



NATIONAL REINSURANCE CORPORATION OF THE PHILIPPINES



2004 ANNUAL REPORT

OUR COVER

*A*h, a garden full of trees, lush with green and where sunlight shows the way. Serene, vibrant and resplendent, you echo what's in us - strong and mighty as a security, pleasant to be with, focused in its ways.

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National Re believes in outstanding service to clients rather than competitive or predatory actions. Our strategies, way of doing business and employees' mindset are firmly anchored on this belief. We keep our employees aware that our Company's life depends on the labors of our clients, and that we must exert ourselves to give, at the very least, the same measure of service as we are receiving from our business partners. We strive to reciprocate in good measure our clients' initiatives, create an environment that fosters client creativity and empower them in the pursuit of their own goals through focused service.

CHAIRMAN'S MESSAGE

The Year 2004 came to a close with a bright note - the economy expanded at an unprecedented pace since the Asian financial crisis. The GDP grew at 6.1% and there was broad-based growth, as all sectors reflected significant gains over the previous year. Of particular significance was the turn around in the construction sector, which showed an 8.9% increase during the year after remaining in doldrums for a good number of years. Transportation and communication continued its rapid expansion pace, growing by 12.2%.

Your Company rode the growth in the economy. Gross premiums broke the ₱2.0 billion mark, as your Company registered a 12.5% increase in premiums. Total equity, likewise, reached an unprecedented level of more than ₱1.0 billion.

As globalization deepens, the expansion path of the Philippine economy will become clearer. At this time the road points to continuity in labor migration and agriculture, which appears to be the path fostered for the Philippines by the country-specialization economic system that globalization promotes. Remittances shall continue to bolster spending and labor migration will continue to play a major role in defining the economic landscape of the country in the foreseeable future. Government policy pronouncements and actions clearly support agriculture and micro-to-medium enterprises. This shall also impact on the economic environment.

Given the changing Philippine economic landscape and deepening globalization, your Company needs to brace itself and attune its policies and resources to their demands. We must have the financial strength and products that will support direct writers' quest for a share of the consumer's purse.

It is the desire to serve the interests of stakeholders that ceaselessly motivates your Company to seek avenues that would optimize the Company's value to its stakeholders, particularly shareholder-cessionaires. Financial strength, adequate capacity, steady stream of dividends and fair returns are what your Company relentlessly pursues. These were the same factors which influenced your Company to embark on a Capital Enhancement Programme ("CEP"). This programme should be pursued in order to make your Company a "Locally Dominant and Regionally Respected" professional reinsurer and ensure the Company's future growth and profitability.

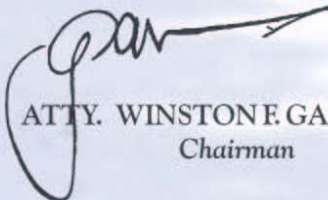
Your Company's vision to be the country's premier reinsurance company that consistently and efficiently services the reinsurance requirements of the domestic market has been achieved. This underscores the success of the various strategies and underwriting philosophy that your Company has been using. It is crucial however for your Company not to lose momentum, sustain its gains, scale greater heights and accomplish greater achievements in the future.

As an integral part of the insurance industry, your Company has the added responsibility to do its share and contribute to the overall effort to strengthen the economy. The importance of limiting, as much as possible, the outflow of resources of the industry cannot be overemphasized and the need to support one another and contribute more to nation building should be advocated by all concerned so that the insurance industry will grow. Along this line, rest assured that we at the GSIS shall be fully supportive. We are one with the Arroyo Administration in giving value to private initiatives, and would only be too happy to help spur the development of the insurance market in pursuit of national interest.

Your Company anticipates the market arena to be competitive in 2005. The road ahead for sure will have some rough spots. As before, your Company shall continue to focus on flexible and creative strategies, cost effectiveness and employee empowerment as the main instrument for achieving significant gains in its operation.

Your Company's achievements in 2004, and even in the years before that, were made possible through cooperative efforts of all stakeholders. Thus, in behalf of the Board of Directors, I wish to thank the officers and staff led by the President for their exemplary dedication to duty and commitment to their tasks, the Company's stockholder-cessionaires for their patronage, confidence and trust, and friends from the industry for their encouragement and support.

Thank you.



ATTY. WINSTONE E. GARCIA
Chairman

REPORT TO STOCKHOLDERS

TO ALL STOCKHOLDERS:

The Philippine economy continued in its growth path during the year 2004 as real Gross Domestic Product ("GDP") grew by 6.1%, which exceeded the official forecast of 4.9-5.8%. Likewise, Gross National Product ("GNP") surpassed expectation as it also rose by 6.1% due to robust growth in net factor income from abroad.

There was broad-based growth in 2004, as all economic sub-sectors in services, agriculture and industry sectors grew. Services, however, remained the banner sector in 2004, expanding by 7.3% as against the 5.8% growth in 2003.

Globalization continues to shape the economic landscape of the Philippines. Country-specialization seems to earmark agriculture and labor migration as the main growth engines for the Philippines.

The global reinsurance market experienced unprecedented natural catastrophe losses, estimated to reach more than US\$46 billion, during the year 2004. On the other hand, the local insurance industry, particularly the non-life sector, experienced a number of relatively large fire and marine single losses. However, in the absence of major Natural Peril losses, the market is still projected to produce, in general, a positive underwriting outcome for the year 2004.

For the year under review, I am pleased to report that your Company posted another year of achievements, as shown by the following results of operations.

FINANCIAL RESULTS

Your Company fared reasonably well during the year 2004. Its net income after tax reached ₱95.8 million, yielding a 9.71% return on equity. Stockholders' Equity showed moderate growth, expanding by 8.6% to ₱1,072.1 million at the end of the year. Earnings per share dropped to ₱15.66 from ₱21.39 during the preceding year mainly due to the increase in number of shares issued brought about by the 35% stock dividend declaration in 2004 coupled with the effects of extraordinary expenses related to your Company's Capital Enhancement Project.

UNDERWRITING OPERATIONS

The performance of your Company during the year was commendable. Amidst a broadly competitive market, your Company was able to maintain preferred signings. Our core philosophy of long-term commitment and flexible solutions has proven once again to be the key factor in maintaining strong client relationships.

In 2004, your Company was able to improve underwriting profit even under pressure from competitive forces.

- Gross Premiums surpassed the ₱2.0 billion mark, as it reached ₱2.042 billion, an increment of ₱228 million or 12.5% over the 2003 gross premiums of ₱1.814 billion.
- Net Premiums Retained stood at ₱591 million, 7.1% higher than the 2003 retention.
- Loss ratio dropped slightly from 60.8% in 2003 to 60.0% in 2004.
- By line of business, Casualty remained the biggest contributor to total production at 47.0% or ₱960 million, which was 32.6% higher than the previous year's level of ₱724 million. This was followed by Fire with a contribution of 27.1% or ₱553 million, down by 20.6% against the preceding year's production of ₱696 million. Marine & Aviation, combined, accounted for 20.9% or ₱426 million, up by 30.4% from ₱327 million in 2003. Life insurance continued to expand at a fast pace, growing by 52.7% from ₱67 million in 2003 to ₱103 million in 2004 and contributing 5.0% to gross premiums.
- Underwriting Income amounted to ₱93.5 million, higher by a whopping 42.4% over that of the previous year. The increase in underwriting profit was due to stricter underwriting and continued adherence to minimum rates in respect of Earthquake and Natural Perils. These propelled underwriting margin in the Property line by 59.4% despite the 20.6% drop in premiums, which enabled Fire to contribute ₱36.9 million or 39.5% to total Underwriting Income. Casualty remained the biggest contributor, as it chipped in 57.1% or ₱53.3 million to underwriting profit. Life added ₱11.7 million or 12.5% to total Underwriting Income. On the other hand, Marine dragged down profitability by 9.1% as it posted an underwriting loss.
- Expense ratio increased from 12.1% to 16.7%, mainly due to extraordinary expenses incurred on account of the Company's Capital Enhancement Program.

Your Company's corporate philosophy of underwriting for profit contributed greatly to its success. The corporate strategy of selective yet flexible and focused underwriting, diversity in business and investment portfolio has continued to work well.

INVESTMENTS

Your Company remained conservative in its investment policy, as it focused mainly on government securities, a strategy that has served it well in the past, and more so during this period of prolonged bearishness of the equity market. Investments during the year were heavily biased in favor of fixed-rate treasury notes/T-bills, which accounted for 92.3% of total investment portfolio. Equity investments, on the other hand, accounted for only 7.7%. Total Investment and Other Income in 2004 amounted to ₱122.0 million, almost the same level as that of last year.

