

NATIONAL REINSURANCE CORPORATION OF THE PHILIPPINES



2005 ANNUAL REPORT

OUR

COVER

Our cover of migratory birds in flight symbolizes our corporate way of life and system of beliefs and values. The flight formation of these birds yields aerodynamic benefits which allow them to conserve energy and facilitate orientation and communication. Like these birds, we value teamwork, optimal work process and shared responsibility in the pursuit of goals.

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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.



In the Year 2005, the Philippine economy has remained resilient in the face of external and domestic threats. The Gross Domestic Product (GDP) rose by 5.1%, bannered, as in previous years, by the Service Sector. The Gross National Product (GNP), on the other hand, grew by 5.7%, due to robust inflows from abroad, which came mostly from the all-time high remittances of Overseas Filipino Workers (OFWs). The challenge now is to accelerate growth to a level where the fruits of the economy would significantly raise the standards of living of the majority of the Filipinos.

Your Board of Directors has crafted two years ago a program that seeks to address the challenge of accelerated growth in this era of global competitiveness and fast-paced business activities. The first two phases of your Company's four-phased Capital Enhancement Program (CEP) were successfully completed. The rights issue was fully subscribed, and this generated P776 million of fresh funds for your Company. Likewise, the merger of your Company and UMRe was approved by the stockholders of both companies with your Company as the surviving entity.

The merger will not only add financial muscles to your Company but more importantly it will bring together a respected and formidable team, the BPI and YGC groups, into the management of your Company.

The remaining phases of the CEP - the IPO and the search for a strategic partner - are in the pipeline. The IPO is designed to firm up your Company's status as a national institution through an ownership diversification plan in which all insurance industry players, executives and employees, as well as the general public, will be encouraged to purchase shares of your Company's stocks. On the other hand, the forging of a strategic alliance with a foreign partner will bring us closer to the realization of your Company's vision as a National Champion, one carrying the Philippine flag and the Filipino entrepreneurial skills into foreign soils.

The management of your Company is steadfastly committed to its mandates, as stipulated in PD1270. Increased national retention, insurance industry development and regional cooperation are central to your Company's strategic initiatives. The CEP was crafted to strengthen your Company's capability to pursue its mandates. With greater resources, your Company hopes to lend its financial muscles to smaller players to the betterment, ultimately, of the general public.

Your Company has done well in Year 2005, as it registered the highest gross premium income so far at P 2.6 billion, upped by 26.9% from its year 2004 production of P2.0 billion. This all-time high production level would not have been possible without your unwavering support.

We all took part in molding the character and identity of National Re. I do hope that we shall continue to dedicate the same, if not greater, measure of commitment and support in the coming years. Your continued patronage is indispensable, especially, now that your Company is charting a more challenging course.

Your Board of Directors is well aware of your primary expectation of continuous growth in shareholders' wealth. It is this expectation that motivates us to take bolder steps, strengthen your Company's capabilities and dare explore uncharted waters. Your Board is fully conscious of the perils of uncharted soils, but the promise of reward is too tempting to

resist; thus, your Board wishes to assure all Company stockholders that your Company shall not go through this blindly. This early, factors that are likely to enhance your Company's chance of success are being put in place: careful planning, incessant effort, precise execution, and teamwork among players are at work.

The GSIS recognizes that National Re showcases a working partnership between the government and the private sector, which is a solid proof of the government's ability to catalyze the development of a market in pursuit of national interest. We, at the GSIS, are aware of the strategic importance of your Company as a vehicle that can be effectively used to rationalize the insurance industry and to penetrate the Asian reinsurance market. We appreciate your Company's active participation in regional cooperative undertakings, in controlling leakages in the domestic economy through higher national retention, and serving as an effective income redistribution channel. It is the pursuit of national interest that inspires us to remain steadfastly committed to National Re's mandates.

Your Company has already achieved local dominance. It has now trained its sight to earning regional respect. The fact that your Company has gained dominance in a relatively short period is a testament to the outstanding effort and service rendered by all Company stakeholders; thus, I wish to thank all the Stockholders, the Officers and Staff, led by the Company President, the Members of the Board of Directors, clients and friends from the industry for their unwavering support and dedication, without which the success story of your Company would not be possible.

Lastly, I enjoin all stakeholders to join hands to turn the Company's vision and mission into a reality: United, we shall survive and grow. It is in united undertaking that we are tested, and from which the best in us shines.

Thank you.



ATTY. WINSTON F. GARCIA
Chairman

PRESIDENT'S REPORT TO STOCKHOLDERS

The Philippine economy managed to reach the high-end of the National Economic Development Authority's forecast band, as Gross Domestic Product rose by 5.1% in 2005. The robust growths achieved in the Industry, Manufacturing and Services sectors continued to prop up domestic output, while the all-time record level of overseas Filipino workers remittances boosted the trade sector. The Mining sector also contributed significantly to overall growth as it surged by 9.3% due to the change in policy environment and rising metal prices in the world market.

In 2005, the local insurance industry, particularly the non-life sector, experienced a number of relatively large Fire and Marine single losses. Even with these losses, the market, in the absence of major natural peril losses, is still projected to produce, in general, a positive underwriting outcome for the year.

However, the Philippine insurance market, especially the property line, remained soft due to stiff competition among domestic insurers and price-gouging wars among intermediaries which seem to have been abetted by reinsurance capacity obtained from overseas. As a consequence, premium rates have fallen to dangerously low levels. This may adversely affect the underwriting integrity and loss absorption capacity of the market in the near term, especially if a major natural catastrophe occurs which scientists and experts believe is just a matter of time. Soft market conditions also adversely affected the non-life market production which recorded nominal growth.

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

UNDERWRITING OPERATIONS

Your Company rose to the challenge posed by the soft market conditions as it posted an all-time high production volume in 2005.

Gross Premiums reached P2.59 billion 26.9% higher than what was registered in 2004. By line, Casualty continued to be your Company's major source of business, as it carved up 46.4% of total output. Marine, which posted the biggest jump of 58.9% in production, contributed 26.2% of gross premiums. Fire, which traditionally ranks high in terms of portfolio participation, registered minimal growth, reflecting market softness. This caused its share to drop from 27.1% in 2004 to 21.5% in 2005. The Life business, though chipping in only 5.9% of the Company's total premium volume, recorded an impressive gain of 48.9% in production.

Net retained premiums grew by P232.9 million or 39.4% from P591.3 million in 2004 to P824.1 million in 2005. Marine accounted for 38.5% of retained business, followed by Casualty at 29.1%, Fire at 24.2%, and Life at 8.1%.



The 2005 Underwriting result was still satisfactory: The Company generated an Underwriting profit of P75.1 million, though this was lower by 25.3% as against what was posted in 2004. An overall gain was achieved despite significant losses posted from the Marine line due to positive contribution of the other lines, foremost of which was Casualty which put in P80.3 million to total underwriting income.

INVESTMENT

Investment and other income were heavily weighed down by the adjustment in the value of foreign currency transactions of the Company, which caused this account to register a negative growth of 10.7%. Sans the effect of foreign currency exchange losses amounting to P46 million (against a P7.2 million gain in 2004), the investment and other income which reached P109 million, would have recorded an increase from P112.0 million in 2004 to P152.9 million in 2005 or by 36.5%.

FINANCIAL REPORTS

Your Company ended the year 2005 with another passing mark. Notwithstanding a higher loss ratio, extraordinary expenses and a downtrend in investment and other income, the Company still managed to produce a net income after tax amounting to P98.7 million, almost matching the previous year's figure of P99.9 million.

Total Assets grew by 51.9% from P2.9 billion a year ago to P4.4 billion in 2005, primarily on account of the 90.4% expansion in Stockholders' Equity. Book value per share increased by 16.5% to P213.08 at the end of 2005.

Your Company's corporate philosophy of underwriting for profit contributed greatly to its success. Its strategy of focused and selective yet flexible underwriting, diversity in business portfolio, and prudence in investment paid dividends.

OUTLOOK AND PLANS

We expect the Philippine insurance industry to continue struggling to reach its robust levels of growth in the past which in some instances even outpaced the growth of the country's GNP. Uncertainties in the macro environment and the soft market conditions pose formidable obstacles. The full underwriting impact of the record level catastrophe losses in 2004 and 2005 in major international reinsurance markets has yet to be felt in the Philippine market which escaped those losses. The entry of fresh funds in the reinsurance arena in 2005 will also temper any tendency towards immediate hardening of the market.

It is our hope that constraining factors will halt any further decline in reinsurance prices in the years ahead. Recalibration of catastrophe models, shrinking risk appetite for peak exposures, the restructuring of coverage on a more restrictive basis and increased cost of underwriting funds are major factors that could restore stability in the market.

We anticipate that a more discerning reinsurance mindset among cedants will characterize allocation decision: Hedging and quality of securities are likely to be the main variables.

The developments in 2005 highlighted the timeliness and relevance of your Company's Capital Enhancement Program (CEP), particularly in respect of the expansion of your Company's capital base and the amendment of its By-Laws to make it more vibrant and attuned to current and future operational requirements. The CEP codifies short and long-term moves that will enable your Company adopt a timely and appropriate response to changing industry conditions, diversify its revenue base, and strengthen its market position and its inherent competitive advantage.

