gains in respect of AFS financial assets recorded under Revaluation Reserve for AFS financial assets amounted to ₱20,085,003 and ₱2,053,534 in 2006 and 2005, respectively. The amounts recognized and transferred to the statements of income from equity on derecognition and impairment amounted to ₱6,000,739 and ₱5,767,014 in 2006 and 2005, respectively.

c) *Loans and receivables*

	2006	2005
Reinsurance recoverable on paid losses	<b>₱48,034,234</b>	₱61,963,453
Accounts receivable	<b>13,376,608</b>	16,631,446
Car financing loans	<b>10,938,940</b>	8,616,509
Mortgage loans	<b>8,257,040</b>	8,752,208
	<b>80,606,822</b>	95,963,616
Less allowance for doubtful accounts	<b>1,760,432</b>	666,821
	<b>₱78,846,390</b>	₱95,296,795

The current and noncurrent portion of the loans and receivables are as follows:

	2006	2005
Current portion	<b>₱60,138,169</b>	₱78,723,227
Noncurrent portion	<b>18,708,221</b>	16,573,568
	<b>₱78,846,390</b>	₱95,296,795

The following presents the breakdown of car financing and mortgage loans by contractual maturity dates as of December 31, 2006 and 2005:

	2006	2005
<b>Car financing loans</b>		
Due within one year	<b>₱ 487,759</b>	₱ 723,264
Due over one year	<b>10,451,181</b>	7,893,245
	<b>₱10,938,940</b>	₱8,616,509

	2006	2005
<b>Mortgage loans</b>		
Due within one year	<b>₱ -</b>	₱ 71,885
Due over one year	<b>8,257,040</b>	8,680,323
	<b>₱ 8,257,040</b>	₱8,752,208

Mortgage and car financing loans earn interest ranging from 0% to 16% per annum and with maturity of 1 to 10 years.

Accounts receivable are all due within one year.

The following table sets forth the carrying values and estimated fair values of financial assets recognized as of December 31, 2006 and 2005. There are no material unrecognized financial assets as of December 31, 2006 and 2005.

	2006		2005	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Cash and cash equivalents	<b>₱262,752,672</b>	<b>₱262,752,672</b>	₱187,385,782	₱187,385,782
Insurance receivables - net	<b>153,664,719</b>	<b>153,664,719</b>	321,847,778	321,847,778
HTM financial assets	<b>876,445,791</b>	<b>939,110,218</b>	676,474,858	694,370,434
AFS financial assets	<b>148,760,322</b>	<b>148,760,323</b>	48,690,000	48,690,000
Loans and receivables - net	<b>78,846,390</b>	<b>78,144,434</b>	95,296,795	98,743,456

Fair values of financial assets are estimated as follows:

	Methods and Assumptions
Cash and cash equivalents	Due to the short-term nature of the instrument, the fair value approximates the carrying amount as of balance sheet date.
Debt securities (shown under HTM financial assets)	Fair values are based on quoted prices. For unquoted securities, fair value is determined by using the discounted cash flow methodology.
Equity securities (shown under AFS financial assets)	Fair values are based on quoted prices. For unquoted securities, carrying amounts (cost less allowance for impairment losses) approximate fair values due to the unpredictable nature of future cash flows and lack of suitable methods of arriving at reliable fair values.
Mortgage and car financing loans (shown as loans and receivables)	Fair values are estimated using the discounted cash flow technique that makes use of MART 1 rates. There is also an assumption that credit risk is minimal for such types of secured lending instruments.

## 8. Prepayments and Accrued Income

This account consists of:

	2006	2005
Accrued interest income	<b>₱24,610,871</b>	₱16,981,931
Rent receivable	-	104,825
Prepaid income tax	-	82,607
	<b>₱24,610,871</b>	<b>₱17,169,363</b>

Accrued interest income pertains mainly to interest accrued arising from cash and cash equivalents, investments in bonds and government securities, car financing and mortgage loans with interest rates ranging from 4.9% to 19.0% in 2006 and 4.7% and 22.8% in 2005.

## 9. Reinsurance Assets

This account consists of:

	2006	2005
RI recoverable on unpaid losses	<b>₱422,568,533</b>	₱118,432,512
Reinsurance premiums reserve	<b>121,909,403</b>	159,926,395
	<b>₱544,477,936</b>	<b>₱278,358,907</b>

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## 10. Deferred Acquisition Costs

The rollforward analysis of this account follows:

	2006	2005
At January 1	P 73,913,832	P 53,670,162
Cost deferred during the year	261,001,624	139,392,164
Amortization during the year	(220,578,836)	(119,148,494)
At December 31	<b>P114,336,620</b>	<b>P 73,913,832</b>

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## 11. Investment Property

The rollforward analysis of this account follows:

	2006	2005
Acquisition cost	<b>P29,217,064</b>	P29,217,064
Accumulated depreciation:		
At beginning of year	1,553,708	963,119
Depreciation for the year	590,589	590,589
At end of year	<b>2,144,297</b>	1,553,708
Net book value	<b>P27,072,767</b>	<b>P27,663,356</b>

Depreciation on investment property charged to operations amounted to P590,589 in 2006 and 2005 (see Note 24).

Rental income earned from investment property amounted to P2,265,485 and P2,949,431 in 2006 and 2005, respectively, which is included in investment income (see Note 20). Direct expenses incurred on the investment property were shouldered by the lessees.

The fair value of the investment property was estimated to be P29,367,360 and P35,289,000 as of December 31, 2006 and 2005, respectively. The property was independently valued by a professionally qualified appraiser using the Market Data Approach which considers the sales and listings of comparable property registered within the vicinity.