OUTLOOK and PLANS

Your Company expects the soft market to exert pressures on its pricing policy as direct insurers compete to maintain or increase market share. The relatively good overall underwriting result in the past couple of years will also add pressure on prices, even for Natural Perils, to decline to a level that may not be sustainable in the long term.

It is for this reason that your Company has persisted in adopting its renewal condition of maintaining minimum Natural Perils premium for its inward 2005 treaty portfolio. Underwriting sense dictates that to do otherwise would make writing Natural Perils uneconomical.

Also, in the coming year, we share the concerns of analysts and global reinsurers that the very short turn-around period from hard to soft market did not allow sufficient breathing spell for most reinsurance companies to recover their losses. Reserve additions brought about by old claims like asbestos and the increasing frequency and magnitude of natural catastrophe events will likely impact on the financial strength of some global reinsurers. Whether or not these would be sufficient to convince some market reinsurers to at least maintain established underwriting discipline remains to be seen.

The emerging economic landscape indicates that insurance products that cater to labor migrants such as telecommunication and dwellings, agri-business, liability covers and more animated foreign trade such as Marine and Aviation would be growth areas.

While Investment yields are expected to be better in 2005 than in the last few years, these are not likely to head towards a level high enough to allow for subsidization of premium rates, unhealthy competition and a mad scramble for market share.

Given the above conditions, your Company is not too optimistic that the very satisfactory underwriting results posted by most Philippine insurance companies will be repeated in 2005.

Under this operating environment, your Company will stay cautious and focused in its underwriting to minimize the effect of the soft market condition on our 2005 operating results. It shall offer products and support ceding companies' activities in the identified growth areas.

Your Company has braced itself to face the many challenges that lie ahead. It is steadfast in its resolve to have sound business fundamentals such as capital strength and efficient and effective manpower capabilities. It has faced squarely the challenges and opportunities of the past year and will rigidly follow established strategies and action plans.

With your unselfish support and understanding, your Company will pursue its capital enhancement activities in order to provide greater capacity and more value added services to its clients and better returns to its stockholders-cessionaires in the future.

The present operating environment undoubtedly makes the goals your Company has set for this year appear tough, but with your unwavering support and cooperation, we are convinced that your Company will achieve its target of greater growth and higher profit this year.

On behalf of the Management, I wish to express our sincerest gratitude to the Members of the Board of Directors, Stockholder-cessionaires, Company personnel and industry friends for their invaluable contributions towards the achievement of your Company's goals and missions.

Thank you.



WILFRIDO C. BANTAYAN
President

FINANCIAL HIGHLIGHTS

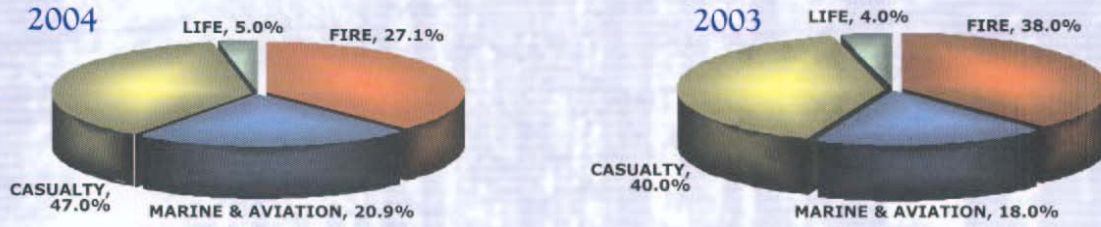
	<u>2004</u>	<u>2003</u>	<u>Increase/(Decrease)</u>	
			<u>Amount</u>	<u>%</u>
Gross Premiums	P 2,041,583,755	P 1,813,944,006	P 227,639,749	12.55
Net Premiums	591,258,410	551,890,732	39,367,678	7.13
Net Losses Incurred	343,032,780	309,923,080	33,109,700	10.68
Underwriting Income	93,464,667	65,655,421	27,809,246	42.36
Investment & Other Income	121,897,495	122,035,924	(138,429)	(0.11)
Net Income After Tax	95,795,495	97,183,009	(1,387,514)	(1.43)
Earnings Per Share*	15.66	21.39	(5.73)	(26.79)
Total Assets	2,334,401,774	2,461,618,866	(127,217,092)	(5.17)
Stockholders' Equity	1,072,133,611	987,014,342	85,119,269	8.62
Book Value Per Share*	175.25	217.23	(41.98)	(19.33)
Return on Equity**	9.71%	10.71%	(1%)	(9.34)
General Expenses	98,505,630	66,537,386	31,968,244	48.05
Ratio of General Expenses to Net Premiums	16.66%	12.06%	4.60%	38.14
Combined Ratio	99.56%	97.19%	2.37%	2.44
Loss Ratio	59.95%	60.75%	(.80%)	(1.32)
Commission Ratio	22.95%	24.38%	(1.43%)	(5.87)
Expense Ratio	16.66%	12.06%	4.60%	38.14

*Based on 6,142,365 issued and outstanding shares of stocks less 24,717 Treasury Stocks in 2004 and 4,552,185 issued and outstanding shares of stocks less 8,600 Treasury Stocks in 2003.

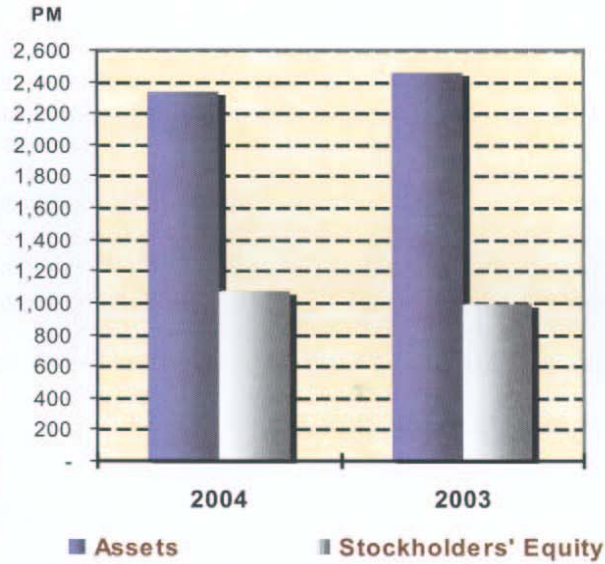
**Based on preceding year's stockholders' equity.

FINANCIAL GRAPHS

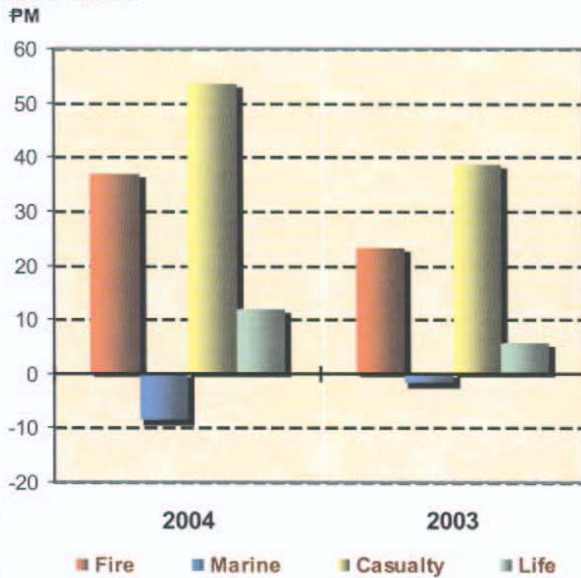
DISTRIBUTION OF GROSS PREMIUMS BY LINE OF BUSINESS, 2003-2004



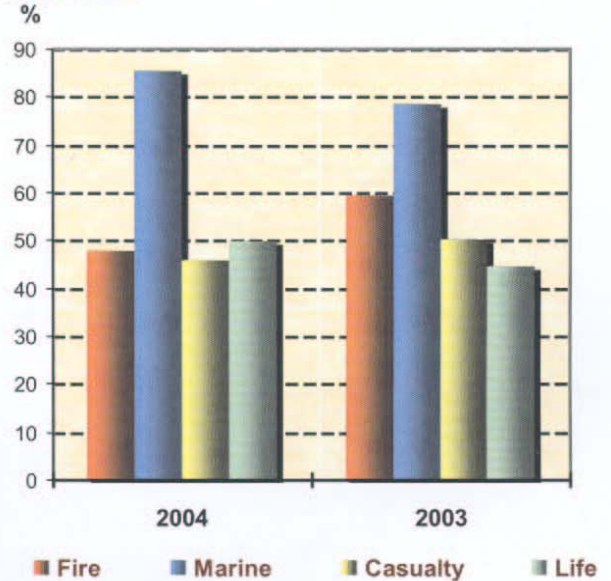
TOTAL ASSETS & STOCKHOLDERS' EQUITY, 2003-2004



UNDERWRITING INCOME BY LINE OF BUSINESS, 2003-2004



LOSS RATIO BY LINE OF BUSINESS, 2003-2004



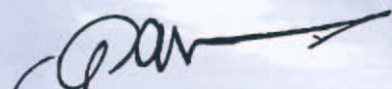
STATEMENT OF RESPONSIBILITY MANAGEMENT'S FOR FINANCIAL STATEMENTS

The management of National Reinsurance Corporation of the Philippines is responsible for all information and representations contained in the financial statements for the year ended December 31, 2004. The financial statements have been prepared in conformity with generally accepted accounting principles and reflect amounts that are based on the best estimate and informed judgement of management with an appropriate consideration to materiality.

