



National Reinsurance Corporation of the Philippines

2006 ANNUAL REPORT

New Company Logo



After our merger with Universal Malayan Reinsurance Corporation, we are now known as *Philippine National Reinsurance Company* or *PhilNaRe*. "Philippines" fittingly pertains to our major role as the country's sole domestic reinsurer, proud of our strong roots and rich heritage. The pillar on our new logo symbolizes the Company's operational and financial strength. The thick line below our name represents stability and commitment, while the running lines above stand for the Company's vision and our forward-looking thrust into the future.

Philosophy

PhilNaRe believes in outstanding service to clients. Our strategies and way of doing business are firmly anchored on this belief. As we aim to be the dominant reinsurance company in the Philippines and a regionally respected reinsurer, we continuously strive to extend the best measure of service to our clients, who are the foundation of our business. We listen and respond to their needs and provide them with innovative solutions to empower them to pursue their goals.

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In 2006, we achieved significant milestones that allowed us to reach higher ground while skillfully tackling new important challenges. Amidst generally favorable developments in the Philippine economy and a positive economic outlook, your Company performed exceptionally well, delivering yet another year of outstanding growth and record profits.

I am proud to report that in 2006, your Company posted an all-time high of P3.8 billion in premium production, a 46% increase over the previous year's level. The highlight of the year was the merger of your Company and Universal Malayan Reinsurance Corporation (UMRE), which was completed in March 2006. The merger represents Phase II of our four-stage Capital Enhancement Program (CEP). Phase I, a rights offering which raised P776 million, was completed in 2005. The synergistic combination of your Company and UMRE resulted in raising our net underwriting profit to P187 million and net income to P275 million in 2006, an impressive leap of 149% and 179%, respectively, over the figures recorded in 2005.

The merger was a breakthrough in Philippine business, combining the strengths of three entities which are the best in their field: Bank of the Philippine Islands (BPI), Malayan Insurance Company and the Government Service Insurance System (GSIS). This strategic tripartite partnership has been hailed as a landmark achievement in the corporate community. To inaugurate the merger, your Company adopted a new logo of a pillar which depicts our strength and permanence of commitment, as well as a new trade name reflecting our vision as a locally dominant and regionally respected professional reinsurer: PhilNaRe.

At the same time, your Company remains on track to accomplish the third stage of the CEP, the Initial Public

"I am proud to report that in 2006, your Company posted an all-time high of P3.8 billion in premium production, a 46% increase over the previous year's level."

Message to Stockholders

Offering (IPO), through which we aim to increase our capital, add financial strength, and attain an even wider and more diverse ownership base. Total stockholders' equity, which already stands at P3.8 billion as of 31 December 2006, will be further boosted by proceeds from the IPO. This should allow your Company to gain an acceptable global security rating which will aid our international expansion, particularly in the Asian region. In addition, the IPO will enhance our ability to establish strategic alliances with regional partners, which is the fourth and final stage of the CEP.

The Government Service Insurance System (GSIS), ever cognizant of PhilNaRe's role as a showcase of a successful working partnership between the government and the private sector, fully supports your Company's mandate and initiatives. We are committed to your Company's balanced pursuit of serving the national interest while continuing the quest for expanded wealth and added value to our shareholders.

In closing, I wish to thank all our customers and shareholders for their unwavering commitment to and

support of the Company's business. I would also like to express my appreciation to the management and staff of your Company, for their dedication to achieving excellent business results and to their skill in the implementation of our strategic initiatives and plans.

Together, we shall continue to chart your Company's course towards greater growth and success, mindful of the formidable challenges that lie ahead and vigilant in the exercise of underwriting prudence and sound business judgment. To all the various publics we serve, we unequivocally convey PhilNaRe's renewed message of commitment. Stay with us in the coming years as we continue to build a leading institution of which you can be proud.



Atty. Winston F. Garcia
Chairman of the Board



“We are now a stronger and more solid company, anchored to high standards of service and corporate governance—disciplines that continue to guide us as we pursue a more vigorous path of growth.”

The year 2006 was a critical period during which we surmounted challenges and eventually reaped rewards for the efforts that we exerted. We are now a stronger and more solid company, anchored to high standards of service and corporate governance—disciplines that continue to guide us as we pursue a more vigorous path of growth.

Overall, the economic environment was a fitting backdrop for your Company's success. With GDP growing by 5.4% and GNP rising by 6.2%, broad-based growth was experienced in all the major economic sectors of Services (6.3%), Agriculture (4.1%) and Industry (4.8%).

The Philippine insurance industry in 2006 generally kept pace with the overall economy even as conditions of overcapacity and heightened competition depressed premium rates (especially on the property line) to historically low levels. Nevertheless, the Insurance Commission's move to set the minimum rates on natural perils at 0.15% was a positive measure that was met with widespread compliance by the industry. This, together with on-going moves to increase insurance companies' capitalization and net worth, are seen to further strengthen the industry, particularly the non-life sector.

President's Report

Underwriting Operations

The merger of your Company and Universal Malaysian Reinsurance Corporation, completed in March 2006, produced impressive results and established new milestones, as the combined portfolios generated gross premium income of almost P3.8 billion, a 46% growth rate that far exceeded the single digit growth rate of the direct writing industry. The successful merger involved various overhauls—information technology systems integration, benefits alignment and right-sizing—that paid off immensely in the end.