## 12. Property and Equipment

The rollforward analysis of this account follows:

	2006				
	Building and Building Improvements	Office Furniture and Equipment	Transportation Equipment	Leasehold Improvements	Total
<b>Cost:</b>					
As of January 1, 2006	₱95,684,389	₱58,820,440	₱ 25,133,158	₱7,731,242	₱187,369,229
Additions	485,179	11,377,276	4,452,904	2,722,802	19,038,161
Disposal	—	—	(1,680,455)	—	(1,680,455)
As of December 31, 2006	96,169,568	70,197,716	27,905,607	10,454,044	204,726,935
<b>Accumulated depreciation and amortization:</b>					
As of January 1, 2006	24,298,500	40,099,056	15,488,098	6,338,066	86,223,720
Additions	3,395,853	6,975,773	4,026,488	552,299	14,950,413
Disposal	—	—	(1,680,455)	—	(1,680,455)
As of December 31, 2006	27,694,353	47,074,829	17,834,131	6,890,365	99,493,678
<b>Net book value as of December 31, 2006</b>	<b>₱68,475,215</b>	<b>₱23,122,887</b>	<b>₱ 10,071,476</b>	<b>₱3,563,679</b>	<b>₱105,233,257</b>
	2005				
	Building and Building Improvements	Office Furniture and Equipment	Transportation Equipment	Leasehold Improvements	Total
<b>Cost:</b>					
As of January 1, 2005	₱95,666,662	₱48,949,713	₱ 22,552,741	₱6,443,395	₱173,612,511
Additions	17,727	10,472,982	5,984,767	1,287,847	17,763,323
Disposal	—	(602,255)	(3,404,350)	—	(4,006,605)
As of December 31, 2005	95,684,389	58,820,440	25,133,158	7,731,242	187,369,229
<b>Accumulated depreciation and amortization:</b>					
As of January 1, 2005	19,155,168	35,274,674	15,852,631	5,489,056	75,771,529
Additions	5,143,332	5,426,637	3,039,817	849,010	14,458,796
Disposal	—	(602,255)	(3,404,350)	—	(4,006,605)
As of December 31, 2005	24,298,500	40,099,056	15,488,098	6,338,066	86,223,720
<b>Net book value as of December 31, 2005</b>	<b>₱71,385,889</b>	<b>₱18,721,384</b>	<b>₱ 9,645,060</b>	<b>₱1,393,176</b>	<b>₱101,145,509</b>

Total depreciation and amortization expense of property and equipment amounted to ₱14,950,413 and ₱14,458,796 in 2006 and 2005, respectively (see Note 24).

## 13. Other Assets

Included in the Other assets account is the Company's 49.875% investment in MAIC Insurance Agency, which is carried at cost amounting to ₱249,375. The Company did not present consolidated financial statements because it is a subsidiary of Mapfre Internacional, the ultimate parent, with registered office address at Paseo de Recoletos, 25 28004 Madrid, Spain. Mapfre Internacional prepares and publishes consolidated financial statements for the Group. The financial statements prepared by the ultimate parent comply with IFRS.

#### 14. Trade and Other Liabilities

This account consists of:

	2006	2005
Output value-added tax	P29,523,297	P24,247,497
Taxes payable	17,888,945	31,192,904
Accounts payable	8,860,990	6,843,510
Accrued expenses	5,091,344	2,964,583
Income tax payable	2,296,555	-
Commissions payable	-	7,722,117
Others	32,821	916,682
	<b>P63,693,952</b>	<b>P73,887,293</b>

All liabilities are expected to be settled within twelve months after the balance sheet dates.

#### 15. Insurance Contract Liabilities and Reinsurance Assets

Short-term nonlife insurance liabilities may be analyzed as follows:

	Insurance Contract liabilities	Reinsurers' share of liabilities (Note 9)	Net 2006	Insurance contract liabilities	Reinsurers' share of liabilities (Note 9)	Net 2005
Provision for claims reported and loss adjustment expenses	P 599,384,462	P408,052,000	P191,332,462	P255,097,645	P109,373,292	P145,724,353
Provision for IBNR	37,099,095	14,516,533	22,582,562	23,906,630	9,059,220	14,847,410
<b>Total claims reported and IBNR</b>	<b>636,483,557</b>	<b>422,568,533</b>	<b>213,915,024</b>	<b>279,004,275</b>	<b>118,432,512</b>	<b>160,571,763</b>
Reserve for unearned premiums	513,740,630	121,909,403	391,831,227	487,846,363	159,926,395	327,919,968
<b>Total Insurance Contract Liabilities</b>	<b>P1,150,224,187</b>	<b>P544,477,936</b>	<b>P605,746,251</b>	<b>P766,850,638</b>	<b>P278,358,907</b>	<b>P488,491,731</b>

Provisions for claims reported by policyholders and IBNR may be analyzed as follows:

	Insurance contract liabilities	Reinsurers' share of liabilities	Net 2006	Insurance Contract Liabilities	Reinsurers' share of liabilities	Net 2005
At January 1, as previously stated	₱279,004,275	₱118,432,512	₱160,571,763	₱225,004,786	₱142,644,875	₱ 82,359,911
Reversal of catastrophe loss reserve (Notes 3 and 14)	-	-	-	(5,510,462)	-	(5,510,462)
At January 1, as restated	279,004,275	118,432,512	160,571,763	219,494,324	142,644,875	76,849,449
Claims incurred during the year (Note 22)	669,343,587	364,752,802	304,590,785	300,848,987	52,599,933	248,249,054
Claims paid - net of recoveries (Note 22)	(325,056,770)	(66,074,094)	(258,982,676)	(309,323,214)	(99,198,926)	(210,124,288)
Increase (decrease) in IBNR	13,192,465	5,457,313	7,735,152	(23,387,158)	(24,502,795)	1,115,637
Claims payable assumed from merger	-	-	-	91,371,336	46,889,425	44,481,911
<b>At December 31</b>	<b>₱636,483,557</b>	<b>₱422,568,533</b>	<b>₱213,915,024</b>	<b>₱279,004,275</b>	<b>₱118,432,512</b>	<b>₱160,571,763</b>

Provision for unearned premiums may be analyzed as follows:

	Insurance contract liabilities	Reinsurers' share of liabilities	Net 2006	Insurance Contract Liabilities	Reinsurers' share of liabilities	Net 2005
At January 1	₱ 487,846,363	₱159,926,395	₱327,919,968	₱325,277,138	₱109,750,571	₱215,526,567
New policies written during the year (Note 19)	1,188,998,997	342,499,053	846,499,944	880,137,486	322,439,508	557,697,978
Premiums earned during the Year	(1,163,104,730)	(380,516,045)	(782,588,685)	(787,499,295)	(292,385,205)	(495,114,090)
Unearned premiums reserve assumed from merger	-	-	-	69,931,034	20,121,521	49,809,513
<b>At December 31</b>	<b>₱ 513,740,630</b>	<b>₱121,909,403</b>	<b>₱391,831,227</b>	<b>₱487,846,363</b>	<b>₱159,926,395</b>	<b>₱327,919,968</b>

## 16. Other Insurance Contract Liabilities

This account consists of:

	2006	2005
Due to reinsurers	₱ 90,819,028	₱ 73,675,101
Funds held for reinsurers	31,735,976	24,232,171
Premium deposit fund	-	17,833,680
	<b>₱122,555,004</b>	<b>₱115,740,952</b>

The rollforward analysis of insurance balances payable follows:

	<b>Premiums due to reinsurers</b>	<b>Funds held for reinsurers</b>
<b>At January 1, 2005</b>	₱ 34,721,012	₱21,308,751
Arising during the year	252,012,351	18,921,622
Assumed from merger	37,548,961	5,306,339
Utilized	(250,607,223)	(21,304,541)
Foreign exchange adjustment	-	-
<b>At December 31, 2005</b>	73,675,101	24,232,171
Arising during the year	267,530,023	25,687,494
Utilized	(250,386,096)	(18,183,689)
Foreign exchange adjustment	-	-
<b>At December 31, 2006</b>	<b>₱90,819,028</b>	<b>₱31,735,976</b>

#### 17. Insurance Contract Liabilities and Reinsurance Assets - Terms, Assumptions and Sensitivities

##### Terms and Conditions

The major classes of general insurance written by the Company include motor, property, casualty, marine and engineering. Risks under these policies usually cover a 12-month duration.

For general insurance contracts, claims provisions (comprising provisions for claims reported by policyholders and IBNR claims) are established to cover the ultimate cost of settling the liabilities in respect of claims that have occurred and are estimated based on known facts at the balance sheet date.

The provisions are refined quarterly as part of a regular ongoing process as claims experience develops, certain claims are settled and further claims are reported. Outstanding claims provisions are not discounted for the time value of money.

The measurement process primarily includes projections of future claims through use of historical experience statistics. In certain cases, where there is a lack of reliable historical data on which to estimate claims development, relevant benchmarks of similar business are used in developing claims estimates. Claims provisions are separately analyzed by geographical area and class of business. In addition, claims are usually assessed by loss adjusters.

##### *Assumptions*

The principal assumption underlying the estimates is the Company's past claims development experience. This includes assumptions in respect of average claim costs, claims handling costs, claims inflation factors, and claim numbers for each accident year. Judgment is used to assess the extent to which external factors such as judicial decisions and government legislation affect the estimates.

Other key assumptions include variation in interest and delays in settlement changes in foreign currency rates.

*Sensitivities*

The general insurance claims provision is sensitive to the above key assumptions. The sensitivity of certain variables such as legislative change and uncertainty in the estimation process, is not possible to quantify. Furthermore, because of delays that arise between occurrence of a claim and its subsequent notification and eventual settlement, the outstanding claim provisions are not known with certainty at the balance sheet date.

Consequently, the ultimate liabilities will vary as a result of subsequent developments. Differences resulting from reassessments of the ultimate liabilities are recognized in subsequent financial statements.

The table below indicates the impact of changes in certain key assumptions in respect of general insurance business whilst other assumptions remain unchanged.

	Change in assumption %	Impact on insurance contract liabilities / reinsurance assets	Impact on profit before tax
Average claim costs	+ 7.08 %	₱12,687,731	(₱12,687,731)
Average number of claims	+ 25.35 %	45,448,295	(45,448,295)
Period of settlement	Within 12 months		

*Loss Development Table*

Reproduced below is an exhibit that shows the development of claims over a period of time on a gross and net reinsurance basis:

Accident year	2002 and prior	2003	2004	2005	2006	Total
<b>Estimate of ultimate claim costs:</b>						
At the end of accident year	₱159,855,276	₱185,719,867	₱344,687,223	₱277,461,829	₱682,536,056	₱1,650,260,251
One year later	257,955,362	287,332,810	497,717,383	370,955,414	-	1,413,960,969
Two years later	267,510,523	297,577,702	503,415,553	-	-	1,068,503,778
Three years later	267,954,394	296,947,238	-	-	-	564,901,632
Four years later	331,370,695	-	-	-	-	331,370,695
Current estimate of cumulative claims	331,370,695	296,947,238	503,415,553	370,955,414	682,536,056	2,185,224,956
Cumulative payments to date	258,799,451	294,564,988	470,511,680	239,883,944	284,981,336	1,548,741,399
<b>Total gross insurance liability in the balance sheet</b>	<b>₱ 72,571,244</b>	<b>₱ 2,382,250</b>	<b>₱ 32,903,873</b>	<b>₱131,071,470</b>	<b>₱397,554,720</b>	<b>₱ 636,483,557</b>