In this regard, management maintains a system of accounting and reporting which provides for the necessary internal controls to ensure that transactions are properly authorized and recorded, assets are safeguarded against unauthorized use or disposition and liabilities are recognized.

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

Punongbayan & Araullo, the independent auditors appointed by the stockholders, has examined the financial statements of the Company in accordance with generally accepted auditing standards and has expressed its opinion on the fairness of presentation upon completion of such examination, in its report to stockholders.



ATTY. WINSTON E. GARCIA
Chairman



WILFRIDO C. BANTAYAN
President



MANUEL U. CO
Treasurer

REPORT OF INDEPENDENT AUDITORS

*The Board of Directors
National Reinsurance Corporation of the Philippines*

We have audited the accompanying balance sheets of National Reinsurance Corporation of the Philippines as of December 31, 2004 and 2003, and the related statements of income, changes in equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the Philippines. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of National Reinsurance Corporation of the Philippines as of December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in accordance with generally accepted accounting principles in the Philippines.

Punongbayan & Ocasio
PTRN 09454913
January 14, 2005
Makati City

March 29, 2005

BALANCE SHEETS

DECEMBER 31, 2004 AND 2003

	2004	2003
<u>ASSETS</u>		
Cash and Cash Equivalents (Note 4)	P 68,804,330	P 31,827,453
Short-term Investments (Note 5)	-	78,507,521
Reinsurance Balances Receivable - Net (Note 6)	1,303,507,625	1,288,942,588
Deferred Acquisition Costs - Net	48,058,667	41,716,242
Investments (Notes 3, 7, 9 and 13)		
Government securities	776,457,541	882,194,209
Shares of stock	64,408,859	56,448,393
Property and Equipment - Net (Note 8)	47,947,378	51,341,087
Other Assets (Notes 7 and 9)	25,217,374	30,641,373
TOTAL ASSETS	P 2,334,401,774	P 2,461,618,866
<u>LIABILITIES AND EQUITY</u>		
Reinsurance Balances Payable (Note 6)	P 993,360,796	P 1,237,756,058
Reserve for Unexpired Risks	228,418,689	209,343,101
Catastrophe Loss Reserve (Note 14)	12,697,073	10,300,592
Accounts payable and accrued expenses	5,231,861	7,153,589
Income tax payable	4,846,981	3,261,682
Deferred tax liabilities (Notes 3, 7, and 13)	17,712,763	6,789,502
	1,262,268,163	1,474,604,524
EQUITY		
Capital stock (Note 15)	614,236,500	455,218,500
Treasury shares (Note 15)	(5,552,798)	(2,001,014)
Reserve for fluctuation in value of investment in shares of stock - net of deferred tax liability of P7,267,818 in 2004 (Notes 3, 7 and 13)	11,824,336	11,480,688
Accumulated foreign exchange differences in investments in shares of stock of a foreign entity- net of deferred tax liability of P7,809,615 in 2004 (Notes 3, 7 and 13)	16,595,431	24,056,046
Retained earnings (Notes 14 and 15)	435,030,142	498,260,122
Total Equity	1,072,133,611	987,014,342
TOTAL LIABILITIES AND EQUITY	P 2,334,401,774	P 2,461,618,866

STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
Reinsurance Premium Income		
Reinsurance premiums - net of returns	P 2,041,583,755	P 1,813,944,006
Retroceded premiums	<u>1,450,325,345</u>	<u>1,262,053,274</u>
Reinsurance premiums retained	591,258,410	551,890,732
Increase in reserve for unexpired risks	<u>(19,075,588)</u>	<u>(41,764,996)</u>
	<u>572,182,822</u>	<u>510,125,736</u>
Underwriting Deductions		
Share in claims and losses	343,032,780	309,923,080
Commissions - net	<u>135,685,375</u>	<u>134,547,235</u>
	<u>478,718,155</u>	<u>444,470,315</u>
Net Underwriting Income	93,464,667	65,655,421
Investments and Other Income (Notes 4, 5, 7 and 11)	<u>121,897,495</u>	<u>122,035,924</u>
Income After Investments and Other Income	215,362,162	187,691,345
General and Administrative Expenses (Notes 10 and 12)	<u>98,505,630</u>	<u>66,537,386</u>
Income Before Tax	116,856,532	121,153,959
Tax Expense (Notes 3 and 13)	<u>21,061,037</u>	<u>23,970,950</u>
Net Income	<u>P 95,795,495</u>	<u>P 97,183,009</u>

See Notes to Financial Statements

STATEMENTS OF CHANGES IN EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

	2004	2003
Capital Stock (Note 15)		
Balance at beginning of year	P 455,218,500	P 421,504,600
Issuance of shares	159,018,000	33,713,900
Balance at end of year	<u>614,236,500</u>	<u>455,218,500</u>
Treasury Shares - At Cost (Note 15)		
Balance at beginning of year	2,001,014	-
Acquisition of shares	3,551,784	2,001,014
Balance at end of year	<u>5,552,798</u>	<u>2,001,014</u>
Reserve for Fluctuation in Value of Investments in Shares of Stock (Note 7)		
Balance at beginning of year	11,480,688	11,587,334
Net increase (decrease) in value of investments during the year:		
Increase (decrease) during the year	7,611,466	(106,646)
Effect of adoption of new accounting standard on income taxes (Notes 3 and 13)	(7,267,818)	-
	<u>343,648</u>	<u>(106,646)</u>
Balance at end of year	<u>11,824,336</u>	<u>11,480,688</u>
Accumulated Foreign Exchange Differences in Investment in Shares of Stock of a Foreign Entity (Note 7)		
Balance at beginning of year	24,056,046	22,819,546
Net increase (decrease) in value of investments during the year:		
Increase during the year	349,000	1,236,500
Effect of adoption of new accounting standard on income taxes (Notes 3 and 13)	(7,809,615)	-
	<u>(7,460,615)</u>	<u>1,236,500</u>
Balance at end of year	<u>16,595,431</u>	<u>24,056,046</u>
Retained Earnings		
Appropriated for contingencies (Note 14)		
Balance at beginning of year	104,009,996	94,291,695
Additional appropriations during the year	9,579,549	9,718,301
Balance at end of year	<u>113,589,545</u>	<u>104,009,996</u>
Unappropriated		
Balance at beginning of year	394,250,126	357,365,970
Net income	95,795,495	97,183,009
Dividends (Note 15)		
Stock dividends - 35% in 2004 and 8% in 2003	(159,018,000)	(33,713,900)
Cash dividends	(7,475)	(16,866,652)
Appropriated for contingencies (Note 14)	(9,579,549)	(9,718,301)
Balance at end of year	<u>321,440,597</u>	<u>394,250,126</u>
	<u>435,030,142</u>	<u>498,260,122</u>
Total Equity	<u>P 1,072,133,611</u>	<u>P 987,014,342</u>