Substantial gains were recorded in the Fire, Casualty, and Life lines of business, from both treaty and facultative sources, even as your Company had to contend with market conditions which continued to remain soft and at times uncertain. Premiums from Fire rose strongly by 111% from the previous year's level, despite declining rates on property business, and accounted for 31% of gross premium income for the year under review. Casualty, which continues to be the Company's main line, registered a growth rate of almost 40% over 2005, and accounted for 44% of the Company's gross premium volume. The Life business significantly increased by 151% from P153M in 2005 to P384M in 2006, almost



doubling its contribution to total gross premium income from 5.9% in 2005 to 10.2% in 2006.

Your Company's underwriting profit showed even better results with net underwriting income of P187M exceeding the previous year's figure of P75M by 149%, as the combined profits from Fire (P84M), Casualty (P68M), and Life (P67.5M) negated the losses incurred under our Marine business. Of particular significance is the much-improved loss ratio in Fire, which settled at 36% in 2006 as against a loss ratio of 63.4% in 2005. Gradually emerging as a potential source of future growth and profits is the Life business, which represents 10% of the total premium portfolio and yet accounted for 36% of your Company's underwriting income.

Investments & Financial Reports

With a significantly bigger financial base resulting from the merger, your Company's investment and other income amounted to over P304M, for a 179% growth over the previous year's income. These gains more than compensated for the foreign currency translation losses incurred during the year under review.

Your Company's substantially bigger base of premium and investment income have favorably coincided with a drop in overall loss ratio, from 67% in 2005 to 59.8% in 2006, to produce a net income for the year of P275M, surpassing the previous year's net income of P99M by 179%. Total Assets grew by 104.5% from P4.4B in 2005 to P9.1B in 2006. Your Company's net worth stood at P3.8B as of yearend 2006, 80% higher than the previous year.

Corporate Governance

Cognizant of sound business practices, your Company takes a proactive approach in corporate governance, ensuring transparency and accountability in every process to protect the interest of shareholders and create value for all stakeholders. A compliance officer, who is responsible on a continuing basis for monitoring compliance with the provisions of your Company's Manual of Corporate Governance, has been appointed. The Board has likewise established an Executive Committee and a Nomination and Compensation Committee, pursuant to said Manual. Effective July 2006, your Company has appointed its independent directors as members of its Audit Committee, developing an effective system of checks and balances within the organization.

Furthermore, your Company continues to improve corporate governance through constant training of management on the best practices of good corporate governance. Such measures are part of our mission to lead our industry by example and strive to be a decisive force for sustainable progress for the benefit of the entire industry.

Plans and Directions

With your unwavering support and cooperation, we have taken broad strides in bringing PhilNaRe to its present stature of preeminence and financial strength. We have launched the third stage of our CEP, the IPO, the proceeds of which will be used to further boost your Company's paid-up capital, secure an acceptable

global rating and increase our capacity to accept and retain premiums. Strategic alliances are on the horizon, as we gear up to expand our presence in the regional market.

In support of regional expansion, we have taken on two additional senior executives--one to augment the Life Division management team and another to handle special projects involving large risks. We have also added personnel in the actuarial and medical underwriting functions, to enhance the array of technical and support services we provide to our clientele.

Your Company remains focused on the pursuit of growth and profitability for our shareholders, consistent with the principle of being an instrument of national development. The blessings and accomplishments of the year just passed would not have been possible without the unselfish support of and cooperation from all our shareholders and stakeholders. United in our vision and purpose, we endeavor to scale new heights of excellence and achievement.

As always, I wish to extend our thanks and appreciation to our Board of Directors for their inspiration and guidance, to our Stockholder-cessionaires for their trust and confidence, to our Management and Staff for their efforts and efficiency, and to our friends and partners in the industry for their invaluable contribution to your Company's success.



Wilfrido C. Bantayan
President & CEO

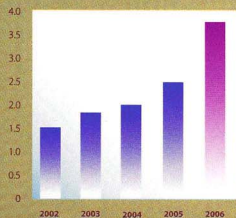
“Your Company remains focused on the pursuit of growth and profitability for our shareholders, consistent with the principle of being an instrument of national development.”

Financial Highlights

	2006	2005	2004	2003	2002
Gross Premiums	3,781,503,835	2,589,783,755	2,041,583,755	1,813,944,006	1,698,844,720
Net Premiums	953,875,519	824,140,197	591,258,410	551,890,732	472,388,939
Underwriting Income	186,988,989	75,154,460	100,595,737	65,655,421	66,606,027
Investment & Other Income	304,422,736	108,963,935	122,057,980	122,035,924	126,719,376
Net Income After Tax	274,931,380	98,664,163	99,938,278	97,183,009	85,599,673
Total Assets	9,116,344,345	4,458,118,108	2,933,977,951	2,461,618,866	2,260,432,095
Stockholders' Equity	3,831,005,885	2,130,645,221	1,118,928,891	987,014,342	907,569,145
Book value Per Share	2.58	2.13	1.83	2.17	2.15
Return on Average Equity	9.20%	6.10%	9.50%	10.30%	9.70%
Expense Ratio	22.98%	9.84%	16.85%	12.06%	16.98%
Loss Ratio	59.76%	66.97%	58.71%	60.75%	57.90%
Combined Ratio	102.29%	97.99%	98.51%	97.19%	101.12%