Accident year	2002 and prior	2003	2004	2005	2006	Total
<b>Estimate of ultimate claims costs:</b>						
At the end of accident year	₱141,295,488	₱136,278,902	₱179,302,653	₱249,364,691	₱312,325,941	₱1,018,567,675
One year later	137,291,078	130,790,709	288,234,334	251,125,479	-	807,441,600
Two years later	140,614,138	135,076,060	290,225,203	-	-	565,915,402
Three years later	140,699,206	135,412,652	-	-	-	276,111,859
Four years later	157,739,810	-	-	-	-	157,739,811
Current estimate of cumulative claims	157,739,810	135,412,652	290,225,203	251,125,479	312,325,941	1,146,829,085
Cumulative payments to date	137,621,260	134,577,810	286,163,441	217,723,319	156,828,231	932,914,061
<b>Total net insurance liability in the balance sheet</b>	<b>₱ 20,118,550</b>	<b>₱ 834,842</b>	<b>₱ 4,061,762</b>	<b>₱ 33,402,160</b>	<b>₱155,497,710</b>	<b>₱ 213,915,024</b>

## 18. Capital Stock

The details of this account follows:

	2006	2005
<i>Authorized</i>		
8,000,000 shares at ₱50 par value		
<i>Issued and outstanding</i>		
Balance at beginning of the year - 7,972,089 shares in 2006 and 6,000,000 shares in 2005	<b>₱398,604,450</b>	₱300,000,000
Issuance during the year - 27,911 shares in 2006 and 1,972,089 shares in 2005 (Note 2)	<b>1,395,550</b>	98,604,450
Balance at end of the period - 8,000,000 shares in 2006 and 7,972,089 shares in 2005	<b>₱400,000,000</b>	₱398,604,450

## 19. Net Insurance Revenue

Gross earned premiums on insurance contracts

	2006	2005
Insurance contract premiums revenue:		
Direct insurance (Note 29)	<b>₱ 778,453,017</b>	₱734,986,258
Assumed reinsurance	<b>410,545,980</b>	145,151,228
Total insurance contract premiums revenue	<b>1,188,998,997</b>	880,137,486
Gross change in unearned premium provision (Note 15)	<b>(25,894,267)</b>	(92,638,191)
<b>Total gross earned premiums on insurance</b>	<b>₱1,163,104,730</b>	₱787,499,295

Reinsurers' share of gross earned premiums on insurance contracts

	2006	2005
Reinsurers' share of insurance contract		
premiums revenue:		
Direct insurance (Note 29)	<b>₱247,313,976</b>	₱219,809,506
Assumed reinsurance	<b>95,185,077</b>	102,630,002
Total reinsurers' share of insurance contract		
premiums revenue	<b>342,499,053</b>	322,439,508
Reinsurers' share of gross change in unearned		
premium provision (Note 15)	<b>38,016,992</b>	(30,054,303)
<b>Total reinsurers' share of gross earned premiums</b>		
<b>  on insurance</b>	<b>380,516,045</b>	292,385,205
<b>Total net insurance revenue</b>	<b>₱782,588,685</b>	₱495,114,090

20. Investment Income

This account consists of:

	2006	2005
Interest income:		
HTM financial assets	<b>₱81,377,834</b>	₱45,134,432
Cash and cash equivalents	<b>10,747,968</b>	8,313,192
Loans	<b>2,175,426</b>	3,866,351
Other invested assets	<b>1,296,625</b>	945,019
FVPL financial assets	-	2,519,611
Dividend income	<b>4,795,899</b>	2,881,140
Rental income (see Notes 11, 29 and 32)	<b>2,265,485</b>	2,949,431
IMA trust fees	-	(112,343)
Loss on impairment of AFS financial		
assets	<b>(2,931,229)</b>	(5,767,015)
Other expense - net	<b>(1,291,166)</b>	(627,328)
	<b>₱98,436,842</b>	₱60,102,490

21. Realized Gains

This account consists of:

	2006	2005
Gain on sale of AFS financial assets	<b>₱8,931,968</b>	₱12,581,908
Gain (loss) on foreign exchange - net	<b>(5,886,133)</b>	214,150
Gain on sale of property and equipment	-	1,171,819
Gain on maturities of FVPL financial assets	-	644,777
	<b>₱3,045,835</b>	₱14,612,654

## 22. Net Insurance Benefits and Claims

Gross insurance contract benefits and claims incurred:

	2006	2005
Insurance contract benefits and claims incurred:		
Direct insurance	P594,686,781	P250,279,200
Assumed reinsurance	87,849,271	27,182,629
Change in provision for IBNR	(13,192,465)	23,387,158
<b>Total insurance contract benefits and claims incurred (Note 15)</b>	<b>P669,343,587</b>	<b>P300,848,987</b>

Reinsurers' share of gross insurance contract benefits and claims incurred:

	2006	2005
Reinsurers' share of insurance contract benefits and claims incurred:		
Direct insurance	P349,415,023	P15,477,544
Assumed reinsurance	20,795,092	12,619,594
Change in provision for IBNR	(5,457,313)	24,502,795
<b>Total reinsurers' share of general insurance contract benefits and claims incurred (Note 15)</b>	<b>P364,752,802</b>	<b>P52,599,933</b>

Gross insurance contract benefits and claims paid:

	2006	2005
Insurance contract benefits and claims paid:		
Direct insurance	P288,555,281	P287,155,905
Assumed reinsurance	36,501,489	22,167,309
<b>Total insurance contract benefits and claims paid (Note 15)</b>	<b>P325,056,770</b>	<b>P309,323,214</b>

Reinsurers' share of gross insurance contract benefits and claims paid:

	2006	2005
Reinsurers' share of insurance contract benefits and claims paid:		
Direct insurance	P63,567,293	P92,621,572
Assumed reinsurance	2,506,801	6,577,354
<b>Total reinsurers' share of general insurance contract benefits and claims paid (Note 15)</b>	<b>P66,074,094</b>	<b>P99,198,926</b>

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### 23. Finance Costs

This account consists of:

	2006	2005
Interest expense	₱1,437,957	₱1,952,047
Amortization of discount on off-market loans	280,051	313,157
	<b>₱1,718,008</b>	<b>₱2,265,204</b>

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### 24. General and Administrative Expenses

This account consists of:

	2006	2005
Salaries and benefits (Note 26)	₱ 78,443,481	₱ 62,590,926
Depreciation and amortization (Notes 11 and 12)	15,541,002	15,049,385
Defined benefit pension costs (Notes 25 and 26)	13,242,548	4,189,013
Entertainment, amusement and recreation	12,912,857	10,569,804
Professional and other fees	12,657,131	7,859,923
Advertising and promotions	11,499,179	10,364,941
Transportation and travel	7,831,872	4,948,722
Rent (Note 32)	7,618,119	5,508,704
Communications	7,598,003	6,469,923
Light and water	6,070,323	5,323,574
Stationery and supplies	5,348,605	2,983,017
Provision for doubtful accounts	5,338,604	823,740
Repairs and maintenance	5,091,628	4,357,699
Scholarship and training	2,821,212	1,481,012
Taxes and licenses	1,767,735	1,301,769
Insurance	1,381,663	984,539
Donations	688,232	581,781
Books and periodicals	157,917	298,946
Miscellaneous	237,109	297,019
	<b>₱196,247,220</b>	<b>₱145,984,437</b>

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### 25. Employee Benefits

#### *Pension plans*

The Company has a defined benefit plan, covering substantially all of its employees, which requires contribution to be made to administered funds. The plan is administered by a local bank as trustee.

The following tables summarize the components of net benefit expense recognized in the income statement and the funded status and amounts recognized in the balance sheet for the plan:

*Net Benefit Expense*

	2006	2005
Current service cost	<b>₱ 4,720,016</b>	₱2,968,916
Interest cost on benefit obligation	<b>5,374,395</b>	4,560,962
Expected return on plan assets	<b>(4,296,937)</b>	(3,340,865)
Past service cost - vested benefits	<b>7,339,751</b>	-
Past service cost - non-vested benefits	<b>105,323</b>	-
<b>Net benefit expense</b>	<b>₱13,242,548</b>	₱4,189,013
<b>Actual return on plan assets</b>	<b>₱ 7,758,683</b>	₱4,017,426

*Pension Benefit Obligation*

	2006	2005
Benefit obligation	<b>₱53,853,100</b>	₱44,786,621
Plan assets	<b>50,683,015</b>	36,569,676
	<b>3,170,085</b>	8,216,945
Unrecognized net actuarial losses (gains)	<b>(8,073,507)</b>	1,226,549
Unrecognized past service cost	<b>210,648</b>	-
<b>Pension benefit obligation</b>	<b>₱11,032,944</b>	₱ 6,990,396

Rollforward of unrecognized net actuarial losses (gains) are as follows:

At January 1, 2006	<b>₱1,226,549</b>
Actuarial gains on obligation	<b>(5,838,310)</b>
Actuarial gains on plan assets	<b>(3,461,746)</b>
<b>At December 31, 2006</b>	<b>(₱8,073,507)</b>

Changes in the present value of the defined benefit obligation are as follows:

	2006	2005
Opening defined benefit obligation	<b>₱44,786,621</b>	₱32,578,302
Interest cost	<b>5,374,395</b>	4,560,962
Current service cost	<b>4,720,016</b>	2,968,916
Benefits paid	<b>(2,845,344)</b>	(680,650)
Past service cost - vested benefits	<b>7,339,751</b>	-
Past service cost - non-vested benefits	<b>315,971</b>	-
Actuarial losses (gains) on obligation	<b>(5,838,310)</b>	5,359,091
<b>At end of year</b>	<b>₱53,853,100</b>	₱44,786,621

Experience adjustment in 2006 on the pension benefit obligation amounted to a gain of ₱8,130,620.

Changes in the fair value of plan assets are as follows:

	2006	2005
Opening fair value of plan assets	<b>₱36,569,676</b>	₱28,432,900
Expected return	<b>4,296,937</b>	3,340,865
Contributions by employer	<b>9,200,000</b>	4,800,000
Benefits paid	<b>(2,845,344)</b>	(680,650)
Actuarial gains on plan assets	<b>3,461,746</b>	676,561
At end of year	<b>₱50,683,015</b>	₱36,569,676

Experience adjustment in 2006 on the plan asset amounted to a gain of ₱2,891,463.

The Company expects to contribute ₱7.2 million to its defined benefit pension plan in 2007.

The distribution of the plan assets at year end is as follows:

	2006	2005
Bonds/Notes	<b>76.39%</b>	89.00%
Cash	-	0.01
Other investments	<b>23.61</b>	10.99
	<b>100.00%</b>	100.00%

The principal assumptions used in determining pensions for the Company's plan are shown below:

	2006	2005
Discount rate	<b>8.00%</b>	14.00%
Expected rate of return on plan assets	<b>11.75%</b>	11.75%
Rate of salary increase	<b>11.75%</b>	11.75%

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## 26. Personnel Expenses

	2006	2005
Salaries and wages	<b>₱57,501,958</b>	₱49,830,774
Others	<b>20,941,523</b>	12,760,152
Total salaries and benefits (Note 24)	<b>78,443,481</b>	62,590,926
Defined benefit pension costs (Notes 24 and 25)	<b>13,242,548</b>	4,189,013
	<b>₱91,686,029</b>	₱66,779,939

## 27. Income Taxes

The Company's net deferred tax asset (liability) consists of:

	2006	2005
Deferred tax assets on:		
Excess of unearned premiums per books over tax basis	<b>₱15,286,409</b>	₱20,330,900
Deferred reinsurance commissions	<b>6,542,552</b>	11,683,033
IBNR	<b>8,423,215</b>	6,476,594
Allowance for doubtful accounts	<b>3,887,949</b>	1,508,305
MCIT	<b>2,980,400</b>	1,556,424
Retirement liability	<b>3,309,883</b>	2,262,085
Unamortized past service cost	<b>1,356,233</b>	-
Accrued long-term employee benefits	<b>1,192,957</b>	751,509
Accrued rent expense	<b>390,188</b>	31,029
Unamortized discount of off-market loans	<b>111,341</b>	255,172
Unearned rent income	<b>118,965</b>	-
NOLCO	-	1,563,161
	<b>43,600,092</b>	46,418,212
Deferred tax liabilities on:		
Deferred acquisition costs	<b>46,560,369</b>	37,157,503
Accrued rent income	-	206,668
	<b>46,560,369</b>	37,364,171
Net deferred tax asset (liability)	<b>(₱ 2,960,277)</b>	₱ 9,054,041