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

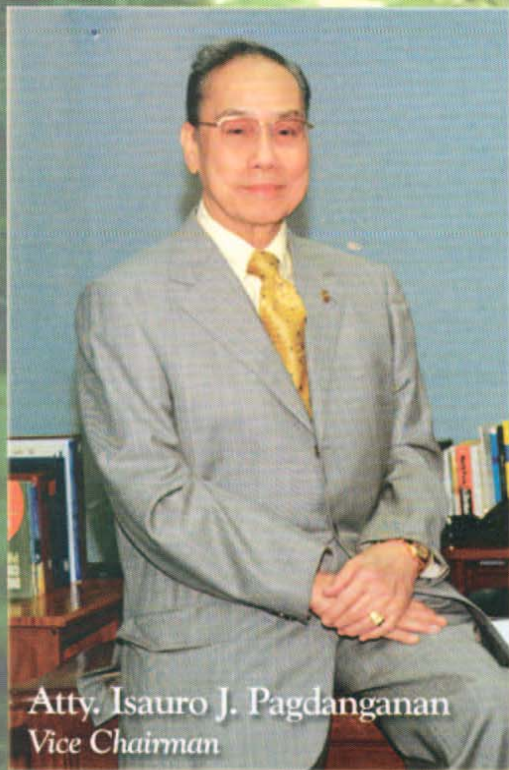
	<u>2004</u>	<u>2003</u>
Cash Flows from Operating Activities		
Income before tax	P 116,856,532	P 121,153,959
Adjustments for:		
Depreciation	4,567,710	4,602,588
Increase in catastrophe loss reserve	2,396,481	2,382,869
Dividend income	(2,472,990)	(223,575)
Gain on sale of investments	-	(388,942)
Increase in reserve for unexpired risks	19,075,588	41,764,996
Unrealized foreign currency gains	(9,058,019)	(7,910,368)
Interest income	(112,155,213)	(112,288,662)
Operating income before working capital changes	<u>19,210,089</u>	<u>49,092,865</u>
Increase in reinsurance balances receivable	(4,986,408)	(128,321,972)
Decrease (increase) in deferred acquisition costs	(6,342,425)	4,370,942
Decrease in other assets	343,210	278,722
Increase (decrease) in reinsurance balances payable	(247,796,246)	81,833,678
Increase (decrease) in accounts payable and accrued expenses	(1,921,728)	8,658,996
Cash generated from (used in) operations	<u>(241,493,508)</u>	<u>15,913,231</u>
Cash paid for income taxes	<u>(23,629,910)</u>	<u>(37,963,589)</u>
Net Cash Used in Operating Activities	<u>(265,123,418)</u>	<u>(22,050,358)</u>
Cash Flows from Investing Activities		
Proceeds from disposal/maturities of:		
Short-term investments	78,911,675	102,048,359
Investments in government securities	399,527,737	120,262,672
Investments in shares of stock	-	1,523,857
Property and equipment	-	17,250
Interest received	117,236,002	109,711,956
Dividends received	2,472,990	223,575
Acquisitions of:		
Short-term investments	-	(136,230,498)
Investments in government securities	(291,314,849)	(230,204,407)
Investments in shares of stock	-	(1,013,609)
Property and equipment	(1,174,001)	(4,439,690)
Net Cash from (Used in) Investing Activities	<u>305,659,554</u>	<u>(38,100,535)</u>
Cash Flows from Financing Activities		
Fractional shares paid	(7,475)	(6,468)
Treasury shares acquired	(3,551,784)	(2,001,014)
Cash dividends paid	-	(16,860,184)
Net Cash Used in Financing Activities	<u>(3,559,259)</u>	<u>(18,867,666)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	36,976,877	(79,018,559)
Cash and Cash Equivalents at Beginning of Year	<u>31,827,453</u>	<u>110,846,012</u>
Cash and Cash Equivalents at End of Year	P 68,804,330	P 31,827,453

See Notes to Financial Statements

NATIONAL REINSURANCE CORP. OF THE PHILIPPINES



Atty. Winston F. Garcia
Chairman of the Board



Atty. Isauro J. Pagdanganan
Vice Chairman



Wilfrido C. Bantayan
President



Manuel U. Co
Treasurer



Alfonso L. Salcedo, Jr.
Director



Armando C. Trinidad
Director



Joli Co Wu
Director



Josefina L. Valera
Director



Atty. Adelita A. Vergel de Dios
Director

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2004 AND 2003

1. CORPORATE INFORMATION

National Reinsurance Corporation of the Philippines (the "Company") was incorporated in 1978 by virtue of Presidential Decree No. 1270, as a domestic professional reinsurance firm to provide life and non-life reinsurance capacity to the Philippines and neighboring insurance markets. Under the Decree, it became the vehicle for the Philippine insurance industry's participation in the Asian Reinsurance Corporation, a multigovernment-initiated reinsurance entity, based in Bangkok, Thailand, which was established to foster regional cooperation among insurance companies doing business in Asia.

On May 28, 2004, the Company entered into a Memorandum of Agreement (MOA) with Universal Malayan Reinsurance Corporation (UMRC) for the merger of the two entities. The MOA contained certain provisions and conditions which the Parties agreed to meet and satisfy prior to the execution of a Plan of Merger. Subsequently, during a special stockholders' meeting held on January 21, 2005, the stockholders' votes in favor of the planned merger with UMRC did not meet the minimum legal requirement of 2/3 votes.

The registered office of the Company is located at 18th Floor, Philippine AXA Life Center, Sen. Gil J. Puyat Avenue corner Tindalo Street, Makati City.

The Company operates within the Philippines and had 87 employees as of December 31, 2004 and 2003.

The financial statements of the Company as of and for the years ended December 31, 2004 and 2003 were authorized for issue by the Company's Board of Directors (BOD) on March 29, 2005.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Preparation of Financial Statements

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) prescribed under Statement of Financial Accounting Standards (SFAS) 27, "Accounting and Reporting for the Nonlife Insurance Industry" and other relevant GAAP applicable to enterprises, in general. In certain respects, these principles and practices differ from GAAP in the Philippines followed by other enterprises in determining financial position and operating results. A summary of the more significant accounting policies under SFAS 27 follows:

a. *Reinsurance Premium Revenue Recognition*

Reinsurance premiums from short duration insurance contracts are recognized as revenue over the period of the contracts using the 24th method except for revenues from marine cargo risks which are recognized based on the relevant provisions of the Insurance Code. The portion of the reinsurance premiums retained that relate to the unexpired periods of the policies at balance sheet dates are accounted for as Reserve for Unexpired Risks and presented in the liability section of the balance sheets. The net changes in the account Reserve for Unexpired Risks between balance sheet dates are recognized in the statements of income.

b. *Claim Cost Recognition*

Share in liabilities for claim costs and claim adjustment expenses relating to insurance contracts are accrued when insured events occur.

The share in liabilities for claims (including those for incurred but not reported) are based on the estimated ultimate cost of settling the claims. The method of determining such estimates and establishing reserves are continually reviewed and updated. Changes in estimates of claim costs resulting from the continuous review process and differences between estimates and payments for claims are recognized as income or expense of the period in which the estimates are changed or payments are made.

Share in recoveries on claims are evaluated in terms of the estimated realizable values of the salvage recoverables. Recoveries on settled claims are recognized in the statements of income in the period the recoveries are made while estimated recoveries on unsettled claims are deducted from the liability for unpaid claims.

c. *Acquisition Costs*

Costs that vary with and are primarily related to the acquisition of new and renewal reinsurance contracts such as commissions, certain underwriting costs and inspection fees, are deferred and charged to expense in proportion to reinsurance premium revenue recognized. Unamortized acquisition costs are shown in the balance sheets as Deferred Acquisition Costs.

d. *Commission on Retrocessions*

Commission on retrocessions are deferred and deducted from the applicable deferred acquisition costs, subject to the same amortization method as the related acquisition costs.

The financial statements have been prepared on a historical cost basis except for the measurement at market or book value of investments in shares of stock.

The accounting policies have been consistently applied by the Company and are consistent with those used in the previous year, except for the adoption of new accounting standards as stated in the next page.

Adoption of New Accounting Standards

In 2004 and 2003, the Company adopted the following Statements of Financial Accounting Standards ("SFAS")/International Accounting Standards ("IAS") issued by the Accounting Standards Council ("ASC") which became effective on January 1, 2004 and 2003, respectively, and are relevant to the Company:

<u>2004</u>		
SFAS 12/IAS 12	:	Income Taxes
<u>2003</u>		
SFAS 8A	:	Deferral of Foreign Exchange Differences
SFAS 10/IAS 10	:	Events After the Balance Sheet Date
SFAS 37/IAS 37	:	Provisions, Contingent Liabilities and Contingent Assets
SFAS 38/IAS 38	:	Intangible Assets

The effects of the Company's adoption in 2004 of SFAS 12/IAS 12 are discussed in Note 3. The adoption of the other new accounting standards did not result in material adjustments to the financial statements of the current and prior years.