The first two phases of the CEP have been successfully implemented. In June 2005, fresh capital infusion of P776 million was made by the stockholders through a rights issue. Just recently, in March 6, 2006, the merger between your Company and Universal Malayan Re was approved by the Securities & Exchange Commission, which brought in a new equity of P1.37 billion, bringing your Company's networth to a new high of P3.50 billion.

Your Company, with much greater financial muscle, 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, efficient and effective systems and manpower capabilities. Strategies that would further exploit its competitive edge and enable your Company to face squarely the challenges and opportunities of the coming years have been crafted and are being vigorously and singlemindedly pursued.

We look at 2006 with guarded optimism. Our major plans for the year includes the thorough examination of the efficacy of our underwriting mix, the crafting of measures to achieve greater retention level and the initiation of major steps towards increasing our presence in the regional market. Also, as decreed by its charter, your Company's role in contributing towards further development of a strong national insurance industry and higher national retention will be a priority activity.

The goals we have set for this year are very challenging. Under these circumstances, we commit ourselves to exert extra effort to maintain positive underwriting results and to relentlessly pursue your Company's fundamental objective of increasing shareholders' value as the heart of corporate strategies. Fully servicing the needs of stockholders-cessionaires, sensitivity to clients' requirements and customer-focused approach, as before, shall underpin the thrust of your Company in the coming year. Your unwavering support and cooperation more than ever will be needed for your Company to continually outperform the market in terms of growth and profitability.

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

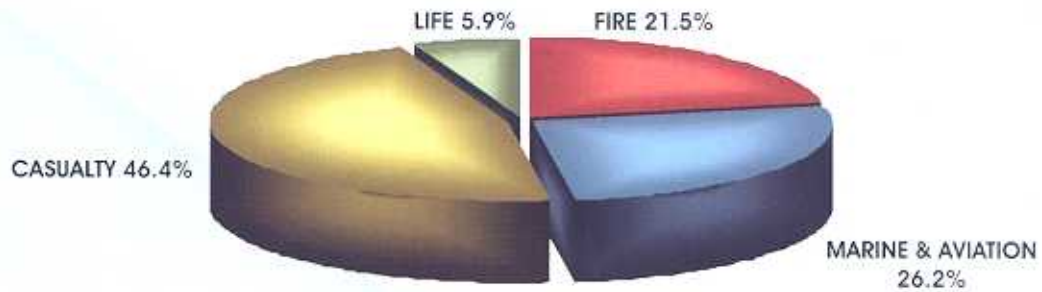
	<u>2005</u>	<u>2004</u>	<u>Increase/(Decrease)</u>	
			<u>Amount</u>	<u>%</u>
Gross Premiums	₱ 2,589,783,755	₱ 2,041,583,755	₱ 548,200,000	26.85
Net Premiums	824,140,197	591,258,410	232,881,787	39.39
Net Losses Incurred	506,213,424	335,901,710	170,311,714	50.70
Underwriting Income	75,154,460	100,595,737	(25,441,277)	(25.29)
Investment & Other Income				
Interest	152,883,075	111,966,698	40,916,377	36.54
Foreign currency gain (losses)	(45,952,689)	7,201,781	(53,154,470)	(738.07)
Others	2,033,549	2,889,501	(855,952)	(29.62)
	<u>108,963,935</u>	<u>122,057,980</u>	<u>(13,094,045)</u>	<u>(10.73)</u>
Net Income After Tax	98,664,163	99,938,278	(1,274,115)	(1.27)
Earnings Per Share*	9.87	16.34	(6.47)	(39.60)
Total Assets	4,458,118,108	2,933,977,951	1,524,140,157	51.95
Stockholders' Equity	2,130,645,221	1,118,928,891	1,011,716,330	90.42
Book Value Per Share*	213.08	182.90	30.18	16.50
Return on Equity**	8.82%	10.13%	-1.31%	(12.93)
General Expenses	81,078,085	99,608,244	(18,530,159)	(18.60)
Ratio of General Expenses to Net Premiums	9.84%	16.85%	-7.01%	(41.60)
Combined Ratio	97.99%	98.51%	-0.52%	(0.53)
Loss Ratio	66.97%	58.71%	8.26%	14.07
Commission Ratio	21.18%	22.95%	-1.77%	(7.71)
Expense Ratio	9.84%	16.85%	-7.01%	(41.60)

*Based on 10,000,000 issued and outstanding shares of stocks less 869 Treasury Stocks in 2005 and 6,142,365 issued and outstanding shares of stocks less 24,717 Treasury Stocks in 2004.

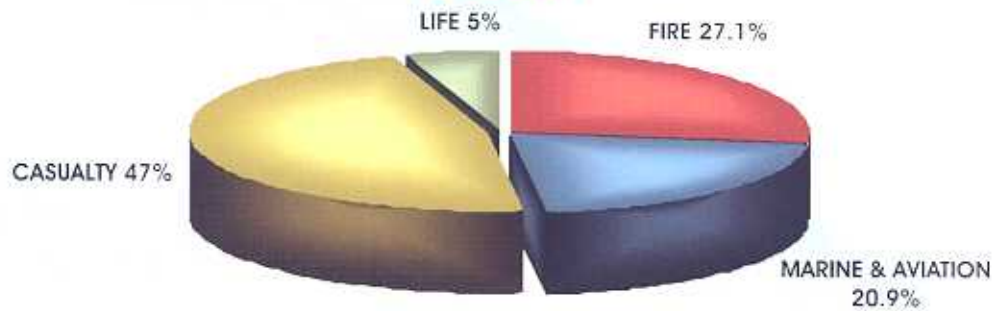
**Based on preceding year's stockholders' equity.

GROSS PREMIUMS BY LINE (2004-2005)

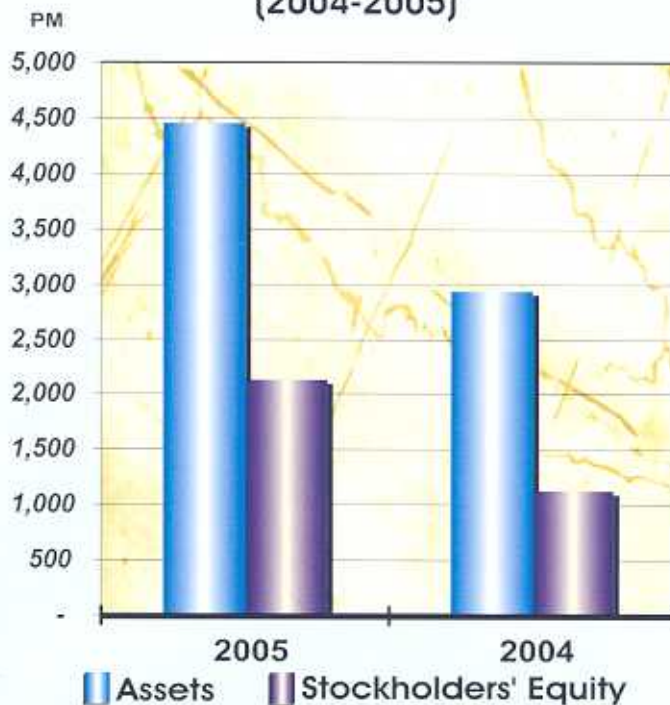
2005



2004



TOTAL ASSETS & STOCKHOLDERS' EQUITY (2004-2005)



STATEMENT OF MANAGEMENT'S RESPONSIBILITY 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, 2005. The financial statements have been prepared in conformity with generally accepted accounting principles and reflect amounts that are based on the best estimates and informed judgment 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 F. GARCIA
Chairman of the Board



WILFRIDO C. BANTAYAN
President & CEO



RAFAEL C. GALLAGA
Treasurer

**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, 2005 and 2004, 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, 2005 and 2004, 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 & ARAULLO



By: Lilian S. Linsangan
Partner
CPA Reg. No. 0046660
TIN No. 109-228-234
PTR No. 4182120, January 4, 2006, Makati City
Partner SEC Accreditation No. 0008-AR-1
BIR AN 08-002511-3-2005 (Dec. 27, 2005 to 2008)

April 5, 2006

BALANCE SHEETS

DECEMBER 31, 2005 AND 2004

	Notes	2005	2004
<u>A S S E T S</u>			
CASH AND CASH EQUIVALENTS	4	P 141,980,545	P 68,804,330
REINSURANCE BALANCES RECEIVABLE - Net	5	1,668,259,780	1,303,507,625
DEFERRED ACQUISITION COSTS		133,273,725	136,938,363
INVESTMENTS	6		
Available-for-sale financial assets		1,656,818,555	663,512,515
Held-to-maturity securities		188,337,735	199,604,939
Others		4,041,020	-
OTHER RECEIVABLES	7	43,190,297	22,322,809
PROPERTY AND EQUIPMENT - Net	8	49,188,152	47,947,378
DEFERRED REINSURANCE PREMIUMS		543,471,360	488,378,113
DEFERRED INPUT VALUE ADDED TAX		23,765,892	-
OTHER ASSETS	9	5,791,047	2,961,879
TOTAL ASSETS		P 4,458,118,108	P 2,933,977,951
<u>LIABILITIES AND EQUITY</u>			
REINSURANCE BALANCES PAYABLE	5	P 1,332,709,346	P 976,484,832
RESERVE FOR UNEXPIRED RISKS		840,144,577	716,796,802
DEFERRED REINSURANCE COMMISSIONS		82,025,786	88,879,696
INCOME TAX PAYABLE	12	-	4,846,981
DEFERRED OUTPUT VALUE ADDED TAX		36,721,512	-
ACCOUNTS PAYABLE AND ACCRUED EXPENSES		15,706,285	9,400,875
DEFERRED TAX LIABILITIES	12	20,165,381	18,639,874
		2,327,472,887	1,815,049,060
EQUITY		2,130,645,221	1,118,928,891
TOTAL LIABILITIES AND EQUITY		P 4,458,118,108	P 2,933,977,951