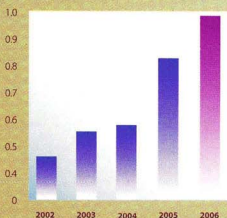
Gross Premiums

In Billion Pesos



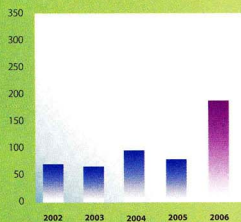
Net Premiums

In Billion Pesos



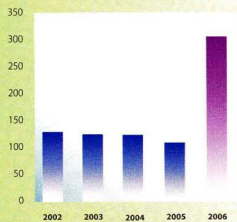
Underwriting Income

In Million Pesos



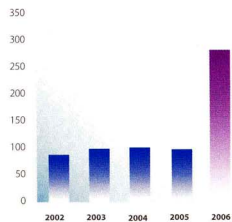
Investment & Other Income

In Million Pesos



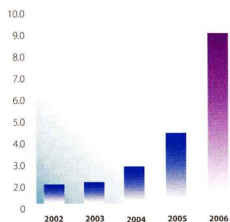
Net Income After Tax

In Million Pesos



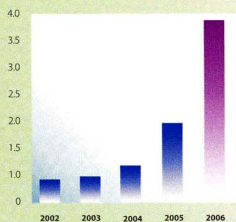
Total Assets

In Billion Pesos



Stockholders' Equity

In Billion Pesos





Atty. Winston F. Garcia
Chairman of the Board



Atty. Adelita A. Vergel De Dios
Vice Chairman



Wilfrido C. Bantayan
President & CEO

Board of Directors



Rafael C. Gallaga

Director



Alfonso L. Salcedo, Jr.

Director



Emilio S. de Quiros, Jr.

Director



Manuel L. Co

Director



Romeo L. Bernardo

Director



Josefina L. Valera

Director



Joli Co Wu

Director



Yvonne S. Yuchengco

Director

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 years ended December 31, 2006, 2005 and 2004. The financial statements have been prepared in conformity with generally accepted accounting principles in the Philippines 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 management likewise discloses to the company's audit committee and to its external auditor: (i) all significant deficiencies in the design or operation of internal controls that could adversely affect its ability to record, process, and report financial data; (ii) material weaknesses in the internal controls; and (iii) any fraud that involves management or other employees who exercise significant roles in internal controls.

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 in the Philippines and has expressed its opinion on the fairness of presentation upon completion of such examination, in its report to the Board of Directors and stockholders.

NATIONAL REINSURANCE CORPORATION OF THE PHILIPPINES




WINSTON F. GARCIA

Chairman of the Board



WILFRIDO C. BANTAYAN

President & CEO



ALFONSO L. SALCEDO, JR.

Treasurer

Report of Independent Auditors

The Board of Directors

National Reinsurance Corporation
of the Philippines

18th Floor, Philippine AXA Life Center
Sen. Gil J. Puyat Avenue corner
Tindalo Street, Makati City

We have audited the accompanying financial statements of National Reinsurance Corporation of the Philippines, which comprise the balance sheets as at December 31, 2006, 2005, and 2004, and the income statements, statements of changes in equity and cash flow statements for the years then ended, and notes to financial statements comprising of a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

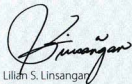
Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of National Reinsurance Corporation of the Philippines as of December 31, 2006, 2005, and 2004, and of its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards.

Emphasis of a Matter

As discussed in Note 23, subsequent to the issuance of the 2006 financial statements on which we have rendered our report dated February 20, 2007, the Company revised its 2006 financial statements to include additional disclosures on certain balances for its initial public offering. We were able to satisfy ourselves as to the propriety of the additional disclosures of the affected accounts which are presented in detail in Note 23.

PUNONGBAYAN & ARAULLO



Lillian S. Linsangan

Partner

CPA Reg. No. 0046660

TIN No. 109-228-234

PTR No. 0267683, January 2, 2007, Makati City

SEC Accreditation No. 0008-AR-1

BIR AN 08-002511-3-2005 (Dec. 27, 2005 to 2008)

April 3, 2007

National Reinsurance Corporation of the Philippines
BALANCE SHEETS

December 31, 2006, 2005 and 2004
(Amounts in Philippine Pesos)