Certain accounts in the 2003 financial statements have been reclassified to conform to the 2004 presentation and classification.

Impact of New and Revised Accounting Standards Effective Subsequent to 2004

In 2004, the ASC issued a series of new accounting standards that are adopted from existing IAS, revised IAS and new International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board ("IASB"). The new ASC accounting standards are effective in the Philippines for financial statements covering periods beginning on or after January 1, 2005. Also, the ASC re-named its accounting standards to correspond better with the IASB pronouncements. Philippine Accounting Standards ("PASs") correspond to the adopted IASs, while Philippine Financial Reporting Standards ("PFRSs") correspond to the adopted IFRSs. Existing SFASs and SFASs/IASs not yet superseded will be reissued by the ASC as PASs.

The new ASC pronouncements that are effective in 2005 and are relevant to the Company are the following:

PAS 1	:	Presentation of Financial Statements
PAS 8	:	Accounting Policies, Changes in Accounting Estimates and Errors
PAS 10	:	Events after the Balance Sheet Date
PAS 16	:	Property, Plant and Equipment
PAS 19	:	Employee Benefits
PAS 21	:	The Effects of Changes in Foreign Exchange Rates
PAS 24	:	Related Party Disclosures
PAS 29	:	Financial Reporting in Hyperinflationary Economies
PAS 32	:	Financial Instruments: Disclosures and Presentation
PAS 36	:	Impairment of Assets
PAS 38	:	Intangible Assets
PAS 39	:	Financial Instruments: Recognition and Measurement
PAS 40	:	Investment Property
PFRS 1	:	First-time Adoption of PFRS
PFRS 4	:	Insurance Contracts

The Company will apply the relevant new accounting standards in 2005 in accordance with their transitional provisions. It is currently evaluating the impact of those standards on its financial statements and has initially determined that the following new standards may have significant effects on the financial statements for 2005, as well as for prior and future periods:

- PAS 19, *Employee Benefits*. This new accounting standard prescribes the accounting and disclosure by employers for employee benefits. Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees. These benefits include short-term benefits (such as short-term compensated absences and profit sharing and bonus plans), post-employment benefits (such as pension plans), other long-term benefits (such as long-service leave or sabbatical leave) and termination benefits. Presently, the Company provides short-term benefits to its employees and recognizes employee benefits on its defined benefit retirement plan.
- PAS 21, *The Effects of Changes in Foreign Exchange Rates*. This new accounting standard requires the recognition of foreign exchange differences as income or as expenses in the period in which they arise and allows capitalization of foreign exchange losses only under certain restrictive conditions. Currently, foreign exchange differences are recognized in the statements of income, except for the unrealized foreign exchange gain on investment in shares of stock of a foreign entity which is charged

to Accumulated Foreign Exchange Differences in Investment in Shares of Stock of a Foreign Entity account in the balance sheets.

- **PAS 32, *Financial Instruments: Disclosures and Presentation*.** PAS 32 prescribes the requirements for the presentation of financial instruments and identifies information that should be disclosed about them. The presentation requirements apply to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments, as well as the classification of the related income and expense items. The required disclosures include information that affect the amount, timing and certainty of future cash flows relating to the financial instruments, the accounting policies applied to those instruments and the risks associated with them and management's policies for controlling those risks. The standard also requires and provides guidance on the separation of the liability and equity components of a compound financial instrument.
- **PAS 39, *Financial Instruments: Recognition and Measurement*.** This new standard prescribes the principles for recognizing, measuring and disclosing information about financial instruments in the financial statements of companies. It requires initial recognition of a financial asset or liability at fair value, which is normally the transaction price (i.e., the fair value of the consideration given or received). Subsequent measurement is at fair value, amortized cost using the effective interest method, or cost depending on the classification of the financial asset or liability. Recognition of gains or losses mainly from changes in the fair values, amortization, impairment and derecognition also depends on the classification of the financial instruments. The initial adoption by the Company of PAS 39 in 2005 may give rise to recognition of previously unrecognized assets and liabilities, the derecognition of previously recognized assets and liabilities and recognition of gains or losses from fair value changes that may have material impact on its financial statements.
- **PFRS 4, *Insurance Contracts*.** PFRS 4 applies to all insurance contracts (including reinsurance contracts) that a company issues and to reinsurance contracts that it holds. Phase I of this standard requires that deposit components of some insurance contracts be accounted for separately to avoid omission of assets and liabilities from the balance sheet. This standard also prohibits recognition of liabilities relating to insurance contracts that are not in existence as of the balance sheet date (i.e., catastrophe and equalization provisions). Further, a test of the adequacy of recorded insurance liabilities and an impairment test for reinsurance assets are also required by PFRS 4. This standard also states that insurance liabilities should be recognized in the balance sheet until these are discharged, cancelled or expired and to present insurance liabilities in the balance sheet without offsetting against related reinsurance assets. PFRS 4 requires companies to disclose in the financial statements amounts that arise from insurance contracts and the estimated amount, timing and uncertainty of future cash flows from insurance contracts.

Cash and Cash Equivalents

Cash and cash equivalents are defined as cash on hand, demand deposits and short-term, highly liquid investments with maturity of three months or less and readily convertible to known amounts of cash.

Investments

Investments are initially recorded at cost at the time of acquisition, which is generally measured by the purchase price of the security, or the fair value of the asset given up or the security received in the exchange and other costs directly related to the acquisition. Subsequent to acquisition, the carrying values of the investments are determined as follows:

- Investments in government securities - These are carried at cost adjusted for amortization of premium or accretion of discount.
- Investments in shares of stock - Investments in shares of stock that are quoted in the stock exchange are carried at market value determined as of the balance sheet date. Investments in shares of stock which are not quoted in the stock exchange are carried at market or book values recommended by the Insurance Commission (IC) or book value based on the latest audited financial statements of the investee company; where such book or market value is not available, the investments are carried at cost. Any difference between aggregate costs and market values/recommended book values is charged to Reserve for Fluctuation in Value of Investments in Shares of Stock account shown under the equity section of the balance sheets. However, upon disposal, the difference between the selling price and acquisition cost is credited or charged against operations with a corresponding adjustment to the Reserve for Fluctuation in Value of Investments in Shares of Stock account.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and any impairment in value. The cost of an asset comprises its purchase price and directly attributable costs of bringing the asset to working condition for its intended use. Expenditures for additions, improvements and renewals are capitalized; expenditures for repairs and maintenance are charged to expense as incurred. When assets are sold, retired or otherwise disposed of, their cost and related accumulated depreciation and impairment losses are removed from the accounts and any resulting gain or loss is reflected in income for the period.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

Condominium units	40 years
Office improvements	10 years
Office furniture and equipment	5 years
Transportation equipment	5 years
EDP equipment	5 years

Fully depreciated assets are retained in the accounts until these are no longer in use and no further charge for depreciation is made in respect of those assets.

Foreign Currency Transactions

The accounting records of the Company are maintained in Philippine pesos. Foreign currency transactions during the year are translated into Philippine pesos at exchange rates which approximate those prevailing on transaction dates. Foreign currency monetary assets and liabilities at the balance sheet date are translated into Philippine pesos at exchange rates which approximate those prevailing on that date. Exchange gains and losses are recognized in income for the period, except for unrealized exchange gains or losses pertaining to investment in shares of stock of a foreign entity which is charged to Accumulated Foreign Exchange Differences in Investment in Shares of Stock of a Foreign Entity account in the balance sheets.

Impairment of Assets

The carrying values of investments and property and equipment are reviewed for impairment when events or changes in circumstances indicate that their carrying values may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash generating units are written down to their recoverable amount. The recoverable amount of property and equipment is the greater of 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 assessments of 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 statements of income.

If there is any indication at the balance sheet date that an impairment loss recognized for an asset in prior years may no longer exist or may have decreased, the Company estimates the recoverable amount of that asset and the carrying amount of the asset is adjusted to the recoverable amount resulting in the reversal of the impairment loss.

Retirement Cost

The Company has a defined benefit retirement plan covering all regular full-time employees. The retirement plan is tax qualified, noncontributory and administered by a trustee. The cost of providing benefits under the plan is determined using the projected unit credit actuarial valuation method, which utilizes the normal cost, actuarial liability and unfunded actuarial liability concepts. Unrecognized experience adjustments, past service costs and the effects of changes in actuarial assumptions are amortized over the expected remaining working lives of the employees covered by the plan.