See Notes to Financial Statements

STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

	<u>Notes</u>	<u>2005</u>	<u>2004</u>	
REINSURANCE PREMIUM INCOME				
Reinsurance premiums - net of returns		P 2,589,783,755	P 2,041,583,755	
Retroceded premiums		<u>1,765,643,558</u>	<u>1,450,325,345</u>	
Reinsurance premiums retained		824,140,197	591,258,410	
Increase in reserve for unexpired risks	(<u>68,254,528</u>)	(<u>19,075,588</u>)
		<u>755,885,669</u>	<u>572,182,822</u>	
UNDERWRITING DEDUCTIONS				
Share in claims and losses		506,213,424	335,901,710	
Commissions - net		<u>174,517,785</u>	<u>135,685,375</u>	
		<u>680,731,209</u>	<u>471,587,085</u>	
NET UNDERWRITING INCOME		<u>75,154,460</u>	<u>100,595,737</u>	
INVESTMENTS AND OTHER INCOME (CHARGES)				
Interest		152,883,075	111,966,698	
Foreign currency gain (losses)	(45,952,689)	(7,201,781)
Others		<u>2,033,549</u>	<u>2,889,501</u>	
		<u>108,963,935</u>	<u>122,057,980</u>	
INCOME AFTER INVESTMENTS AND OTHER INCOME		184,118,395	222,653,717	
GENERAL AND ADMINISTRATIVE EXPENSES	10	<u>81,078,085</u>	<u>99,608,244</u>	
INCOME BEFORE TAXES		103,040,310	123,045,473	
TAX EXPENSE	12	<u>4,376,147</u>	<u>23,107,195</u>	
NET INCOME		<u>P 98,664,163</u>	<u>P 99,938,278</u>	

See Notes to Financial Statements

STATEMENTS OF CHANGES IN EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

	Notes	Capital Stock		Additional Paid-in-Capital
		No. of Shares	Amount	
Balance as of January 1, 2004, as previously stated		4,552,185	P 455,218,500	P -
Effect of transition to PFRS	2	-	-	-
Balance as of January 1, 2004, as restated		4,552,185	455,218,500	-
Shares issued (reacquired)		1,590,180	159,018,000	
Increase (decrease) during the year				
Stock dividends				
Cash dividends				
Appropriated for contingencies				
Net income				
Total equity as of December 31, 2004		<u>6,142,365</u>	<u>P 614,236,500</u>	<u>P -</u>
Balance as of January 1, 2005		6,142,365	P 614,236,500	P -
Effect of transition to PFRS	2	-	-	-
Balance as of January 1, 2005, as restated		6,142,365	614,236,500	-
Shares issued and disposed	13	3,857,635	385,763,500	385,154,102
Increase (decrease) during the year				
Appropriated for contingencies	13			
Net income				
Total equity as of December 31, 2005		<u>10,000,000</u>	<u>P 1,000,000,000</u>	<u>P 385,154,102</u>

See Notes to Financial Statements

Treasury Shares	Revaluation Reserves	Retained Earnings		Total Equity
		Appropriated	Unappropriated	
(P 2,001,014)	P 35,536,734	P 104,009,996	P 394,250,126	P 987,014,342
<u>-</u>	<u>51,325,640</u>	<u>-</u>	<u>30,937,244</u>	<u>82,262,884</u>
(2,001,014)	86,862,374	104,009,996	425,187,370	1,069,277,226
(3,551,784)				155,466,216
	(46,727,354)			(46,727,354)
			(159,018,000)	(159,018,000)
			(7,475)	(7,475)
		9,579,549	(9,579,549)	-
<u>-</u>	<u>-</u>	<u>-</u>	<u>99,938,278</u>	<u>99,938,278</u>
(P 5,552,798)	P 40,135,020	P 113,589,545	P 356,520,624	P 1,118,928,891
(P 5,552,798)	P 28,419,767	P 113,589,545	P 321,440,597	P 1,072,133,611
<u>-</u>	<u>11,715,253</u>	<u>-</u>	<u>35,080,027</u>	<u>46,795,280</u>
(P 5,552,798)	40,135,020	113,589,545	356,520,624	1,118,928,891
5,378,672				776,296,274
	136,755,893			136,755,893
		9,866,416	(9,866,416)	-
<u>-</u>	<u>-</u>	<u>-</u>	<u>98,664,163</u>	<u>98,664,163</u>
(P 174,126)	P 176,890,913	P 123,455,961	P 445,318,371	P 2,130,645,221

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before tax	P 103,040,310	P 123,045,473
Adjustments for:		
Increase in reserve for unexpired risks	68,254,528	19,075,588
Unrealized foreign currency loss (gain)	55,692,983	(9,058,019)
Depreciation	4,661,906	4,567,710
Interest income	(152,883,075)	(111,966,698)
Dividend income	(1,959,994)	(2,472,990)
Operating income before working capital changes:	<u>76,806,658</u>	<u>23,191,064</u>
Increase in reinsurance balances receivable	(386,309,975)	(4,986,408)
Increase in deferred input value added tax	(23,765,892)	-
Decrease (increase) in deferred acquisition costs	(3,189,272)	(6,342,425)
Decrease in other assets	(3,849,337)	(416,316)
Increase in other receivables	(22,449,011)	(3,221,449)
Increase (decrease) in reinsurance balances payable	367,944,135	(247,796,246)
Increase in deferred output value added tax	36,721,512	-
Increase (decrease) in accounts payable and accrued expenses	<u>6,305,410</u>	<u>(1,921,728)</u>
Cash generated from (used in) operations	48,214,228	(241,493,508)
Cash paid for income taxes	(4,846,981)	(23,629,910)
 Net Cash From (Used in) Operating Activities	 <u>43,367,247</u>	 <u>(265,123,418)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from disposal/maturities of:		
Available-for-sale financial assets	281,579,875	293,041,273
Held-to-maturity securities	-	185,168,485
Interest received	133,569,116	117,236,002
Dividends received	1,959,994	2,472,990
Acquisitions of:		
Available-for-sale financial assets	(1,152,736,726)	(140,312,710)
Property and equipment	(5,902,680)	(1,174,001)
Other investments	(4,041,020)	-
Held-to-maturity securities	<u>-</u>	<u>(151,002,139)</u>
 Net Cash From (Used in) Investing Activities	 <u>(745,571,441)</u>	 <u>305,429,900</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance/reissuance of:		
Common shares	771,527,000	-
Treasury shares	4,943,400	-
Acquisitions/payments of:		
Treasury shares	(174,126)	(3,551,784)
Fractional shares	<u>-</u>	<u>(7,475)</u>
 Net Cash From (Used in) Financing Activities	 <u>776,296,274</u>	 <u>(3,559,259)</u>
 NET INCREASE IN CASH AND CASH EQUIVALENTS	 74,092,080	 36,747,223
EFFECTS OF FOREIGN CURRENCY REVALUATION ON CASH AND CASH EQUIVALENTS	(915,865)	229,654
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>68,804,330</u>	<u>31,827,453</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>P 141,980,545</u>	<u>P 68,804,330</u>

Supplemental Information on Noncash Financing Activity

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.

See Notes to Financial Statements

DECEMBER 31, 2005 AND 2004

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. On October 24, 2005, the planned merger with UMRC was approved by the vote of stockholders owning 86.92% of the outstanding capital stock. Subsequently, on March 6, 2006, the plan was approved by the Securities and Exchange Commission (SEC).

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 financial statements of the Company for the year ended December 31, 2005 (including the comparatives for the year ended December 31, 2004) were authorized for issue by the Company's Board of Directors (BOD) on April 5, 2006.

2. TRANSITION TO PHILIPPINE FINANCIAL REPORTING STANDARDS

The Accounting Standards Council (ASC), the accounting standards-setting body in the Philippines, started a program in 1997 to move fully to the International Accounting Standards (IASs) issued by the then International Accounting Standards Committee (IASC). In April 2001, IASC was succeeded by the International Accounting Standards Board (IASB) which since then has issued revised IASs and new International Financial Reporting Standards (IFRSs).

To correspond better with the issuances of the IASB, the ASC re-named the Standards it issues as Philippine Financial Reporting Standards or PFRSs (previously referred to as Statements of Financial Accounting Standards or SFASs). PFRSs consist of:

- a. PFRSs (corresponding to IFRSs);
- b. Philippine Accounting Standards or PASs (corresponding to IASs), and
- c. Interpretations (corresponding to IFRICs and SICs).