As of December 31, 2006, the unexpired excess of the MCIT over the normal tax, which can be claimed as deductions against income tax due are as follows:

Year incurred	MCIT	Expiry Date
2006	₱1,943,295	December 31, 2009
2005	421,796	December 31, 2008
2004	615,309	December 31, 2007
	<b>₱2,980,400</b>	

The 2005 NOLCO amounting to ₱4,466,173, net of availments, was claimed as deduction from taxable income during 2006.

Movements in net deferred tax assets comprise of:

	2006	2005
At January 1	<b>₱9,054,041</b>	₱7,349,291
Amounts charged to income statement	<b>(12,014,318)</b>	4,222,978
Amounts charged to equity	-	(1,141,661)
Net deferred tax liability assumed from merger	-	(1,376,567)
At December 31	<b>(₱2,960,277)</b>	₱9,054,041

The reconciliation of statutory income tax rate to effective income tax rate is as follows:

	<b>2006</b>	2005
Statutory income tax rate	<b>35.00%</b>	32.50%
Tax effects of:		
Dividend income	<b>(1.19)</b>	(1.96)
Income already subjected to final tax	<b>(25.28)</b>	(27.75)
Nondeductible expense	<b>6.27</b>	6.88
Others	<b>7.12</b>	1.83
Effective income tax rate	<b>21.92%</b>	11.50%

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## 28. Management of Insurance and Financial Risk

### Governance Framework

The Company has established a risk management function with clear terms of reference and with the responsibility for developing policies on market, credit, liquidity, insurance and operational risks.

The policies define the Company's identification of risk and its interpretation, limit structure to ensure the appropriate quality and diversification of assets, alignment of underwriting and reinsurance strategy to the corporate goals and specify reporting requirements.

### Capital Management Framework

The Company's risk management function has developed and implemented certain minimum stress and scenario tests for identifying the risks to which each of its business units and the Company as a whole are exposed, quantifying their impact on the volatility of economic capital. The results of these tests, particularly the anticipated impact on the realistic balance sheet and revenue account of each business unit, are reported to the Company's risk management function. The risk management function then considers the aggregate impact of the overall capital requirement revealed by the stress testing to assess how much capital is needed to mitigate the risk of insolvency to a selected remote level.

### Regulatory Framework

Regulators are interested in protecting the rights of the policyholders and maintain close vigil to ensure that the Company is satisfactorily managing affairs for their benefit. At the same time, the regulators are also interested in ensuring that the Company maintains appropriate solvency position to meet liabilities arising from claims and that the risk levels are at acceptable levels.

The operations of the Company are subject to the regulatory requirements of the IC. Such regulations not only prescribe approval and monitoring of activities but also impose certain restrictive provisions (e.g. capital adequacy to minimize the risk of default and insolvency on the part of the insurance companies to meet the unforeseen liabilities as these arise).

### Financial Risk

The Company is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and insurance liabilities. In particular, the key financial risk is that the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance contracts. The most important components of this financial risk are credit risk, liquidity risk and market risk.

These risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The risk that the Company primarily faces due to the nature of its investments and liabilities is interest rate risk.

### *Credit Risk*

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

The Company manages the level of credit risk by setting up exposure limits for each counterparty or group of counterparties and industry segments; right of offset where counterparties are both debtors and creditors; guidelines on obtaining collaterals and guarantees; reporting of credit risk exposures; monitoring compliance with credit risk policy and review of credit risk policy for pertinence and changing environment.

The Company further restricts its credit risk exposure by entering into master netting arrangements with counterparties with which it transacts significant volumes of transactions. Although, such arrangements do not generally result in offset of balance sheet assets and liabilities, as transactions are usually settled on gross basis. However, the credit risk associated with such balances is reduced in the event of a default, when such balances are settled on a net basis. The situation may however change substantially within a short period following the balance sheet date because the exposure is affected by transactions subject to the arrangement.

Reinsurance is placed with high-rated counterparties and concentration of risk is avoided by following policy guidelines in respect of counterparties' limits that are set each year and are subject to regular reviews. At each year-end, management performs assessment of credit worthiness of reinsurers to update reinsurance purchase strategies and ascertain a suitable allowance for impairment of reinsurance assets.

In respect of investment securities, the Company secures satisfactory credit quality by setting maximum limits of portfolio securities with a single issuer or group of issuers, excluding those secured on specific assets and setting the minimum ratings for the issuer.

The Company sets the maximum amounts and limits that may be advanced to/placed with individual corporate counterparties which are set by reference to their long term ratings.

Credit risk exposure in respect of all other counterparties is managed by setting standard business terms that are required to be met by all counterparties. Commissions due to intermediaries are netted off against amounts receivable from them to reduce the risk of doubtful debts. The credit risk in respect of customer balances, incurred on nonpayment of premiums or contributions will only persist during the grace period specified in the policy document.

The Company did not have any significant concentration of credit risk with a single counterparty or group of counterparties and industry segments as of December 31, 2006.

*Liquidity Risk*

Liquidity or funding risk is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from either the inability to sell financial assets quickly at their fair values; or counterparty failing on repayment of a contractual obligation; or insurance liability falling due for payment earlier than expected; or inability to generate cash inflows as anticipated.

The major liquidity risk confronting the Company is the daily calls on its available cash resources in respect of claims arising from insurance contracts.