Income Taxes

Deferred income tax is provided using the balance sheet liability method effective 2004 (see Note 3) 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. Under the balance sheet liability method, with certain exceptions, deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets are recognized for all deductible temporary differences and the carryforward of unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the deferred tax assets 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 probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are 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.

3. CHANGE IN ACCOUNTING POLICY

On January 1, 2004, the Company adopted the balance sheet liability method of accounting for income taxes under SFAS 12/IAS 12, *Income Taxes*, which became effective on January 1, 2004. Prior to 2004, the Company used the method of accounting for income taxes wherein deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences mainly between the taxable income and accounting income and tax consequences of net operating loss carryover. Also, prior to 2004, deferred tax assets are recognized in full and a valuation allowance is recognized for the portion that is not expected to be realized in the future.

As permitted by the transitory provisions of SFAS 12/IAS 12, the Company adopted SFAS 12/IAS 12 on a prospective basis (allowed alternative treatment). As a result of the adoption of this new standard, the Company recognized deferred tax liabilities totaling to P15,077,433 pertaining to the tax effect of the Reserve for Fluctuation in Value of Investments in Shares of Stock and Accumulated Foreign Exchange Differences on Investment in Shares of Stock of a Foreign Entity accounts in the balance sheets. Additional information that are required under the new accounting standard were also disclosed in the financial statements (see Note 13).

4. CASH AND CASH EQUIVALENTS

This account consists of:

	<u>2004</u>	<u>2003</u>
Cash on hand and in banks	P 54,737,580	P 31,827,453
Time deposits	<u>14,066,750</u>	<u>-</u>
	<u>P 68,804,330</u>	<u>P 31,827,453</u>

Time deposits were made for varying periods of between one day and one month depending on the liquidity requirement of the Company and earn interest at short-term deposit rates. The cash and cash equivalents account include foreign currency denominated cash of US\$329,132 (P18,519,249) as of December 31, 2004 and US\$155,799 (P8,657,641) as of December 31, 2003.

5. SHORT-TERM INVESTMENTS

As of December 31, 2003, this account is composed of:

Peso denominated investments	P 55,563,887
US dollar denominated investments	<u>22,943,634</u>
	<u>P 78,507,521</u>

Short-term investments that are denominated in Philippine peso consist of investments in fixed treasury notes with maturity dates ranging from six months to one year. These investments, which matured in 2004, earned interest at rates ranging from 6% to 8% per annum both in 2004 and 2003.

The US dollar denominated short-term investment pertains to the Company's investment with a local bank which declared a bank holiday on April 25, 2000 and was subsequently placed under receivership. The bank's rehabilitation plan, including its merger with another bank, was approved by the Bangko Sentral ng Pilipinas and the Securities and Exchange Commission on July 12, 2001 and January 31, 2002, respectively.

Under the agreement with the bank depositors as provided for in the rehabilitation plan, the said placements with the rehabilitated bank with a balance of approximately US\$1 million as of April 25, 2000 shall be repaid and serviced as follows:

- a. Conversion into common shares of the rehabilitated bank of 10% of said placements amounting to P5,827,000. The Company received 5,827,000 shares of the new bank (resulting from the merger discussed above) on August 22, 2002. This is shown as part of investments in shares of stock under the Investment account in the balance sheets (see Note 7).
- b. Partial payment of P500,000 on September 14, 2001. The Company received the said amount on the same date.
- c. Remaining balance shall be payable as follows:

September 14, 2002	US\$ 301,790
September 14, 2003	309,664
September 14, 2004	412,885

The balance due on September 14, 2002, 2003 and 2004 were received by the Company on September 10, 2002, September 9, 2003, and September 13, 2004, respectively.

6. REINSURANCE BALANCES

The details of reinsurance balances are as follows:

	<u>2004</u>	<u>2003</u>
Reinsurance balances receivable:		
Reinsurance recoverable on losses	P 739,901,672	P 669,494,012
Due from ceding companies	539,356,437	587,451,582
Funds held by ceding companies	37,198,254	44,195,732
	<u>1,316,456,363</u>	<u>1,301,141,326</u>
Allowance for doubtful accounts	<u>(12,948,738)</u>	<u>(12,198,738)</u>
	<u><u>P1,303,507,625</u></u>	<u><u>P 1,288,942,588</u></u>
Reinsurance balances payable:		
Claims payable	P 717,233,849	P 896,500,642
Due to retrocessionaires	242,578,101	297,985,867
Funds held for retrocessionaires	33,548,846	43,269,549
	<u>P 993,360,796</u>	<u>P 1,237,756,058</u>

7. INVESTMENTS

Government Securities

The following presents the breakdown of amortized cost of investments in government securities by contractual maturity dates:

	<u>2004</u>	<u>2003</u>
Due within one year	P 121,627,091	P 76,081,737
Due after one year through five years	461,453,457	583,826,265
Due after five years through ten years	188,942,573	217,849,782
Due after ten years	4,434,420	4,436,425
	<u>P 776,457,541</u>	<u>P 882,194,209</u>

Government securities earn interest rates ranging from 5.625% to 20.88% both in 2004 and 2003 (see Note 9).

Government securities totaling P18,750,000 in 2004 and 2003 are on deposit with the IC as a security for the benefit of policyholders and creditors of the Company in accordance with the provisions of the Insurance Code of the Philippines.

Shares of Stock

The balance of investments in shares of stock consists of:

	<u>2004</u>	<u>2003</u>
Cost:		
Quoted in the stock exchange	P 15,548,205	P 15,548,205
Not quoted in the stock exchange	5,363,454	5,363,454
	<u>20,911,659</u>	<u>20,911,659</u>
Unrealized appreciation (decline) in value of investments:		
Quoted in the stock exchange	(2,419,646)	(3,890,012)
Not quoted in the stock exchange	21,511,800	15,370,700
	<u>19,092,154</u>	<u>11,480,688</u>
Accumulated foreign exchange differences in investment in shares of stock of a foreign entity	24,405,046	24,056,046
	<u><u>P 64,408,859</u></u>	<u><u>P 56,448,393</u></u>

Investments in shares of stock which are not quoted in the stock exchange consist mainly of shares of stock of Asian Reinsurance Corporation (Asian Re). The shares of Asian Re, which was paid for by the Company, have been issued in the name of the Government of the Philippines (GoP) who assigned such shares, including any interest accruing thereon, to the Company. The GoP designated the Company as the national institution authorized to subscribe and pay for the said shares of stock.

In 2004, as a result of the adoption of SFAS 12/IAS 12, the Company recognized deferred tax liabilities pertaining to the unrealized appreciation (decline) in value of investments and accumulated foreign exchange differences in investment in shares of stock of a foreign entity amounting to P7,267,818 and P7,809,615, respectively (see Notes 3 and 13).

The effect of any appreciation or decline in value of investments in shares of stock on actual future earnings will depend on the market prices of these investments in shares of stock at the time of sale.

8. PROPERTY AND EQUIPMENT

Presented below is a reconciliation of the carrying amounts at the beginning and end of 2004 and the gross carrying amounts and the accumulated depreciation of property and equipment.

	Condominium Units	Office Improvements	Office Furniture & Equipment	Transportation Equipment	EDP Equipment	Total
Balance at January 1, 2004, net of accumulated depreciation	P 41,741,948	P 2,706,368	P 1,051,507	P 3,518,277	P 2,322,987	P 51,341,087
Additions	-	-	203,281	-	970,720	1,174,001
Depreciation charge for the year	(1,339,314)	(554,076)	(424,286)	(1,347,340)	(902,694)	(4,567,710)
Balance at December 31, 2004 net of accumulated depreciation	<u>P 40,402,634</u>	<u>P 2,152,292</u>	<u>P 830,502</u>	<u>P 2,170,937</u>	<u>P 2,391,013</u>	<u>P 47,947,378</u>
January 1, 2004						
Cost	P 53,572,553	P 5,540,763	P 6,507,564	P 7,562,017	P 5,171,400	P 78,354,297
Accumulated depreciation	(11,830,605)	(2,834,395)	(5,456,057)	(4,043,740)	(2,848,413)	(27,013,210)
Net carrying amount	<u>P 41,741,948</u>	<u>P 2,706,368</u>	<u>P 1,051,507</u>	<u>P 3,518,277</u>	<u>P 2,322,987</u>	<u>P 51,341,087</u>
December 31, 2004						
Cost	P 53,572,553	P 5,540,763	P 2,469,339	P 7,205,370	P 4,301,115	P 73,089,140
Accumulated depreciation	(13,169,919)	(3,388,471)	(1,638,837)	(5,034,433)	(1,910,102)	(25,141,762)
Net carrying amount	<u>P 40,402,634</u>	<u>P 2,152,292</u>	<u>P 830,502</u>	<u>P 2,170,937</u>	<u>P 2,391,013</u>	<u>P 47,947,378</u>

9. OTHER ASSETS

The Other Assets account includes the following:

	2004	2003
Accrued interest receivables (see Note 7)	P 21,645,995	P 26,726,784
Prepayments	2,577,316	2,485,673
Loans receivable	693,278	1,096,131
Deposit	203,200	235,200
Security Fund	97,585	97,585
	<u>P 25,217,374</u>	<u>P 30,641,373</u>

Security fund represents amount deposited with the IC. The fund was created under Section 367 of Presidential Decree No. 612, as amended under Presidential Decree No. 1640, to be used for the payment of valid claims against insolvent insurance companies.