	Notes	<u>2006</u>	<u>2005</u>	<u>2004</u>
A S S E T S				
CASH AND CASH EQUIVALENTS	4	P 446,834,344	P 141,980,545	P 68,804,330
REINSURANCE BALANCES RECEIVABLE - Net	5	2,955,711,652	1,668,259,780	1,303,507,625
DEFERRED ACQUISITION COSTS		275,114,923	133,273,725	136,938,363
INVESTMENTS	6			
Available-for-sale		3,445,458,733	1,656,818,555	663,512,515
Held-to-maturity		-	188,337,735	199,604,939
Others		55,303,206	4,041,020	-
LOANS AND RECEIVABLES	7	154,900,847	43,190,297	22,322,809
PROPERTY AND EQUIPMENT - Net	8	89,987,570	49,188,152	47,947,378
DEFERRED REINSURANCE PREMIUMS	9	1,371,157,013	543,471,360	488,378,113
DEFERRED INPUT VALUE ADDED TAX		214,182,979	23,765,892	-
DEFERRED TAX ASSETS	16	28,198,157	-	-
OTHER ASSETS	10	79,494,921	5,791,047	2,961,879
TOTAL ASSETS		<u>P 9,116,344,345</u>	<u>P 4,458,118,108</u>	<u>P 2,933,977,951</u>
LIABILITIES AND EQUITY				
REINSURANCE BALANCES PAYABLE	5	P 2,863,904,231	P 1,332,709,346	P 976,484,832
RESERVE FOR UNEXPIRED RISKS	9	1,816,299,487	840,144,577	716,796,802
DEFERRED REINSURANCE COMMISSIONS		221,051,056	82,025,786	88,879,696
INCOME TAX PAYABLE	16	-	-	4,846,981
DEFERRED OUTPUT VALUE ADDED TAX		324,901,892	36,721,512	-
ACCOUNTS PAYABLE AND ACCRUED EXPENSES	11	59,181,794	15,706,285	9,400,875
DEFERRED TAX LIABILITIES	16	-	20,165,381	18,639,874
		5,285,338,460	2,327,472,887	1,815,049,060
EQUITY		<u>3,831,005,885</u>	<u>2,130,645,221</u>	<u>1,118,928,891</u>
TOTAL LIABILITIES AND EQUITY		<u>P 9,116,344,345</u>	<u>P 4,458,118,108</u>	<u>P 2,933,977,951</u>

See Notes to Financial Statements.

National Reinsurance Corporation of the Philippines
INCOME STATEMENTS

For the years ended December 31, 2006, 2005 and 2004
(Amounts in Philippine Pesos)

	<u>Notes</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
REINSURANCE PREMIUM INCOME				
Reinsurance premiums - net of returns	18	P 3,781,503,835	P 2,589,783,755	P 2,041,583,755
Retroceded premiums	18	<u>2,827,628,316</u>	<u>1,765,643,558</u>	<u>1,450,325,345</u>
Reinsurance premiums retained		953,875,519	824,140,197	591,258,410
Increase in reserve for unexpired risks	9	(<u>25,879,655</u>)	(<u>68,254,528</u>)	(<u>19,075,588</u>)
		<u>927,995,864</u>	<u>755,885,669</u>	<u>572,182,822</u>
UNDERWRITING DEDUCTIONS	13			
Share in claims and losses		554,566,237	506,213,425	335,901,710
Commissions - net		<u>186,440,638</u>	<u>174,517,784</u>	<u>135,685,375</u>
		<u>741,006,875</u>	<u>680,731,209</u>	<u>471,587,085</u>
NET UNDERWRITING INCOME		<u>186,988,989</u>	<u>75,154,460</u>	<u>100,595,737</u>
INVESTMENT AND OTHER INCOME - Net	12	<u>304,422,736</u>	<u>108,963,935</u>	<u>122,057,980</u>
INCOME AFTER INVESTMENT AND OTHER INCOME		<u>491,411,725</u>	<u>184,118,395</u>	<u>222,653,717</u>
GENERAL AND ADMINISTRATIVE EXPENSES	14, 15	<u>219,158,763</u>	<u>81,078,085</u>	<u>99,608,244</u>
INCOME BEFORE TAXES		<u>272,252,962</u>	<u>103,040,310</u>	<u>123,045,473</u>
TAX EXPENSE (BENEFIT)	16	(<u>2,678,418</u>)	<u>4,376,147</u>	<u>23,107,195</u>
NET INCOME		<u>P 274,931,380</u>	<u>P 98,664,163</u>	<u>P 99,938,278</u>
Earnings Per Share	22	<u>P 0.20</u>	<u>P 0.10</u>	<u>P 0.16</u>

See Notes to Financial Statements.

National Reinsurance Corporation of the Philippines STATEMENTS OF CHANGES in EQUITY

For the years ended December 31, 2006, 2005 and 2004
(Amounts in Philippine Pesos)