The Company manages liquidity risk by specifying minimum proportion of funds to meet emergency calls; setting up of contingency funding plans; specifying the sources of funding and the events that would trigger the plan; determining concentration of funding sources; reporting of liquidity risk exposures; monitoring compliance with liquidity risk policy and review of liquidity risk policy for pertinence and changing environment.

The table below analyzes financial assets and liabilities of the Company into their relevant maturity groups based on the remaining period at the balance sheet date to their contractual maturities or expected repayment dates.

<b>As of December 31, 2006</b>	<b>Up to a year</b>	<b>1-3 years</b>	<b>3-5 years</b>	<b>Over 5 years</b>	<b>Total</b>
Cash and cash equivalents	₱262,752,672	₱ –	₱ –	₱ –	₱ 262,752,672
Insurance receivables	153,664,719	–	–	–	153,664,719
Financial assets:					
HTM financial assets	93,062,407	206,417,848	348,683,929	228,281,607	876,445,791
AFS financial assets	148,760,222	–	–	–	148,760,222
Loans and receivables	60,138,169	5,130,698	4,859,022	8,718,501	78,846,390
Accrued income	24,610,871	–	–	–	24,610,871
<b>Total financial assets</b>	<b>742,989,060</b>	<b>211,548,546</b>	<b>353,542,951</b>	<b>237,000,108</b>	<b>1,545,080,665</b>
Trade and other liabilities	63,693,952	–	–	–	63,693,952
Insurance contract liabilities	636,483,557	–	–	–	636,483,557
Other insurance liabilities	122,555,004	–	–	–	122,555,004
Pension benefit obligation	11,032,944	–	–	–	11,032,944
<b>Total financial liabilities</b>	<b>₱833,765,457</b>	<b>₱ –</b>	<b>₱ –</b>	<b>₱ –</b>	<b>₱ 833,765,457</b>

It is unusual for a Company primarily transacting insurance business to predict the requirements of funding with absolute certainty as theory of probability is applied on insurance contracts to ascertain the likely provision and the time period when such liabilities will require settlement. The amounts and maturities in respect of insurance liabilities are thus based on management's best estimate based on statistical techniques and past experience.

*Market Risk*

Market risk is the risk of change in fair value of financial instruments from fluctuation in foreign exchange rates (currency risk), market interest rates (interest rate risk) and market prices (price risk), whether such change in price is caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market.

The Company structures levels of market risk it accepts through a market risk policy that determines what constitutes market risk for the Company; provides the basis used to fair value financial assets and liabilities; determines asset allocation and portfolio limit structure; sets out diversification benchmarks by type of instrument and geographical area; sets out the net exposure limits by each counterparty or group of counterparties, geographical and industry segments; control over hedging activities; reports of market risk exposures; monitors compliance with market risk policy and reviews the market risk policy for pertinence and changing environment.

*Currency Risk*

The Company's principal transactions are carried out in Philippine Peso and its exposure to foreign exchange risk arise primarily with respect to the US Dollar, as it deals with foreign reinsurers in its settlement of its obligations and receipt of any claim reimbursements.

The Company's financial assets are denominated in the same currencies as its insurance liabilities, which mitigate the foreign currency exchange rate risk for overseas operations. Thus the main foreign exchange risk arises from recognized assets and liabilities denominated in currencies other than those in which insurance liabilities are expected to be settled.

The table below summarizes the Company's exposure to foreign currency exchange risk as of December 31, 2006:

	2006		
	USD	CHF	PHP
Cash and cash equivalents	\$ 69,906	Chf244,354	₱12,999,895
HTM financial assets	1,866,362	–	91,698,082
Insurance receivables	63,583	–	3,125,103

*Interest Rate Risk*

Interest rate risk is the risk that the value/future cash flows of a financial instrument will fluctuate because of changes in interest rates.

The following table shows the information relating to the Company's exposure to fair value interest rate risk.

	Interest rates	Maturity				Total
		Within 1 year	2-3 years	4-5 years	Over 5 years	
HTM financial assets	5% - 19%	₱93,062,407	₱206,417,848	₱348,683,929	₱228,281,607	₱876,445,791
Loans and receivables	0% - 16%	60,138,169	5,130,698	4,859,022	8,718,501	78,846,390

The Company's interest rate risk policy requires it to manage interest rate risk by maintaining appropriate mix of fixed and variable rate instruments. The policy also requires it to manage the maturities of interest-bearing financial assets.

Insurance risk

The risk under an insurance contract is the risk that an insured event will occur, including the uncertainty of the amount and timing of any resulting claim. The principal risk the Company faces under such contracts is that the actual claims and benefit payments exceed the carrying amount of insurance liabilities. This is influenced by the frequency of claims, severity of claims, when actual benefits paid are greater than originally estimated and subsequent development of long-term claims.

The following table sets out the concentration of the claims liabilities by type of contract.

	Gross claims liabilities	Reinsurers' share of claims liabilities	Net claims liabilities
Accident	₱ 1,443,314	₱ (191,588)	₱ 1,634,902
Aviation/hull	23,212,246	12,172,414	11,039,832
Casualty	19,403,809	13,863,118	5,540,691
Engineering	21,935,839	21,316,830	619,009
Fire	339,337,554	299,897,056	39,440,498
Marine	54,223,595	46,714,814	7,508,781
Motorcar	117,436,363	2,297,282	115,139,081
Surety	59,490,837	26,498,607	32,992,230
	<b>₱636,483,557</b>	<b>₱422,568,533</b>	<b>₱213,915,024</b>

For general insurance contracts, the most significant risks arise from climate changes, natural disasters and terrorist activities. These risks vary significantly in relation to the location of the risk insured by the Company and types of risks insured.

The variability of risks is improved by diversification of risk of loss to a large portfolio of insurance contracts as a more diversified portfolio is less likely to be affected across the board by changes in any subset of the portfolio.

The variability of risks is also improved by careful selection and implementation of underwriting strategies, strict claims review policies to assess all new and ongoing claims, as well as the investigation of possible fraudulent claims. The Company also enforces a policy of actively managing and promptly pursuing claims, in order to reduce its exposure to unpredictable future developments that can negatively impact the Company.