10. EMPLOYEE BENEFITS

The Company has a funded, noncontributory defined benefit retirement plan providing for death, disability and retirement benefits for all of its employees. The fund is administered by a local bank as trustee. Retirement expense charged to operations in 2004 and 2003 amounted to P1,603,702 and P1,331,468, respectively (see Note 12).

Based on the latest actuarial valuation report dated July 1, 2004, the actuarial accrued liability amounted to ₱16,288,502 while the fair value of the plan assets amounted to ₱13,910,497. The principal actuarial assumptions used in determining the cost of retirement benefits include an interest of 9% and a salary increase of 7%.

The Company's consulting actuary has certified that the retirement plan is in compliance with the requirements of Republic Act No. 7641, which specifies a minimum provision for retirement benefits.

11. INVESTMENTS AND OTHER INCOME

The details of this account are as follow:

	<u>2004</u>	<u>2003</u>
Interest (see Notes 4, 5 and 7)	₱ 112,155,213	₱ 112,288,662
Foreign currency gain - net	6,852,781	8,651,579
Others	2,889,501	1,095,683
	<u>₱ 121,897,495</u>	<u>₱ 122,035,924</u>

12. GENERAL AND ADMINISTRATIVE EXPENSES

The details of this account follow:

	<u>2004</u>	<u>2003</u>
Salaries, wages and bonuses	₱ 38,720,142	₱ 34,183,351
Professional Fees	28,817,281	2,960,674
Representation and entertainment	7,009,402	6,576,623
Depreciation	4,567,710	4,602,588
Transportation and travelling	3,279,950	2,495,470
Repairs and maintenance	1,939,897	2,127,541
Employee benefits	1,607,724	1,933,919
Retirement (see Note 10)	1,603,702	1,331,468
Printing and office supplies	1,571,183	2,357,589
Light and water	1,351,761	1,240,779
Taxes, licenses and fees	1,258,688	1,035,297
Communication and postages	1,125,883	1,294,611
Doubtful accounts expense	750,000	-
Insurance	609,495	672,326
Professional and technical development	555,211	250,596
Donations and contributions	507,057	578,877
Fringe benefit taxes	310,686	293,745
Miscellaneous	2,919,858	2,601,932
	<u>₱ 98,505,630</u>	<u>₱ 66,537,386</u>

13. INCOME TAXES

The major components of tax expense for the years ended December 31, 2004 and 2003 are as follows:

	<u>2004</u>	<u>2003</u>
Statements of income:		
Current Tax		
At 32%	P 5,858,902	P 4,238,863
At 20%	19,322,631	20,971,038
At 7.5%	33,676	68,125
At 1/2 of 1%	-	7,692
Deferred tax relating to origination and reversal of temporary differences	<u>(4,154,172)</u>	<u>(1,314,768)</u>
Tax expense reported in statements of income	<u>P 21,061,037</u>	<u>P 23,970,950</u>
Statements of changes in equity:		
Deferred tax arising from adoption of new accounting standard on income taxes relating to the following (see Note 3):		
Accumulated foreign exchange differences in investment in shares of stock of a foreign entity	P 7,809,615	P -
Reserve for fluctuation in value of investment in shares of stock	<u>-</u>	<u>-</u>
	<u>7,267,818</u>	<u>-</u>
	<u>P 15,077,433</u>	<u>P -</u>

The reconciliation of the tax on pretax income computed at the applicable statutory rates to tax expense attributable to continuing operations is as follows:

	<u>2004</u>	<u>2003</u>
Tax on pretax income:		
At 32%	P 37,394,090	P 38,769,267
At 20%	19,322,631	20,971,038
At 7.5%	33,676	68,125
At 1/2 of 1%	-	7,692
Tax effects of:		
Nondeductible expenses	350,982	338,469
Exempt income	(2,265,470)	(190,486)
Interest income subjected to final tax	<u>(33,774,872)</u>	<u>(35,993,155)</u>
Tax expense reported in statements of income	<u>P 21,061,037</u>	<u>P 23,970,950</u>

The net deferred tax liabilities as of December 31 relates to the following:

	BALANCE SHEETS		STATEMENTS OF INCOME	
	2004	2003	2004	2003
Deferred tax liabilities:				
Deferred acquisition costs	P 15,378,773	P 13,349,197	P 2,029,576	P (1,398,702)
Accumulated foreign exchange differences in investment in shares of stock of a foreign entity	7,809,615	-	-	-
Reserve for fluctuation in value of investments in shares of stock	7,267,818	-	-	-
Unrealized foreign exchange gain	2,898,567	2,531,318	367,249	775,089
Deferred tax assets:				
Incurred but not reported losses	(5,400,308)	(3,885,240)	(1,515,068)	(601,065)
Allowance for doubtful accounts	(4,143,596)	(3,903,596)	(240,000)	2,496,404
Reserve for catastrophic losses	(4,063,064)	(3,296,190)	(766,874)	(762,518)
Excess of reserve for unexpired risks per books over tax basis	(1,850,572)	2,182,096	(4,032,668)	(1,780,580)
Past service cost	(184,470)	(188,083)	3,613	(43,396)
Deferred tax income			P (4,154,172)	P (1,314,768)
Net Deferred Tax Liabilities	<u>P 17,712,763</u>	<u>P 6,789,502</u>		

14. LOSS RESERVES

As of December 31, 2004 and 2003, reserves for contingency and catastrophe loss are as follows:

	2004	2003
Contingency reserve	P 113,589,545	P 104,009,996
Catastrophe loss reserve	12,697,073	10,300,592
	<u>P 126,286,618</u>	<u>P 114,310,588</u>

Contingency Reserve

On April 18, 1989, the Company's BOD approved the establishment of a special reserve which will serve as cushion to the paid-up capital in the event of extraordinarily high loss occurrences or severe catastrophic losses. The amount of P5,000,000 was initially appropriated from retained earnings for this purpose on April 30, 1989. Subsequently, at December 31 of each year where there is profit, ten percent (10%) of such profit shall be set aside as additional reserve for contingencies. The reserve balance, which is shown as Appropriated for Contingencies under Retained Earnings account in the statements of changes in equity, should not exceed, at any time, the amount of paid-up capital.

Catastrophe Loss Reserve

The office of the IC, in a letter dated October 15, 1996, required that, starting 1996, all insurance companies set up a catastrophe reserve for allied perils (earthquake, typhoon and flood) exposure.

The required reserve will be accumulated over the first 10 years of implementation by charging against current operations a provision equal to 10% of previous year's net retained premiums for allied perils. On the tenth year, the reserve should be equal to 100% of the Company's net retained premiums for allied perils of the previous year and shall be adjusted annually thereafter. The reserve set up by the Company is shown as Catastrophe Loss Reserve account in the balance sheets.

15. EQUITY

Capital Stock

Capital stock consists of:

	SHARES		AMOUNT	
	2004	2003	2004	2003
Common shares - P100 par value				
Authorized - 10,000,000 shares				
Issued:				
Balance at beginning of year	4,552,185	4,215,046	p 455,218,500	P 421,504,600
Stock dividends issued during the year	1,590,180	337,139	159,018,000	33,713,900
Balance at end of year	<u>6,142,365</u>	<u>4,552,185</u>	<u>p 614,236,500</u>	<u>P 455,218,500</u>

Treasury Shares

Treasury shares pertain to the Company's shares of stock held by NIAN's Trading, Inc. which was reacquired in 2003 at a total cost of P2,001,014. In 2004, the Company reacquired its stocks held by Luzon Insurance and Surety Co., Inc and Filipino Merchants Insurance, Inc. at a total cost of P1,652,812 and P1,898,972, respectively.