In compliance with the pronouncements of the ASC and the regulations of the SEC, the Company has adopted all the relevant PFRSs for the first time in its financial statements for the year ended December 31, 2005, with January 1, 2004 as its transition date. The transition from the previous generally accepted accounting principles (GAAP) in the Philippines to PFRSs has been made in accordance with PFRS 1, *First-time Adoption of Philippine Financial Reporting Standards*.

The Company's financial statements for 2005 and the comparatives presented for 2004 comply with all presentation and disclosure requirements of the relevant PFRSs applicable for accounting periods commencing on or after January 1, 2005.

Due to the transition to PFRS, the 2004 comparatives contained in these financial statements differ from those previously presented in the financial statements for the year ended December 31, 2004.

The following reconciliations and explanatory notes describe the effects of the transition on the Company's opening PFRS balance sheet as of January 1, 2004 and for the year ended December 31, 2004. All explanations should be read in conjunction with the PFRS accounting policies of the Company as disclosed in Note 3.

No adjustments to capital stock and additional paid-in-capital were necessary in the opening PFRS balance sheet as of January 1, 2004 and the comparatives prepared for the year ended December 31, 2004.

2.1 Reconciliation

a. The reconciliation of the Company's equity reported under previous Philippine GAAP to its equity under PFRS are summarized as follows:

	Notes	December 31, 2004	January 1, 2004
Revaluation reserves under previous GAAP		P 28,419,767	P 35,536,734
Fair value adjustment of available-for-sale financial assets	2.3	21,108,508	67,683,751
Deferred tax effect	2.3	15,011,791	7,697,935
Accumulated foreign exchange difference on available-for-sale financial assets previously charged directly to equity	2.3	(24,405,046)	(24,056,046)

NATIONAL REINSURANCE CORPORATION OF

PROFESSIONALS



ATTY. WINSTON F. GARCIA
CHAIRMAN OF THE BOARD



ATTY. ADELITA A. VERGEL DE DIOS
VICE CHAIRMAN



WILFRIDO C. BANTAYAN
PRESIDENT



MANUEL U. CO
DIRECTOR



ARMANDO C. TRINIDAD
DIRECTOR



RAFAEL C. GALLAGA
TREASURER



ALFONSO L. SALCEDO, JR.
ASSISTANT TREASURER



JOSEFINA L. VALERA
DIRECTOR



JOLI CO WU
DIRECTOR

	Notes	December 31, 2004	January 1, 2004
Total adjustments to revaluation reserves		11,715,253	51,325,640
Revaluation reserves under PFRS, balance carried forward		P 40,135,020	P 86,862,374
Unappropriated retained earnings under previous GAAP		321,440,597	394,250,126
Accumulated foreign exchange difference on available-for-sale financial assets previously charged directly to equity	2.3	24,405,046	24,056,046
Reversal of incurred but not reported losses (IBNR)	2.8	16,875,963	12,141,375
Reversal of catastrophe loss reserve	2.5	12,697,073	10,300,592
Effect of change from straight line to effective interest amortization method	2.4	1,142,546	1,346,821
Recognition of defined benefit asset	2.6	83,778	100,565
Remeasurement of long-term receivable	2.9	(16,464)	(32,223)
Accrual of leave benefits	2.7	(4,169,014)	(3,083,189)
Deferred tax effect	2.3, 2.5	(15,938,901)	(13,892,743)
Total adjustment to unappropriated retained earnings		35,080,027	30,937,244
Unappropriated retained earnings under PFRS		356,520,624	425,187,370
Total adjustments to Equity		46,795,280	82,262,884
Equity under previous GAAP		1,072,133,611	987,014,342
Equity under PFRS		P 1,118,928,891	P 1,069,277,226

- b. The reconciliation of the Company's equity reported under previous Philippine GAAP to its equity under PFRS are summarized as follows:

	Notes	Previous GAAP	Effects of Transition	PFRS
January 1, 2004				
Changes in assets:				
Investments in government securities	2.2	P 882,194,209	(P 882,194,209)	P -
Investments in shares of stock	2.2	56,448,393	(56,448,393)	-
Available-for-sale financial assets	2.3, 2.4	-	862,619,432	862,619,432
Held-to-maturity securities	2.2	-	145,053,742	145,053,742
Deferred acquisition cost	2.2	41,716,242	75,596,089	117,312,331
Other receivables	2.9	27,822,915	(32,223)	27,790,692
Deferred reinsurance premiums	2.2	-	510,331,952	510,331,952
Other assets	2.6	2,818,458	100,565	2,919,023
Balance carried forward		P1,011,000,217	P 665,026,955	P1,666,027,172
Changes in liabilities:				
Reinsurance balances payable	2.8	(1,237,756,058)	12,141,375	(1,225,614,683)
Reserve for unexpired risks	2.2	(209,343,101)	(510,331,952)	(719,675,053)
Deferred reinsurance commissions	2.2	(-)	(75,596,089)	(75,596,089)
Accounts payable and accrued expenses		(7,153,589)	(3,083,189)	(10,236,778)
Deferred tax liabilities	2.3, 2.5	(6,789,502)	(6,194,808)	(12,984,310)
Reserve for catastrophe loss	2.5	(10,300,592)	10,300,592	-
Total adjustments to equity		(P 460,342,625)	P 82,262,884	(P 378,079,741)

	Notes	Previous GAAP	Effects of Transition	PFRS
December 31, 2004				
Changes in assets:				
Investments in				
government securities	2.2	P 776,457,541	(P 776,457,541)	P -
Investments in shares of stock	2.2	64,408,859	(64,408,859)	-
Available-for-sale financial assets	2.3, 2.4	-	663,512,515	663,512,515
Held-to-maturity securities	2.2	-	199,604,939	199,604,939
Deferred acquisition cost	2.2	48,058,667	88,879,696	136,938,363
Other receivables	2.8	22,339,273	(16,464)	22,322,809
Deferred reinsurance premiums	2.2	-	488,378,113	488,378,113
Other assets	2.6	2,878,101	83,778	2,961,879
Changes in liabilities:				
Reinsurance balances payable	2.8	(993,360,796)	16,875,964	(976,484,832)
Reserve for unearned premiums	2.2	(228,418,689)	(488,378,113)	(716,796,802)
Accounts payable and accrued expenses	2.7	(5,231,861)	(4,169,014)	(9,400,875)
Deferred reinsurance commissions	2.2	-	(88,879,696)	(88,879,696)
Deferred tax liabilities	2.3, 2.5	(17,712,763)	(927,111)	(18,639,874)
Reserve for catastrophe loss	2.5	(12,697,073)	12,697,073	-
		(P 343,278,741)		(P 296,483,461)
Total adjustments to equity			P 46,795,280	

c. Profit and loss under previous GAAP for the year ended December 31, 2004 is reconciled to profit and loss under PFRS as follows:

	Notes	Previous GAAP	Effects of Transition	PFRS
Reinsurance premium income		P 572,182,822	-	P 572,182,822
Underwriting deductions	2.5	(478,718,155)	7,131,070	(471,587,085)
Net underwriting income		93,464,667	7,131,070	100,595,737
Investments and other income	2.4, 2.9	121,897,495	160,485	122,057,980
General and administrative expenses	2.6, 2.7	(98,505,630)	(1,102,614)	(99,608,244)
Income before tax		116,856,532	6,188,941	123,045,473
Tax expense	2.5, 2.7, 2.8	21,061,037	(2,046,158)	(23,107,195)
Net income		P 95,795,495	4,142,783	P 99,938,278

2.2 Revised Structure of Balance Sheet and Statement of Changes in Equity

The Company has modified its previous balance sheet and statement of changes in equity structure on transition to PFRS. The main changes are summarized as follows:

- Investments in Government Securities and Shares of Stock under previous GAAP were reclassified to Available-for-Sale Financial Assets and Held-to-Maturity Securities;
- Accrued interest receivable, loans receivable and other receivables which are previously presented as part of Other Assets under previous GAAP are now shown under a separate balance sheet line item Other Receivables account;
- Deferred Reinsurance Premiums previously offset against Reserve for Unexpired Risks is now presented as a separate line item in the balance sheets;
- Deferred Reinsurance Commissions previously offset against Deferred Acquisition Costs is now presented as a separate line item in the balance sheet; and,
- Reserve for fluctuation in value of investments in shares of stock under previous GAAP is now presented as Revaluation Reserves in statement of changes in equity.

Individual notes to the balance sheet items and the accounting policies provide further details on these changes.

2.3 Fair Value Measurement of Financial Assets

Certain investments in government securities were classified as available-for-sale financial asset, which are measured at fair value. This resulted to the recognition of gains on changes in fair value amounting to P 67,683,751 in the January 1, 2004 opening PFRS balance sheet and P 21,108,508 in December 31, 2004. Moreover, accumulated unrealized foreign exchange difference previously recognized in the equity section amounting to P 24,056,046 and 24,405,046 as of January 1 and December 31, 2004, were charged to the beginning balance of retained earnings and 2004 operations. Consequently, deferred taxes related to the account were recognized. This amounted to P 7,697,935 as of December 31, 2004.