Notes	Capital Stock		Additional Paid-in Capital	Treasury Shares	Revaluation Reserves	Retained Earnings		Total Equity
	No. of Shares	Amount				Appropriated	Unappropriated	
Balance as of January 1, 2004, as previously stated	4,252,180	P 453,218,500	P -	(P 2,001,014)	P 35,536,734	P 104,000,996	P 394,289,126	P 987,014,342
Effects of transition to PFRS	-	-	-	-	51,335,640	-	30,957,244	82,292,884
Balance as of January 1, 2004, as restated	4,552,185	453,218,500	-	(2,001,014)	86,862,374	104,000,996	423,187,370	1,069,277,226
Shares issued (recapitalized)	1,590,180	159,018,000	-	(3,351,784)	-	-	-	155,466,216
Decrease during the year	-	-	-	-	(46,727,334)	-	-	(46,727,334)
Stock dividends	-	-	-	-	-	(159,018,000)	(159,018,000)	(159,018,000)
Cash dividends	-	-	-	-	-	-	(7,475)	(7,475)
Appropriated for contingencies	17	-	-	-	-	9,579,549	(9,579,549)	-
Net income	-	-	-	-	-	-	99,038,278	99,038,278
Total equity as of December 31, 2004	6,142,365	P 614,236,500	P -	(P 5,552,798)	P 40,135,020	P 113,589,545	P 356,520,624	P 1,118,928,891
Balance as of January 1, 2005	6,142,365	P 614,236,500	P -	(P 5,552,798)	P 28,419,707	P 113,589,545	P 321,440,597	P 1,072,133,611
Effects of transition to PFRS	-	-	-	-	11,715,253	-	33,080,027	46,795,280
Balance as of January 1, 2005, as restated	6,142,365	614,236,500	-	(5,552,798)	40,135,020	113,589,545	356,520,624	1,118,928,891
Shares issued and reissued	3,857,635	385,763,500	385,154,102	5,378,672	-	-	-	776,286,274
Increase during the year	6	-	-	-	136,755,893	-	-	136,755,893
Appropriated for contingencies	17	-	-	-	-	9,866,416	(9,866,416)	-
Net income	-	-	-	-	-	-	98,664,163	98,664,163
Total equity as of December 31, 2005	P 10,000,000	P 1,000,000,000	P 385,154,102	(P 174,126)	P 176,890,913	P 123,455,961	P 445,118,371	P 2,130,645,221
Balance as of January 1, 2006	10,000,000	P 1,000,000,000	P 385,154,102	(P 174,126)	P 176,890,913	P 123,455,961	P 443,318,371	P 2,130,645,221
Shares issued (recapitalized)	1, 17	5,885,553	889,782,338	(254,465,509)	-	-	-	1,223,875,229
Increase during the year	6	-	-	-	201,554,055	-	-	201,554,055
Appropriated for contingencies	17	-	-	-	-	27,493,138	(27,493,138)	-
Net income	-	-	-	-	-	-	27,493,180	27,493,180
Total equity as of December 31, 2006	P 15,885,553	P 1,888,558,300	P 1,274,936,540	(P 254,639,635)	P 378,444,968	P 150,949,099	P 692,756,633	P 3,831,065,885

See Notes to Financial Statements.

National Reinsurance Corporation of the Philippines

CASH FLOW STATEMENTS

For the years ended December 31, 2006, 2005 and 2004
(Amounts in Philippine Pesos)

	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before tax	P 272,252,962	P 103,040,310	P 123,045,473
Adjustments for:			
Increase in reserve for unexpired risks	25,879,655	68,254,528	19,075,588
Unrealized foreign currency loss (gain)	81,867,627	55,692,983	(9,058,019)
Depreciation	8,679,824	4,661,906	4,567,710
Gain on acquisition	(51,295,702)	-	-
Interest income	(253,234,383)	(152,883,075)	(111,966,698)
Dividend income	(8,979,802)	(1,959,994)	(2,472,990)
Operating income before working capital changes	75,170,181	76,806,658	23,191,064
Increase in reinsurance balances receivable	(1,106,336,442)	(386,309,975)	(4,986,408)
Increase in deferred input value added tax	(190,417,087)	(23,765,892)	-
Decrease (increase) in deferred acquisition costs	20,174,827	(3,189,272)	(6,342,425)
Increase in other assets	(46,002,000)	(3,849,337)	(416,316)
Increase in loans and receivables	(5,682,704)	(22,449,011)	(3,221,449)
Increase (decrease) in reinsurance balances payable	967,691,772	367,944,135	(247,796,246)
Increase in deferred output value added tax	283,146,942	36,721,512	-
Increase (decrease) in accounts payable and accrued expenses	1,979,388	6,305,410	(1,921,728)
Cash generated from (used in) operations	(275,123)	48,214,228	(241,493,508)
Cash paid for income taxes	(38,077,015)	(4,846,981)	(23,629,910)
Net Cash From (Used in) Operating Activities	(38,352,138)	43,367,247	(265,123,418)
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from disposal/maturities of:			
Available-for-sale financial assets	1,138,510,274	281,579,875	293,041,273
Held-to-maturity investments	87,922,432	-	185,168,485
Interest received	233,920,424	133,569,116	117,236,002
Dividends received	8,979,802	1,959,994	2,472,990
Disposals (acquisitions) of:			
Available-for-sale financial assets	(1,304,055,136)	(1,152,736,726)	(140,312,710)
Property and equipment	(1,950,282)	(5,902,680)	(1,174,001)
Other investments	(454,367)	(4,041,020)	-
Held-to-maturity investments	-	-	(151,002,139)
Net Cash From (Used in) Investing Activities	162,873,147	(745,571,441)	305,429,900
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance/reissuance of:			
Common shares	196,158,513	771,527,000	-
Treasury shares	-	4,943,400	-
Acquisitions/payments of:			
Treasury shares	(10,610,169)	(174,126)	(3,551,784)
Fractional shares	-	-	(7,475)
Net Cash From (Used in) Financing Activities	185,548,344	776,296,274	(3,559,259)
NET INCREASE IN CASH AND CASH EQUIVALENTS	310,069,353	74,092,080	36,747,223
EFFECTS FOREIGN CURRENCY REVALUATION ON CASH AND CASH EQUIVALENTS	(5,215,554)	(915,865)	229,654
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	141,980,545	68,804,330	31,827,453
CASH AND CASH EQUIVALENTS AT END OF YEAR	P 446,834,344	P 141,980,545	P 68,804,330

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.

National Reinsurance Corporation of the Philippines

NOTES to FINANCIAL STATEMENTS

December 31, 2006, 2005 and 2004
(Amounts in Philippine Pesos)

1. CORPORATE INFORMATION

1.1 General

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 (Asian Re), a multi-government-initiated reinsurance entity, based in Bangkok, Thailand, which was established to foster regional cooperation among insurance companies doing business in Asia.