Retained Earnings

On March 30, 2004, the Company's BOD declared 35% stock dividend from its unappropriated retained earnings as of December 31, 2003 to stockholders of record as of June 28, 2004. On June 29, 2004, the Company distributed shares amounting to P159,018,000 equivalent to 1,590,180 shares. The remaining fractional shares amounting to P7,475 was paid in cash.

On April 22, 2003, the Company's BOD approved the declaration of cash dividends amounting to P16,860,184 out of the unappropriated retained earnings as of December 31, 2002 payable to stockholders of record as of June 16, 2003. The cash dividends were paid in July and October 2003. Also on the same date, the BOD declared an 8% stock dividend or P33,720,368 from its unappropriated retained earnings to stockholders of record as of June 16, 2003 to be distributed to stockholders on July 31, 2003. On July 31, 2003, the Company distributed shares amounting to P33,713,900, equivalent to 337,139 shares. The remaining fractional shares amounting to P6,468 was paid in cash.

16. MARGIN OF SOLVENCY

Under the Insurance Code of the Philippines, a nonlife insurance company doing business in the Philippines shall maintain at all times a margin of solvency equal to P500,000 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 same Code), exclusive of its paid-up capital, over the amount of its liabilities, unexpired risks and reinsurance reserves.

The final amount of the margin of solvency can be determined only after the accounts of the Company have been examined and classified as to admitted and nonadmitted assets, as defined in the Insurance Code, by the IC.

The IC has completed the examination of the accounts of the Company as of December 31, 2003. Based on the examination, the Company's surplus that is available to cover the required margin of solvency as of December 31, 2003 amounted to P826,677,576. This amount exceeds the required margin of solvency of P47,238,894 by P779,438,682.

17. RECONCILIATION OF NET INCOME UNDER GAAP TO STATUTORY NET INCOME

The reconciliation of net income under GAAP and statutory net income follows:

	<u>2004</u>	<u>2003</u>
GAAP net income	P 95,795,495	P 97,183,009
Difference in change in reserve for unexpired risks - net	12,602,087	5,564,311
Deferred acquisition costs - net	(6,342,425)	4,370,942
Provision for incurred but not reported losses	4,734,588	1,878,328
Tax effect of the adoption of GAAP accounting	<u>(3,518,160)</u>	<u>(3,780,346)</u>
Statutory net income	<u>P 103,271,585</u>	<u>P 105,216,244</u>

18. CONTINGENCIES

The Company is a defendant in a third party claim filed by a government agency against the Company and other reinsurers. Management believes that the reserve set up relating to this case is adequate to cover any liability that may arise from the ultimate outcome of the case.

operating officers



Wilfrido C. Bantayan
President



Roberto B. Crisol
Executive Vice President



Raymundo T. Bautista, Jr.
SVP-Operations



Amerfil V. Basco
VP-Reinsurance Accounting



Isabelita M. Cabangunay
VP-Administration



Danilo J. Cabero
VP-Underwriting



Buenaventura P. Duran
VP-Special Accounts Unit



Theresa Lorna M. Legaspi
VP-MIS



Regina S. Ramos
VP-Internal Audit



Ma. Lourdes M. Santos
AVP-Treaty

Normando Antonio S. Aguilar
Manager - MIS

Editha B. Geronimo
Manager - Life Business

Honorata S. Lucos
Manager - Reinsurance Accounting

Rowena S. Pangilinan
Manager - Underwriting

Eugenia G. Silva
Manager - Collection

Vicente B. Villarama, Jr.
Manager - Finance & Admin.

Aurora F. Santiago
Asst. Manager - Claims

Castillo, Laman, Tan, Pantaleon, & San Jose
Law Offices
Legal Counsel

Zenaida L. Salipsip
Corporate Secretary

Punongbayan & Araullo
Auditors

COMPANY STOCKHOLDERS

Acropolis Central Guaranty Corporation
AFP General Insurance Corporation
Alliedbankers Insurance Corporation
Alpha Insurance & Surety Company, Inc.
Asia Traders Insurance Corporation
Asia United Insurance, Inc.
Ayala Life Assurance, Inc.
Beneficial-PNB Life Insurance Company, Inc.
BF General Insurance Company, Inc.
BF Life Insurance Corporation
BPI/MS Insurance Corporation
Cathay Insurance Company, Inc.
CCC Insurance Corporation
Centennial Guarantee Assurance Corporation
Central Surety & Insurance Company, Inc.
CGU International Insurance Plc.
Cibeles Insurance Corporation
Commonwealth Insurance Company
Consolidated Insurance Company, Inc.
Cooperative Insurance System of the Phils. Inc.
Country Bankers Insurance Corporation
Country Bankers Life Insurance Corporation
Covenant Assurance Company, Inc.
Development Insurance & Surety Corporation
Eastern Assurance & Surety Corporation
Empire Insurance Company
Equitable Insurance Corporation
Federal Phoenix Assurance Company, Inc.
FGU Insurance Corporation
Fidelity Insurance Company, Inc.
Finman General Assurance Corporation
First Guarantee Life Assurance Company
First Lepanto-Taisho Insurance Corporation
First Nationwide Assurance Corporation, The
First Quezon City Insurance Company, Inc., The
Fortune Life Insurance Company, Inc.
General Insurance & Surety Corporation
Government Service Insurance System
Great Domestic Insurance Co. of the Phils., Inc.
Great Pacific Life Assurance Corporation
Industrial Insurance Company, Inc.
Insular Life Assurance Company, Ltd., The
Insurance Company of North America
Insurance of the Philippine Islands Co., Inc.
Investors Assurance Corporation
Liberty Insurance Corporation
Luzon Insurance & Surety Company, Inc.
Malayan Insurance Company, Inc.
Malayan Zurich Insurance Company, Inc.
Manila Bankers Life Insurance Corporation
Manila Insurance Company, Inc., The
Manila Surety & Fidelity Company, Inc.
Manufacturers Life Insurance Co. (Phils.), Inc.
Mapfre Asian Insurance Corporation
Mega Pacific Insurance Corporation
Mercantile Insurance Company, Inc., The

Meridian Assurance Corporation
Metropolitan Insurance Company
Monarch Insurance Company, Inc.
National Life Insurance Company of the Phils.
New Hampshire Insurance Company
New India Assurance Company, Ltd., The
Northwest Insurance and Surety Company, Inc.
Oriental Assurance Corporation
Pacific Union Insurance Company
Paramount Life & General Insurance Corp.
People's General Insurance Corporation
Perla Compania De Seguros, Inc.
Philam Insurance Company, Inc.
Philippine American Life & Gen. Insurance Co.
Philippine British Assurance Company, Inc.
Philippine Charter Insurance Corporation
Philippine Fire & Marine Insurance Corporation
Philippine Phoenix Surety & Insurance, Inc.
Philippine Prudential Life Insurance Co., Inc.
Philippines First Insurance Company, Inc.
Philippines Int'l. Life Insurance Company, Inc.
Pioneer Asia Insurance Corporation
Pioneer Insurance & Surety Corporation
Pioneer Intercontinental Insurance Corporation
Pioneer Life Inc.
Pioneer Life Holdings, Inc.
Plaridel Surety & Insurance Company, Inc.
PNB General Insurers Company, Inc.
Premier Insurance & Surety Corporation
Prudential Guarantee & Assurance, Inc.
R & B Insurance Corporation
Reliance Surety & Insurance Company, Inc.
Republic Surety & Insurance Company, Inc.
Rico General Insurance Corporation
Seaboard-Eastern Insurance Company, Inc.
Solid Guaranty, Inc., The
South Sea Surety & Insurance Company, Inc.
Sterling Insurance Company, Inc.
Stronghold Insurance Company, Inc.
Sun Life Assurance Company of Canada
TICO Insurance Company, Inc.
Times Surety & Insurance Company, Inc.
Tokio Marine Malayan Insurance Company, Inc.
Travellers Insurance & Surety Corporation
UCPB General Insurance Company, Inc.
Union Insurance Society of Canton Ltd.
United Insurance Company, Inc.
United Life Assurance Corporation
Universal Malayan Reinsurance Corporation
Utility Assurance Corporation
Visayan Surety and Insurance Corporation
Western Guaranty Corporation
Worldwide Insurance and Surety Company
Zenith Insurance Corporation



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