2.4 Effective Interest Amortization

Investments in government securities acquired at a premium or discount were previously amortized using straight-line method. PAS 39 requires amortization of premiums or discounts using effective interest method. This resulted to the increase in retained earnings by P1,346,821 for the period ended January 1, 2004 and P1,142,546 for the period ended December 31, 2004.

2.5 Derecognition of Catastrophe Loss Reserve

PFRS 4 prohibits recognition of liabilities relating to insurance contracts that are not in existence as of the balance sheet date (e.g. catastrophe and equalization provisions). Previously, in compliance with the letter from Insurance Commission dated October 15, 1996, all insurance companies set up a catastrophe loss reserve for exposures on allied perils (earthquake, typhoon and flood). Accordingly, the balance of catastrophe loss reserve amounting to P10,300,592 and P12,697,073 as of January 1 and December 31, 2004 and related deferred tax asset amounted to P3,296,189 and P4,063,063 as of January 1 and December 31, 2004 were reversed against retained earnings.

2.6 Full Recognition of Defined Benefit Asset

Under PFRS, the Company's obligation under post-employment defined benefit plan should be actuarially determined using projected unit credit method. The adoption of the new standard resulted in the recognition of defined benefit asset amounting to P100,565 and P83,778 as of January 1 and December 31, 2004.

2.7 Accrual of Leave Benefits

PAS 19 requires recognition of compensated absences or leave benefits in the period when the service of an employee was rendered. As a result of the adoption of PAS 19, the Company accrued leave benefits amounting to P3,083,189 and P4,169,014 as of January 1 and December 31, 2004, respectively. Consequently, deferred tax assets related to accrued leave benefits amounting to P986,620 and P1,334,084 were also recognized.

2.8 Reversal of Provision for IBNR

As previously mentioned, PFRS 4 prohibits recognition of liabilities relating to insurance contracts that are not in existence as of the balance sheet date. As a result, the Company reversed the provision for IBNR amounting to P12,141,375 and P16,875,963 in January 1 and December 31, 2004, respectively. Accordingly, the related deferred tax on the provision was reversed. This amounted to P5,400,308 and P3,885,240 as of December 31 and January 1, 2005, respectively.

2.9 Measurement of Loans Receivable at Amortized Cost

The Company grants long-term receivables to its employee, which is due in five years. Under PFRS, this type of financial asset is measured at amortized cost using the effective interest rate method. The discount rate used was determined by reference to the market interest rate of comparable financial instrument at the date of the inception of the loan. This resulted to the recognition of day-one loss amounting to P68,039 and interest income of P35,816 and P51,575 in the retained earnings as of January 1 and December 31, 2004, respectively.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies that have been used in the preparation of these financial statements are summarized below. The policies have been consistently applied to all years presented, unless otherwise stated.

3.1 Basis of Preparation

The financial statements of National Reinsurance Corporation of the Philippines have been prepared in accordance with generally accepted accounting principles in the Philippines as set forth in PFRSs.

The financial statements have been prepared on the historical cost basis, except for the revaluation of certain financial assets. The measurement bases are more fully described in the accounting policies below.

It should be noted that accounting estimates and assumptions are used in preparing the financial statements. Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates.

The financial statements are presented in Philippine pesos, the Company's functional currency, and all values represent absolute amounts except when otherwise indicated.

3.2 Impact of New and Revised Accounting Standards Effective Subsequent to 2005

There are new and revised accounting standards, amendments and interpretations to existing standards that have been published by IASB and adopted by the ASC which are mandatory for accounting periods beginning on or after January 1, 2006. Of the new ASC pronouncements, the following standards are relevant to the Company but which the Company has not opted to adopt early:

2006	PAS 19 (Amendment)	:	Employee Benefits
	PAS 39 (Amendment)	:	The Fair Value Option
	PAS 39 and PFRS 4 (Amendment)	:	Financial Guarantee Contracts
	PFRS 1 (Amendment)	:	First-time Adoption of Philippine Financial Reporting Standards
2007	PAS 1 (Amendment)	:	Presentation of Financial Statements
	PFRS 7	:	Financial Instruments: Disclosures

The Company will apply the relevant new accounting standards in 2006 and 2007 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 2006, as well as for prior and future periods:

- PAS 19 (Amended), *Employee Benefits*. This amendment introduces the option of an alternative recognition approach for actuarial gains and losses. It imposes additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. As the Company does not intend to change the accounting policy adopted for recognition of actuarial gains and losses and does not participate in any multi-employer plans, adoption of this amendment will only impact the format and extent of disclosures presented in the accounts. The Company will apply this amendment for annual periods beginning January 1, 2006.
- PAS 39 (Amended), *The Fair Value Option*. This amendment changes the definition of financial instruments classified at fair value through profit or loss and restricts the ability to designate financial instruments as part of this category. The Company believes that this amendment will not have a significant impact on the classification of financial instruments, as the Company would be able to comply with the amended criteria for the designation of financial instruments at fair value through profit or loss. The Company will apply this amendment for annual periods beginning January 1, 2006.
- PFRS 7, *Financial Instruments: Disclosures* and complementary amendment to PAS 1. 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, including sensitivity analysis to market risk. It replaces PAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, and disclosure requirements in PAS 32, *Financial Instruments: Disclosures 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 has assessed the impact of PFRS 7 and the amendment to PAS 1 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by the amendment of PAS 1. The Company will apply PFRS 7 and the amendment to PAS 1 for annual periods beginning January 1, 2007.

As for the other new accounting standards, the Company has initially assessed that these will not result in significant changes to the amounts or disclosures in its financial statements.

3.3 Cash and Cash Equivalents

Cash and cash equivalents are defined as cash on hand, demand deposits and short-term, highly liquid investments readily convertible to cash and which are subject to insignificant risk of changes in value.

3.4 Reinsurance Balances Receivable

Reinsurance balances receivables are recognized and carried at original invoice amounts less impairment and allowance for any uncollectible amounts. An estimate for doubtful receivables is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

3.5 Financial Assets

Financial assets include cash and financial instruments. The Company classifies its financial assets, other than hedging instruments, into the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. Financial assets are assigned to the different categories by management on initial recognition, depending on the purpose for which the investments were acquired. The designation of financial assets is re-evaluated at every reporting date at which date a choice of classification or accounting treatment is available, subject to compliance with specific provisions of applicable accounting standards.

All financial assets are recognized on their trade date. All financial assets that are not classified as at fair value through profit or loss are initially recognized at fair value, plus transaction costs.

- *Financial Assets at Fair Value through Profit or Loss*. This category include financial assets that are either classified as held for trading or are designated by the entity to be carried at fair value through profit or loss upon initial recognition. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorized as 'held for trading' unless they are designated as hedges. Assets in this category are classified as current assets if they are either held for trading or are expected to be realized within 12 months of the balance sheet date.

Subsequent to initial recognition, the financial assets included in this category are measured at fair value with changes in fair value recognized in profit or loss. Financial assets originally designated as financial assets at fair value through profit or loss may not subsequently be reclassified.

- **Receivables:** Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Company provides money, goods or services directly to a debtor with no intention of trading the receivables.

Receivables are subsequently measured at amortized cost using the effective interest method, less impairment losses. Any change in their value is recognized in profit or loss.

Loans and receivables are presented as Reinsurance Balances Receivables and Other Receivables in the balance sheets.

Impairment loss is provided when there is objective evidence that the Company will not be able to collect all amounts due to it in accordance with the original terms of the receivables. The amount of the impairment loss is determined as the difference between the asset's carrying amount and the present value of estimated cash flows.

- **Held-to-maturity investments:** These include non-derivative financial assets with fixed or determinable payments and a fixed date of maturity. Investments are classified as held-to-maturity if the Company has the positive intention and ability to hold them until maturity. Investments intended to be held for an undefined period are not included in this classification.

Held-to-maturity investments are subsequently measured at amortized cost using the effective interest method. In addition, if there is objective evidence that the investment has been impaired, the financial asset is measured at the present value of estimated cash flows. Any changes to the carrying amount of the investment are recognized in profit or loss.

- **Available-for-sale Financial Assets:** This include non-derivative financial assets that are either designated to this category or do not qualify for inclusion in any of the other categories of financial assets.

All financial assets within this category are subsequently measured at fair value, unless otherwise disclosed, with changes in value recognized in equity, net of any effects arising from income taxes. Gains and losses arising from securities classified as available-for-sale are recognized in the statement of income when they are sold or when the investment is impaired.

In the case of impairment, any loss previously recognized in equity is transferred to the income statement. Losses recognized in the statement of income on equity investments are not reversed through the statement of income. Losses recognized in prior period income statements resulting from the impairment of debt instruments are reversed through the income statement.

For investments that are actively traded in organized financial markets, fair value is determined by reference to stock exchange quoted market bid prices at the close of business on the balance sheet date. For investments where there is no quoted market price, fair value is determined by reference to the current market value of another instrument which is substantially the same or is calculated based on the expected cash flows of the underlying net asset base of the investment.