The Company's registered office, which is also its principal place of business, 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, 2006 (including the comparatives for the years ended December 31, 2005 and 2004) were authorized for issue by the Company's Board of Directors (BOD) on April 3, 2007.

1.2 Merger With Universal Malayan Reinsurance Corporation (UMRC)

On May 28, 2004, the Company entered into a Memorandum of Agreement with Universal Malayan Reinsurance Corporation (UMRC) for the merger of the two entities. Subsequently, on October 10, 2005, the Company executed a Plan of Merger (the "Plan") together with UMRC, under which both parties agreed to a combination whereby the Company would be the surviving corporation. The stockholders and BOD of each of the Company and of UMRC approved the Plan on October 4, 2005 and October 24, 2005, respectively.

On March 6, 2006, the planned merger was approved by the Securities and Exchange Commission (SEC) and was eventually consummated by the Company and UMRC on that date.

To consummate the merger, the Company issued 5,885,583 shares of capital stock (with P100 par value) at an agreed exchange value of P251.18 per share amounting to P1,478,340,738 and incurred P4,041,020 for costs directly attributable to the merger, in order to acquire from UMRC the following:

Assets:

Cash and cash equivalents	P 196,158,513
Reinsurance balances receivable	216,597,266
Deferred acquisition costs	36,543,768
Available-for-sale financial assets	1,344,617,555
Held-to-maturity investments	46,906,447
Loans and receivables	86,713,887
Property and equipment	85,898,570
Deferred reinsurance premium	53,621,139
Investment properties	24,556,312
Other assets	<u>22,949,923</u>
	<u>P 2,114,563,380</u>

Liabilities:

Losses and claims outstanding	P 449,780,223
Reinsurance balances payable	138,667,724
Reserve for unexpired risks	176,210,742
Deferred reinsurance commission	13,553,013
Deferred output value-added tax (VAT)	5,033,438
Accounts payable and accrued expenses	<u>41,496,120</u>
	<u>P 824,741,260</u>

The abovementioned merger also resulted to the Company's acquisition of its own shares of stock valued at P243,855,340 (970,839 shares at P251.18 per share) from UMRC which the latter had previously purchased from the Company. These reacquired shares were shown as part of Treasury Shares account in the 2006 statement of changes in equity (see Note 17).

Further, the Company recognized gain on acquisition of net assets of UMRC, brought about by the merger transaction, amounting to P51,295,702, which is shown as part of Investment and Other Income account in the 2006 income statement.

2. 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 the years presented, unless otherwise stated.

2.1 Basis of Preparation

(a) Statement of Compliance with Philippine Financial Reporting Standards (PFRS)

The financial statements of the Company had been prepared in accordance with Philippine Financial Reporting Standards (PFRS). PFRS are adopted by the Financial Reporting Standards Council (FRSC), formerly the Accounting Standards Council, from the pronouncements issued by the International Accounting Standards Board (IASB). PFRS consist of:

- (i) PFRS – corresponding to International Financial Reporting Standards;
- (ii) Philippine Accounting Standards (PASs) – corresponding to International Accounting Standards; and
- (iii) Interpretations to existing standards – representing interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC), formerly the Standing Interpretations Committee (SIC), of the IASB which are adopted by the FRSC.

These 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 that follow.

(b) Transition to PFRS in 2005

In compliance with the pronouncements of the FRSC and the regulations of the SEC, the Company 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 in the Philippines to PFRS was made in accordance with PFRS 1, *First-time Adoption of Philippine Financial Reporting Standards*.

The Company's transition to PFRS in 2005 resulted in the restatement of the balance of Equity as of January 1, 2005 and 2004. The total adjustment to Equity, particularly in the balance of Revaluation Reserves and Unappropriated Retained Earnings, arising from the transition amounted to P46,795,280 and P82,262,884, respectively, and is broken down as follows:

January 1, 2005						
Relevant PFRS		Revaluation Reserves		Retained Earnings		Total Adjustment
Fair value adjustments of available-for-sale financial assets	PAS 39	P	21,108,508	P	-	P 21,108,508
Accumulated foreign exchange difference on available-for-sale financial assets previously charged directly to equity	PAS 21	(	24,405,046)		24,405,046	-
Reversal of incurred but not reported losses (IBNR)	PFRS 4		-		16,875,963	16,875,963
Reversal of catastrophe loss reserve	PFRS 4		-		12,697,073	12,697,073
Effect of change from straight line to effective interest amortization method	PAS 39		-		1,142,546	1,142,546
Recognition of defined benefit asset	PAS 19		-		83,778	83,778
Remeasurement of long-term receivable	PAS 39		-	(	16,464)	(16,464)
Accrual of leave benefits	PAS 19		-	(	4,169,014)	(4,169,014)
Deferred tax adjustments	PAS 12		15,011,791	(	15,938,901)	(927,110)
		P	11,715,253	P	35,080,027	P 46,795,280

January 1, 2004						
Relevant PFRS		Revaluation Reserves		Retained Earnings		Total Adjustment
Fair value adjustments of available-for-sale financial assets	PAS 39	P	67,683,751	P	-	P 67,683,751
Accumulated foreign exchange difference on available-for-sale financial assets previously charged directly to equity	PAS 21	(	24,056,046)		24,056,046	-
Reversal of IBNR	PFRS 4		-		12,141,375	12,141,375
Reversal of catastrophe loss reserve	PFRS 4		-		10,300,592	10,300,592
Effect of change from straight line to effective interest amortization method	PAS 39		-		1,346,821	1,346,821
Recognition of defined benefit asset	PAS 19		-		100,565	100,565
Remeasurement of long-term receivable	PAS 39		-	(	32,223)	(32,223)
Accrual of leave benefits	PAS 19		-	(	3,083,189)	(3,083,189)
Deferred tax adjustments	PAS 12		7,697,935	(	13,892,743)	(6,194,808)
		P	51,325,640	P	30,937,244	P 82,262,884

In addition to the foregoing adjustments to Equity, the structure of the balance sheet and income statement was also revised.