The Company has also limited its exposure by imposing maximum claim amounts on certain contracts as well as the use of reinsurance arrangements. The purpose of these underwriting and reinsurance strategies is to limit exposure to catastrophes to a predetermined maximum amount based on the Company's premiums retained.

The majority of reinsurance business ceded is placed on a quota share basis with retention limits varying by product line and territory. Amounts recoverable from reinsurers are estimated in a manner consistent with the assumptions used for ascertaining the underlying policy benefits and are presented in the balance sheets as reinsurance assets.

Although the Company has reinsurance arrangements, it is not relieved of its direct obligations to its policyholders and thus a credit exposure exists with respect to the reinsurance ceded, to the extent that any reinsurer is unable to meet its obligations assumed under such reinsurance agreements.

The Company's placement of reinsurance is diversified such that it is neither dependent on a single reinsurer nor are the operations of the Company substantially dependent upon any single reinsurance contract. There is no single counterparty exposure that exceeds 5% of the total reinsurance assets at the balance sheet date.

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## 29. Related Party Transactions

Significant related party transactions are summarized below:

a. Compensation of key management personnel

Key management personnel of the Company includes all supervisors, managers and executives.

The summary of compensation of key management personnel is as follows:

	2006	2005
Salaries and other short term employee benefits	<b>₱43,266,267</b>	₱45,303,300
Post-employment benefits	<b>10,196,773</b>	3,134,305
	<b>₱53,463,040</b>	₱48,437,605

b. The Company enters into reinsurance transactions with its affiliate, Mapfre Re Compania de Reaseguros, S.A. (Mapfre Re). The total amount of reinsurance premiums ceded, related commissions and net outstanding liability to Mapfre Re for 2006 and 2005 follows:

	2006	2005
Reinsurance premiums ceded	<b>₱147,372,041</b>	₱151,657,220
Commission income	<b>12,933,199</b>	11,647,812
Net outstanding liability	<b>25,708,091</b>	14,738,086

c. In the ordinary course of business, the Company derives premium revenue from MAIC Insurance Agency (MIA), a subsidiary. Transactions with MIA for 2006 and 2005 are as follows:

	2006	2005
Premium revenue	<b>₱55,299,260</b>	₱51,756,808
Premiums receivable	<b>735,348</b>	1,248,890
Commission expense	<b>12,719,753</b>	12,130,572
Commission payable	<b>164,941</b>	227,640

Also, the Company leases a portion of its office premises to MIA. Rental income amounted to ₱327,765 in 2006 and 2005.

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### 30. Reconciliation of Net Income Under Philippine GAAP to Statutory Net Income

The reconciliation of net income under Philippine GAAP to statutory net income follows:

	2006	2005
Philippine GAAP net income	<b>₱110,518,261</b>	₱42,265,807
Add (deduct):		
Difference in change in reserve for unearned premiums - net	<b>(14,830,884)</b>	16,032,166
Deferred acquisition costs - net	<b>(40,422,788)</b>	(7,064,626)
Provision for IBNR	<b>2,642,831</b>	1,115,637
Tax effect of Philippine GAAP differences	<b>19,588,842</b>	(3,529,112)
<b>Statutory net income</b>	<b>₱ 77,496,262</b>	<b>₱48,819,872</b>

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### 31. Margin of Solvency (MOS)

The Company is required to maintain, at all times, a MOS equal to ₱500,000 or 10% of the total amount of its net premiums written during the preceding year, whichever is higher. The margin of solvency shall be the excess of the value of its admitted assets (as defined under the Code), exclusive of its paid-up capital, over the amount of its liabilities, unearned premiums and reinsurance reserves. Reserve for unearned premiums as of December 31, 2006, determined on the basis of the rates and amounts prescribed in the same Code, amounted to ₱348,155,773, which is lower than the Philippine GAAP net reserve by ₱43,675,454. The Philippine GAAP net reserve amounted to ₱391,831,227, which is the Reserve for unearned premiums amounting to ₱513,740,630 reduced by the Reinsurance premiums reserve amounting to ₱121,909,403 (see Note 15).

As of December 31, 2006, the estimated amount of non-admitted assets, as defined under insurance regulations, which are included in the accompanying balance sheets, follow:

Premiums in course of collection	₱ 35,351,537
Property and equipment – net	19,229,689
Deferred acquisition costs – net	114,336,920
Other assets	50,873,163
	<b>₱219,791,309</b>

The final amount of the MOS can be determined only after the accounts of the Company have been examined by the IC, specifically as to admitted and non-admitted assets as defined in the Insurance Code.

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### 32. Lease Commitment

#### The Company as lessee

Future minimum rentals payable under noncancelable operating leases as of December 31, 2006 follow:

Within one year	₱3,273,662
After one year but not more than five years	1,490,098
	<u>₱4,763,760</u>

#### The Company as lessor

The Company has entered into property leases on its investment property portfolio, consisting of the Company's surplus office spaces. These noncancelable leases have remaining noncancelable lease terms of below 5 years. All leases include a clause to enable upward revision of the rental charge on an annual basis based on prevailing market conditions.

Future minimum rentals receivable under noncancelable operating leases as of December 31, 2006 follow:

Within one year	₱ 7,440,479
After one year but not more than five years	9,556,408
	<u>₱16,996,887</u>

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### 33. Contingencies

The Company is a defendant in several lawsuits arising from the normal course of carrying out its insurance business. Provisions have been recognized in the financial statements to cover liabilities that may arise as a result of adverse decisions that may be rendered by the courts. The information usually required by PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, is not disclosed on the grounds that it can be expected to prejudice the Company's position with regard to the outcome of these claims.

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### 34. Notes to Statements of Cash Flows

The Company's principal noncash transaction in 2005 relates to the merger with Insular General as discussed in Note 2 to the financial statements.