Derecognition of financial assets occurs when the rights to receive cash flows from the financial instruments expire or are transferred and substantially all of the risks and rewards of ownership have been transferred.

3.6 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, major 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

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

The residual values and estimated useful lives of property and equipment are reviewed, and adjusted if appropriate, at each balance sheet date.

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.

Property and equipment is subsequently reassessed for indications that an impairment loss previously recognized may no longer exist and the carrying amount of the asset is adjusted to the recoverable amount resulting in the reversal of the impairment loss.

3.7 Financial Liabilities

Financial liabilities include insurance liabilities and accrued expenses and other payables.

Financial liabilities are recognized when the Company becomes a party to the contractual agreements of the instrument. All interest related charges are recognized as expense in the statement of income.

Insurance liabilities and accrued expenses and other payables are recognized initially at their nominal value and subsequently measured at amortized cost less settlement payments.

Dividend distributions to shareholders are recognized as financial liabilities when the dividends are approved by the shareholders.

Financial liabilities are derecognized from the balance sheet only when the obligations are extinguished either through discharge, cancellation or expiration.

3.8 Provisions

Provisions are recognized when present obligations will probably lead to an outflow of economic resources and they can be estimated reliably even if the timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive commitment that has resulted from past events, for example legal disputes or onerous contracts.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the balance sheet date, including the risks and uncertainties associated with the present obligation. Any reimbursement expected to be received in the course of settlement of the present obligation is recognized, if virtually certain, as a separate asset at an amount not exceeding the balance of the related provision. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. In addition, long-term provisions are discounted to their present values, where time value of money is material.

Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate.

In those cases where the possible outflow of economic resource as a result of present obligations is considered improbable or remote, or the amount to be provided for cannot be measured reliably, no liability is recognized in the financial statements.

Probable inflows of economic benefits that do not yet meet the recognition criteria of an asset are considered contingent assets, hence, are not recognized in the financial statements.

3.9 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.

Interest income is recognized as the interest accrues (taking into account the effective yield on the asset).

3.10 Claim Costs 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 are presented as part of Reinsurance Balances Receivable.

3.11 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.

3.12 Commissions on Retrocessions

Commissions on retrocessions are deferred and are subjected to the same amortization method as the related acquisition costs. Deferred portion are presented in the balance sheet as Deferred Reinsurance Commissions.

3.13 Employee Benefits

Pensions to employees are provided through a defined benefit plan.

A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and salary. The legal obligation for any benefits from this kind of pension plan remains with

the Company, even if plan assets for funding the defined benefit plan have been acquired. Plan assets may include assets specifically designated to a long-term benefit fund as well as qualifying insurance policies. The Company's defined benefit pension plan covers all regular full-time employees. The pension plan is tax-qualified, noncontributory and administered by a trustee.

The asset recognized in the balance sheet for defined benefit pension plans is the excess of the fair value of plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs, over the present value of the defined benefit obligation (DBO) at the balance sheet date. The DBO is calculated annually by independent actuaries using the projected unit credit method. The present value of the DBO is determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating the terms of the related pension liability.

Actuarial gains and losses are not recognized as expense unless the total unrecognized gain or loss exceeds 10% of the greater of the obligation and related plan assets. The amount exceeding this 10% corridor is charged or credited to profit or loss over the employees' expected average remaining working lives. Actuarial gains and losses within the 10% corridor are disclosed separately. Past service costs are recognized immediately in the income statement, 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.

Short-term employee benefits are recognized for the number of paid leave days (including holiday entitlement) remaining at the balance sheet date. They are included in current pension and other employee obligations at the undiscounted amount that the Company expects to pay as a result of the unused entitlement.

3.14 Income Taxes

Current income tax assets or liabilities comprise those claims from, or obligations to, fiscal authorities relating to the current or prior reporting period, that are uncollected or unpaid at the balance sheet date. They are calculated according to the tax rates and tax laws applicable to the fiscal periods to which they relate, based on the taxable profit for the year. All changes to current tax assets or liabilities are recognized as a component of tax expense in the statement of income.

Deferred tax is provided, using the balance sheet liability method on temporary differences at the balance sheet date between the tax base 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 income tax asset 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 income 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.

Most changes in deferred tax assets or liabilities are recognized as a component of tax expense in the statement of income. Only changes in deferred tax assets or liabilities that relate to a change in value of assets or liabilities that is charged directly to equity are charged or credited directly to equity.

3.15 Equity

Capital stock is determined using the nominal value of shares that have been issued.

Additional paid-in-capital includes any premiums received on the initial issuance of capital stock. Any transaction costs associated with the issuance of shares are deducted from additional paid-in-capital, net of any related income tax benefits.

The revaluation reserve comprises gains and losses due to the revaluation of available-for-sale investments.

Retained earnings include all current and prior period results as disclosed in the statement of income.

3.16 Functional Currency and Foreign Currency Transactions

- *Functional and Presentation Currency*

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The financial statements are presented in Philippine pesos, which is the Company's functional currency.

- *Transaction and Balances*

The accounting records of the Company are maintained in Philippine pesos. Foreign currency transactions during the year are translated into the functional currency at exchange rates which approximate those prevailing on transaction dates.

Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of income.

3.17 Impairment of Non-Financial Assets

The Company's investments in equity securities and property and equipment are subject to impairment testing. The individual assets or cash-generating units are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

For purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). As a result, some assets are tested individually for impairment and some are tested at cash-generating unit level.

An impairment loss is recognized for the amount by which the asset or cash-generating unit's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of fair value, reflecting market conditions less costs to sell and value in use, based on an internal discounted cash flow evaluation. Impairment loss is charged pro rata to the other assets in the cash generating unit.

All assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist and the carrying amount of the asset is adjusted to the recoverable amount resulting in the reversal of the impairment loss.

4. CASH AND CASH EQUIVALENTS

This account consists of:

	2005	2004
Cash on hand and in banks	P 141,980,545	P 54,737,580
Time deposits	-	14,066,750
	<u>P 141,980,545</u>	<u>P 68,804,330</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 includes foreign currency denominated cash of US\$286,208 (P 15,188,200) as of December 31, 2005 and US\$329,132 (P 18,519,249) as of December 31, 2004.

5. REINSURANCE BALANCES

The details of reinsurance balances are as follows:

	2005	2004
Reinsurance balances receivable:		
Reinsurance recoverable on losses	P 914,106,854	P 539,356,437
Due from ceding companies	738,109,215	739,901,672
Funds held by ceding companies	29,742,449	37,198,254
	<u>1,681,958,518</u>	<u>1,316,456,363</u>
Allowance for impairment	(13,698,738)	(12,948,738)
	<u>P 1,668,259,780</u>	<u>P 1,303,507,625</u>
Reinsurance balances payable:		
Claims payable	P 819,103,379	P 700,357,884
Due to retrocessionaires	492,650,346	242,578,102
Funds held for retrocessionaires	20,955,621	33,548,846
	<u>P 1,332,709,346</u>	<u>P 976,484,832</u>

The fair values of these short-term financial assets and liabilities are not individually determined as the carrying amount is a reasonable approximation of fair value.

6. INVESTMENTS

6.1 Available-for-Sale Financial Assets

This account is composed of:

	2005	2004
Government securities	P 1,556,903,010	P 621,610,456
Equity securities	18,723,035	13,768,559
Investment in Asian Reinsurance Corporation (Asian Re) shares	81,192,510	28,133,500
	<u>P 1,656,818,555</u>	<u>P 663,512,515</u>

The following presents the fair values of investments in government securities by contractual maturity dates:

	2005	2004
Due within one year	P 219,979,767	P 128,335,461
Due after one year through five years	525,900,802	471,593,613
Due after five years through ten years	804,947,236	16,669,813
Due after ten years	6,075,205	5,011,569
	<u>P 1,556,903,010</u>	<u>P 621,610,456</u>

Government securities earn interest at annual rates ranging from 5.6% to 19.0% in 2005 and 5.6% to 20.5% in 2004. Changes in fair values of these government securities amounted to P 96,501,112 (net increase) in 2005 and P 48,502,720 (net decrease) in 2004.

The balance of equity securities classified as available-for-sale financial asset consists of:

	2005	2004
Cost:		
Quoted in the stock exchange	P 15,716,756	P 15,548,205
Not quoted in the stock exchange	1,694,500	1,635,000
	<u>17,411,256</u>	<u>17,183,205</u>
Fair value gains (losses)		
Quoted in the stock exchange	2,246,779	(2,419,646)
Not quoted in the stock exchange	(935,000)	(995,000)
	<u>1,311,779</u>	<u>(3,414,646)</u>
	<u>P 18,723,035</u>	<u>P 13,768,559</u>

The shares of Asian Re have been issued in the name of the Government of the Philippines (GoP) as the Philippine government's participation in the joint undertaking of Asian countries to organize a reinsurance company that will service the needs of the region. The GoP 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. The shares of stock of Asian Re, while not for sale, were classified under this category since these do not qualify for inclusion in any other categories of financial assets. These shares of stock are measured at fair values and the changes in the fair values are recognized in the equity. The fair value of investments in Asian Re shares amounted to P 81,192,510 and P 28,133,500 as of December 31, 2005 and 2004, respectively. Changes in fair value recognized as part of Revaluation Reserves in the equity section of the balance sheet amounted to P 35,528,356, net of deferred taxes amounting to P 19,130,654 (see Note 12).