(c) *Functional and Presentation Currency*

These financial statements are presented in Philippine pesos, the Company's functional currency, and all values represent absolute amounts except when otherwise indicated (see also Note 2.12).

2.2 Impact of New Standards, and Amendments and Interpretations to Existing Standards that are Relevant to the Company

(a) *Effective in 2006*

In 2006, the Company adopted the amendments and interpretations to existing accounting standards issued by the IASB and adopted by the FRSC which are mandatory for accounting periods beginning on or after January 1, 2006. The relevant amendments and interpretations to the Company are as follows:

PAS 19 (Amendment)	:	Employee Benefits
PAS 39 and PFRS 4 (Amendment)	:	Financial Guarantee Contracts
Philippine Interpretation IFRIC 4	:	Determination Whether an Arrangement Contains a Lease

Discussed below are the impact on the financial statements of each of these amendments and interpretations.

- (i) PAS 19 (Amendment), *Employee Benefits*. The amendment introduces an option for an alternative recognition approach for actuarial gains and losses. It also adds new disclosure requirements and imposes additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. Because the Company does not intend to change its current accounting policy for recognition of actuarial gains and losses and does not participate in any multi-employer plans, the adoption of this amendment did not result in a material adjustment to the financial statements.
- (ii) PAS 39 and PFRS 4 (Amendment), *Financial Guarantee Contracts*. The amendment requires the recognition of guarantee liability, at its fair value, of the parent company in relation to a third party loan to a subsidiary guaranteed by the parent company. The Company's adoption of the amendment did not result in a material adjustment to the financial statements.
- (iii) Philippine Interpretation IFRIC 4, *Determining Whether an Arrangement Contains a Lease*. Philippine Interpretation IFRIC 4 requires the determination of whether an arrangement is or contains a lease based on the substance of the arrangement. It requires an assessment of whether: (a) fulfilment of the arrangement is dependent on the use of a specific asset; and (b) the arrangement conveys a right to use the asset. Based on the management's current year assessment, the adoption of Philippine Interpretation IFRIC 4 has no significant impact on the Company's current operations because there were no outstanding arrangements that were identified to be a lease or contains a lease.

(b) *Effective Subsequent to 2006*

There are a few new standards, and amendments and interpretation to existing standards that are effective for periods subsequent to 2006. Of these new standards, and amendments and interpretations, the following are relevant to the Company but the Company has opted not to adopt them early.

PAS 1 (Amendment)	:	Presentation of Financial Statements
PFRS 7	:	Financial Instruments: Disclosures
Philippine Interpretation IFRIC 10	:	Interim Financial Reporting and Impairment

Below is a discussion of the possible impact of the foregoing standards, amendments and interpretations which the Company will apply in 2007 in accordance with their transitional provisions.

- (i) PFRS 7, *Financial Instruments: Disclosures* and complementary amendment to PAS 1 (effective for annual periods beginning on or after January 1, 2007). 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: Disclosure and Presentation*. It is applicable to all entities that report under PFRS. The amendment to PAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Company 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.

- (ii) Philippine Interpretation IFRIC 10, *Interim Financial Reporting and Impairment* (effective for annual periods beginning on or after November 1, 2006). It prohibits the impairment losses recognized in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date. The Company is currently evaluating the impact of this interpretation on its financial statements and has initially determined that such may not have significant effects on the financial statements for 2007, as well as for prior and future periods.

2.3 Financial Assets

Financial assets include cash and other financial instruments. Financial assets, other than hedging instruments, are classified into the following categories: 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.

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

All financial assets are recognized on their trade date and are initially recognized at fair value, plus transaction costs.

The foregoing categories of financial instruments are more fully described below.

(a) Loans and Receivables

Loans and 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.

Loans and 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. 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 assets' carrying amount and the present value of estimated cash flows.

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

(b) 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 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.

(c) Available-for-sale Financial Assets

These 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 initially recognized at fair value plus transaction costs and 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 income statement when they are sold or when the investment is impaired.

In the case of impairment, the cumulative loss previously recognized directly in equity is transferred to the income statement. If circumstances change, impairment losses on available-for-sale equity instruments are not reversed through the income statement. On the other hand, if in a subsequent period the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in income statement, the impairment loss is 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.

Non-compounding interest and other cash flows resulting from holding financial assets are recognized in profit or loss when earned, regardless of how the related carrying amount of financial assets is measured.

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.

2.4 Property and Equipment

Property and equipment are carried at acquisition cost or construction cost less subsequent depreciation and impairment losses.

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 on the straight-line basis 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 (see Note 2.13).

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 income statement in the year the item is derecognized.

2.5 Investment Property

Investment property is carried at acquisition cost or construction cost less subsequent depreciation and impairment losses.