The reconciliation of the carrying amounts of available-for-sale financial assets are as follows:

	2005	2004
Balance at the beginning of the year	P 663,512,515	P 862,619,432
Additions	1,152,671,083	140,312,710
Disposals	(281,579,875)	(293,041,273)
Fair value gains (losses)	155,886,547	(46,727,354)
Foreign currency gains (losses)	(33,671,715)	349,000
	<u>P 1,656,818,555</u>	<u>P 663,512,515</u>

6.2 Held-to-Maturity Securities

Held-to-maturity securities consist of US dollar denominated fixed treasury notes with three to ten years term and interest rates ranging from 5.6% to 9%.

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

	2005	2004
Due within one year	P 26,494,064	P -
Due after one year through five years	50,554,795	28,046,796
Due after five years through ten years	111,288,876	171,558,143
	<u>P 188,337,735</u>	<u>P 199,604,939</u>

Government securities totaling P 18,750,000 in 2005 and 2004 are on deposit with the IC as security for the benefit of policyholders and creditors of the Company in accordance with the provisions of the Insurance Code of the Philippines.

6.3 Others

Other investments in 2005 pertain to the capitalized expenses, specifically filing and professional fees, incurred for the planned merger with UMRC which amounted to ₱4,041,020.

7. OTHER RECEIVABLES

This account includes the following:

	2005	2004
Current:		
Accrued interest receivable	₱ 40,959,954	₱ 21,645,995
Others	181,097	39,669
Non-current:		
Loans receivable	2,049,246	637,145
	<u>₱ 43,190,297</u>	<u>₱ 22,322,809</u>

The fair values of current portion of Other Receivables are not individually determined as the carrying amount is a reasonable approximation of fair value.

8. PROPERTY AND EQUIPMENT

Presented below is a reconciliation of the carrying amounts at the beginning and end of 2005 and the gross carrying amounts and the accumulated depreciation of property and equipment.

	Condominium Units	Office Improvements	Office Furniture and Equipment	Transportation Equipment	EDP Equipment	Total
Balance at January 1, 2005, net of accumulated depreciation and impairment	₱ 40,402,634	₱ 2,152,292	₱ 830,502	₱ 2,170,937	₱ 2,391,013	₱ 47,947,378
Additions	-	-	49,080	5,660,000	193,600	5,902,680
Disposals	-	-	-	-	-	-
Depreciation charge for the year	(1,339,314)	(554,077)	(367,946)	(1,577,216)	(823,353)	(4,661,906)
Balance at December 31, 2004, net of accumulated depreciation and impairment	<u>₱ 39,063,320</u>	<u>₱ 1,598,215</u>	<u>₱ 511,636</u>	<u>₱ 6,253,721</u>	<u>₱ 1,761,260</u>	<u>₱49,188,152</u>
December 31, 2005						
Cost	₱ 53,572,553	₱ 5,540,763	₱ 2,518,419	₱ 9,652,950	₱ 4,494,715	₱75,779,400
Accumulated depreciation	(14,509,233)	(3,942,548)	(2,006,783)	(3,399,229)	(2,733,455)	(26,591,248)
Net carrying amount	<u>₱ 39,063,320</u>	<u>₱ 1,598,215</u>	<u>₱ 511,636</u>	<u>₱ 6,253,721</u>	<u>₱ 1,761,260</u>	<u>₱49,188,152</u>
Balance at January 1, 2004, net of accumulated depreciation	₱ 41,741,948	₱ 2,706,368	₱ 1,051,507	₱ 3,518,277	₱ 2,322,987	₱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>₱ 40,402,634</u>	<u>₱ 2,152,292</u>	<u>₱ 830,502</u>	<u>₱ 2,170,937</u>	<u>₱ 2,391,013</u>	<u>₱47,947,378</u>
December 31, 2004						
Cost	₱ 53,572,553	₱ 5,540,763	₱ 2,469,339	₱ 7,205,370	₱ 4,301,115	₱73,089,140
Accumulated depreciation	(13,169,919)	(3,388,471)	(1,638,837)	(5,034,439)	(1,910,102)	(25,141,762)
Net carrying amount	<u>₱ 40,402,634</u>	<u>₱ 2,152,292</u>	<u>₱ 830,502</u>	<u>₱ 2,170,937</u>	<u>₱ 2,391,013</u>	<u>₱47,947,378</u>

9. OTHER ASSETS

The Other Assets account includes the following:

	Notes	2005	2004
Deferred withholding value added tax		P 3,214,139	P -
Prepayments		1,770,002	2,577,317
Deposit		251,200	203,200
Defined benefit asset	11	162,062	83,777
Security fund		97,585	97,585
Others		296,059	-
		<u>P 5,791,047</u>	<u>P 2,961,879</u>

Deferred withholding VAT represents unapplied input taxes resulting from unpaid premiums on ceded out transactions.

Prepayments include substantially prepaid insurance on property and equipment and group life insurance and prepaid taxes amounting to P729,242.

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. The balance of the fund earns interest at rates determined by the IC annually.

10. GENERAL AND ADMINISTRATIVE EXPENSES

The details of this account follow:

	Notes	2005	2004
Salaries and employee benefits	11	P 47,313,412	P 41,413,691
Representation and entertainment		6,242,040	7,009,402
Depreciation		4,661,906	4,567,710
Transportation and travelling		2,996,757	3,279,950
Professional fees		2,905,924	28,817,281
Documentary stamps		1,941,938	795,186
Repairs and maintenance		1,757,509	1,939,897
Retirement	11	1,702,402	1,620,490
Light and water		1,466,494	1,351,761
Taxes, licenses and fees		1,406,021	1,258,688
Printing and office supplies		1,373,869	1,571,183
Communication and postages		1,143,631	1,125,883
Doubtful accounts expense		750,000	750,000
Insurance		676,663	609,495
Professional and technical development		482,070	555,211
Donations and contributions		469,250	507,057
Fringe benefits taxes		322,771	310,686
Miscellaneous		3,465,428	2,124,673
		<u>P 81,078,085</u>	<u>P 99,608,244</u>

11. EMPLOYEE BENEFITS

11.1 Short-term Benefits

Expenses recognized for employee benefits are presented below (see Note 10):

	2005	2004
Salaries and wages	P 26,666,537	P 25,473,514
Allowances and bonus	12,266,129	10,968,498
Social security costs	1,130,122	1,060,670
Compensated absences	3,872,326	1,217,460
Others	3,378,298	2,693,549
	<u>P 47,313,412</u>	<u>P 41,413,691</u>

11.2 Post Employment 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 2005 and 2004 amounted to P1,702,402 and P 1,620,490, respectively (see Note 10).

The Company obtained an updated actuarial valuation as of January 1, 2004 to ascertain its transitional asset/liability as of that date in accordance with PAS 19, Employee Benefits. The Company's transition to PAS 19 is discussed in Note 2. Actuarial valuations are made annually to update the retirement benefit costs and the amount of contributions.

The amounts of defined benefit asset recognized in the balance sheets as part of Other Assets are determined as follows (see Note 9):

	<u>2005</u>	<u>2004</u>
Present value of the obligation	P 24,158,148	P 15,244,406
Fair value of plan assets	(18,955,928)	(15,541,394)
Deficiency (excess) of plan assets	5,202,220	(296,988)
Unrecognized actuarial gains	(5,364,282)	213,211
Defined benefit asset	P 162,062	P 83,777

The amounts of retirement expense recorded as part of General and Administrative Expenses account in the statements of income are as follows (see Note 10):

	<u>2005</u>	<u>2004</u>
Current service costs	P 1,265,146	P 1,249,283
Interest costs	1,676,885	1,357,058
Expected return on plan assets	(1,239,629)	(1,009,767)
Net actuarial gain recognized during the year	-	23,916
Retirement benefits	P 1,702,402	P 1,620,490

The movements in the defined benefit asset recognized in the books are as follows:

	<u>2005</u>	<u>2004</u>
Balance at beginning of year	P 83,777	P 100,565
Expense recognized	(1,702,402)	(1,620,490)
Contributions paid	1,780,687	1,603,702
Balance at end of year	P 162,062	P 83,777

For determination of the retirement benefit obligation, the following actuarial assumptions were used:

	<u>2005</u>	<u>2004</u>
Discount rates	11%	9.5%
Expected rate of return on plan assets	8%	8%
Expected rate of salary increases	8%	8%

11.3 Key Management Personnel Compensation

	<u>2005</u>	<u>2004</u>
Short-term benefits	P 22,011,260	P 18,781,767
Post-employment benefits	793,425	678,004
Total	P 22,804,685	P 19,459,771

12. TAXES

12.1 Current and Deferred Income Taxes

The major components of tax expense for the years ended December 31, 2005 and 2004 are as follows:

	<u>2005</u>	<u>2004</u>
Statements of income:		
Current tax expense:		
Regular corporate income tax (RCIT) (at 32%)	P -	P 5,858,902
Minimum corporate income tax (MCIT) (at 2%)	1,020,169	-
Final tax (at 20% and 7.5%)	<u>20,895,482</u>	<u>19,356,307</u>
	<u>21,915,651</u>	<u>25,215,209</u>
Deferred tax resulting from an increase in RCIT rate	1,741,334	-
Deferred tax relating to origination and reversal of temporary differences	(19,280,838)	(2,108,014)
	<u>(17,539,504)</u>	<u>(2,108,014)</u>
Tax expense reported in statements of income	<u>P 4,376,147</u>	<u>P 23,107,195</u>
Statements of changes in equity:		
Deferred tax relating to origination and reversal of temporary difference	<u>P 19,130,654</u>	<u>65,643</u>
	<u>P 19,130,654</u>	<u>P 65,643</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>2005</u>	<u>2004</u>
Tax on pretax income (at 35% in 2005 and 32% in 2004)	P 36,064,109	P 39,374,551
Adjustment for income subjected to lower income tax rates	20,895,482	19,356,307
Tax effect of:		
Increase in deductible temporary difference due to change in RCIT rate	1,741,334	-
Non-deductible expenses	188,261	416,679
Non-taxable income	(714,051)	(2,265,470)
Interest income subjected to final tax	(53,798,988)	(33,774,872)
Tax expense reported in statements of income	<u>P 4,376,147</u>	<u>P 23,107,195</u>

The Company is subject to MCIT, computed at 2% of gross income or RCIT, whichever is higher. The MCIT and net operating loss carryover (NOLCO) resulting from the computation of RCIT can be used by the Company against the regular income tax and taxable income, respectively, in the next three taxable years. In 2005, the Company incurred NOLCO amounting to P 5,087,865 which can be used as deduction against taxable income until 2008.

MCIT for the year amounted to P 1,020,169 and is recorded as part of Deferred Tax Assets account in the 2005 balance sheet.

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

	<u>Balance Sheets</u>		<u>Statements of Income</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Deferred tax liabilities:				
Deferred acquisition costs	P17,936,778	P15,378,773	(P 2,558,005)	P 2,029,576
Revaluation reserves on available-for-sale investments	19,130,654	65,643	-	-
Excess of reserve for unexpired risks per books over tax basis	2,734,101	(1,850,572)	(4,584,673)	(4,032,668)
Deferred tax assets:				
Unrealized foreign exchange gain (loss)	(10,950,775)	10,708,183	21,658,958	478,929
Allowance for doubtful accounts	(4,794,558)	(4,143,596)	650,962	(240,000)
MCIT	(1,020,169)	-	1,020,169	-
NOLCO	(1,780,753)	-	1,780,753	-
Accrued leave benefits	(888,431)	(1,334,087)	(445,656)	(347,464)
Past service cost	(201,466)	(184,470)	16,996	3,613
Deferred Tax Income			<u>P 17,539,504</u>	<u>(P 2,108,014)</u>
Net Deferred Tax Liabilities	<u>P20,165,381</u>	<u>P18,639,874</u>		

12.2 New Tax Regulation

On May 24, 2005, Republic Act No. 9337 ("RA 9337"), amending certain sections of the National Internal Revenue Code of 1997, was signed into law and become effective beginning November 1, 2005. The following are the major changes brought about by RA 9337 that are relevant to the Company:

- a. RCIT rate is increased from 32% to 35% starting November 1, 2005 until December 31, 2008 and will be reduced to 30% beginning January 1, 2009;
- b. VAT rate of 10% remains unchanged, with the President of the Philippines having a stand-by authority effective January 1, 2006 to increase the VAT rate to 12% under certain conditions (the rate is increased to 12% effective February 1, 2006);
- c. VAT rate of 10% is now be imposed on certain goods and services that were previously zero-rated or subject to percentage tax;
- d. Input tax on capital goods shall be claimed on a staggered basis over 60 months or the useful life of the related assets, whichever is shorter; and,
- e. Creditable input VAT is capped by a maximum of 70% of output VAT per quarter.

13. EQUITY

13.1 Capital Stock

Capital stock consists of:

	Shares		Amount	
	2005	2004	2005	2004
Common shares P100 par value Authorized: 10,000,000 shares Issued:				
Balance at beginning of year	6,142,365	4,552,185	P 614,236,500	P 455,218,500
Issuance during the year	3,857,635	-	385,763,500	-
Stock dividends issued during the year	-	1,590,180	-	159,018,000
Balance at end of year	<u>10,000,000</u>	<u>6,142,365</u>	<u>P 1,000,000,000</u>	<u>P 614,236,500</u>

13.2 Treasury Shares

Treasury shares pertain to the Company's shares of stock held by First Quezon City Insurance Co., Inc., which was reacquired in 2005 at a total cost of P 174,126.

13.3 Appropriation for Contingencies

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 P 5,000,000 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 under Retained Earnings account in the statements of changes in equity, should not exceed, at any time, the amount of paid-up capital. The balance of appropriation for contingencies as of December 31, 2005 and 2004 amounted to P 123,455,961 and P 113,589,545, respectively.

13.4 Shareholders Owning at Least 100 Shares

In compliance with SRC Rule 68, the Company has 139 shareholders owning 100 or more shares of stocks of the Company.

14. 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, 2004. Based on the examination, the Company's surplus that is available to cover the required margin of solvency as of December 31, 2004 amounted to P 907,301,940. This amount exceeds the required margin of solvency of P 55,189,073 by P 852,112,867.

15. RECONCILIATION OF NET INCOME UNDER PFRS TO STATUTORY NET INCOME

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

	2005	2004
PFRS net income	P 98,664,163	P 99,938,278
Difference in change in reserve for unexpired risk- net	(13,594,754)	12,602,087
Deferred acquisition costs- net	(3,189,272)	(6,342,425)
Provision for catastrophe loss	(17,077,303)	(2,396,481)
Tax effect of the adoption of GAAP accounting	11,851,465	(1,236,218)
Statutory net income	P 76,654,299	P 102,565,241

16. EVENTS AFTER THE BALANCE SHEET DATE

As mentioned in Note 1, the Company's plan of merger with UMRC was approved by the majority of stockholders on October 20, 2005 and the SEC on March 6, 2006. Consequently, the following were also approved on the same dates:

- Increase in the authorized capital stock from P 1,000,000,000 to P 3,000,000,000
- Amendment of the articles of incorporation which included the following new provisions:
 1. With certain exceptions, no shareholder shall have the right or power to sell or otherwise dispose of any shares of the capital stock of the Company without first offering it to the other shareholders of the Company.
 2. No stockholder shall own or acquire more than 30% of the outstanding capital stock of the Company.
- Amendment of by-laws which introduced two new articles, particularly:
 1. The BOD shall constitute audit committee, nomination committee and compensation committee in aid of good governance.
 2. The Company shall have at least one (1) independent director, or such number as shall constitute at least twenty (20%) of the BOD size, whichever is higher.

17. 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.

18. RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company maybe exposed to a variety of financial risks which results from both its operating and investing activities. The Company's main risk mitigation strategies generally include adoption of underwriting and investment policies and guidelines, annual budget provision and internal audit checks and assessments.

The Company's risk management, in close cooperation with the respective duly constituted Board Committees on Underwriting, Investment, Budget and Audit, focuses on implementing risk control measures addressing underwriting acceptances, claims control, securing short-to-medium term cash flows by minimizing exposure to financial markets while managing long-term financial investments to generate lasting returns.

The Company does not actively engage in the trading of financial assets for speculative purposes nor does it write options. The most significant financial risks to which the Company maybe exposed to are described below.

18.1 Foreign currency risk

The Company is exposed to foreign currency risk which mainly arises from its dollar-denominated investments, receivables and payables. The Company recognized net foreign exchange losses of P 45,952,689 in 2005 and net foreign exchange gain of P 7,201,781 in 2004.

18.2 Credit Risk

Generally, the maximum credit risk exposure of financial assets is the carrying amount of the financial assets as shown on the face of the balance. Credit risk, therefore, is only disclosed in circumstances where the maximum potential loss differs significantly from the financial asset's carrying amount.

The Company's receivables are actively monitored to avoid significant concentrations of credit risk.

18.3 Cash flow and fair value interest rate risks

Currently, the Company has no financial liabilities with floating interest rates.

OPERATING OFFICERS



ROBERTO B. CRISOL
EXECUTIVE VICE PRESIDENT



WILFRIDO C. BANTAYAN
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
EXTERNAL AUDITORS

ACROPOLIS CENTRAL GUARANTY CORPORATION

AFP GENERAL INSURANCE CORPORATION

ALLIEDBANKERS INSURANCE CORPORATION

ALPHA INSURANCE & SURETY COMPANY, INC.

ASIA INSURANCE (PHILIPPINES) CORPORATION

ASIA UNITED INSURANCE, INC.

AVIVA GENERAL INSURANCE PTE. LTD.

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.

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

FLT PRIME INSURANCE CORPORATION

FIRST NATIONWIDE ASSURANCE CORPORATION, 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.

MAA GENERAL ASSURANCE PHILS., 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 HOLDINGS, INC.
 PIONEER LIFE 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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