The cost of the investment property 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 when incurred.

Investment property is derecognized upon disposal or when permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gain or loss on the retirement or disposal of an investment property is recognized in the income statement in the year of retirement or disposal.

2.6 Financial Liabilities

Financial liabilities include reinsurance balances payable and accounts payable and accrued expenses.

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

Reinsurance balances payables and accounts payable and accrued expenses 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.

2.7 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.

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.

2.8 Revenue Recognition

(a) *Reinsurance premiums* – Revenue is recognized for revenue premiums from short duration insurance contracts 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 income statements.

(b) *Interest* – Revenue is recognized as the interest accrues (taking into account the effective yield on the asset).

2.9 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 income statements in the period the recoveries are made while estimated recoveries are presented as part of Reinsurance Balances Receivable.

2.10 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.

2.11 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.

2.12 Functional Currency and Foreign Currency Transactions

(a) 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 and presentation currency.

(b) Transactions 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 currency 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 income statement.

2.13 Impairment of Non-financial Assets

The Company's property and equipment and investment property are subject to impairment testing. All other individual assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized for the amount by which the asset'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.

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.

2.14 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 liability recognized in the balance sheet for defined benefit pension plans is the present value of the defined benefit obligation (DBO) at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs. The DBO is calculated regularly 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 an income or 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.

2.15 Income Taxes

Current 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 income statement.

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 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 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 income statement. 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.

2.16 Equity

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

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.

Treasury shares are stated at the cost of re-acquiring such shares.

Revaluation reserves comprise gains and losses due to the revaluation of certain available-for-sale financial assets.

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

2.17 Earnings Per Share (EPS)

Earnings per share is determined by dividing net income by the weighted average number of shares issued, adjusted for stock dividends and stock split, less shares held in treasury during the period.

3. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The Company's financial statements prepared in accordance with PFRS require management to make judgments and estimates that affect amounts reported in the financial statements and related notes.

3.1 Judgments

In the process of applying the Company's accounting policies, management has made the following judgments, apart from those involving estimation, which have the most significant effect on the amounts recognized in the financial statements:

(a) *Functional Currency*

The Company has determined that its functional currency is the Philippine peso which is the currency of the primary environment in which the Company operates.

(b) *Held-to-maturity Investments*

The Company follows guidance on PAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held to maturity. This classification requires significant judgment. In making the judgment, the Company evaluates its intention and ability to hold its investments in bonds up to maturity.

If the Company fails to keep these investments to maturity other than for specific circumstances explained in PAS 39, it will be required to reclassify the whole class as available-for-sale. The investments would therefore be measured at fair value, not amortized cost.

(c) *Impairment of Available-for-sale Financial Assets*

The Company follows the guidance of PAS 39 on determining when an investment is other-than-temporarily impaired. This determination requires significant judgment. In making this judgment, the Company evaluates, among other factors, the duration and extent to which the fair value of an investment is less than its cost; and the financial health of and near-term business outlook for the investee, including factors such as industry and sector performance, changes in technology and operational and financing cash flow.

(d) *Distinction Between Investment Properties and Owner-managed Properties*

The Company determines whether a property qualifies as investment property. In making its judgment, the Company considers whether the property generated cash flows largely independently of the other assets held by an entity. Owner-occupied properties generate cash flows that are attributable not only to property but also to other assets used in the supply of services or for administrative purposes.

Some properties comprise a portion that is held to earn rental or for capital appreciation and another portion that is held for use in the production and supply of goods and services or for administrative purposes. If these portion can be sold separately (or leased out separately under finance lease), the Company accounts for the portions separately. If the portion cannot be sold separately, the property is accounted for as investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes. Judgment is applied in determining whether ancillary services are so significant that a property does not qualify as investment property. The Company considers each property separately in making its judgment.

(e) *Provisions and Contingencies*

Judgment is exercised by management to distinguish between provisions and contingencies. Policies on recognition and disclosure of provision and disclosure of contingencies are discussed in Note 2.7 and relevant disclosures are presented in Note 24.

3.2 Estimates

The estimates and assumptions used in the financial statements are based upon management's evaluation of relevant facts and circumstances of the Company's financial statements. Actual results could differ from those estimates. The following are the relevant estimates performed by management on its December 31, 2006, 2005 and 2004 financial statements:

(a) *Useful Life of Property and Equipment*

The Company estimates the useful lives of property and equipment based on the period over which the assets are expected to be available for use. The estimated useful lives of property and equipment are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets. In addition, estimation of the useful lives of property and equipment is based on collective assessment of industry practice, internal technical evaluation and experience with similar assets. It is possible, however, that future results of

operations could be materially affected by changes in estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of property and equipment would increase recorded operating expenses and decrease total assets.

Property and equipment net of accumulated depreciation and impairment losses amounted to P89,987,570, P49,188,152, and P47,947,378 as of December 31, 2006, 2005, and 2004, respectively (see Note 8).

(b) *Allowance for Impairment of Reinsurance Balances Receivables, and Loans and Receivables*

Allowance is made for specific and groups of accounts, where objective evidence of impairment exists. The Company evaluates these accounts based on available facts and circumstances, including, but not limited to, the length of the Company's relationship with the customers, the customers' current credit status based on third party credit reports and known market forces, average age of accounts, collection experience and historical loss experience.

Impairment losses on reinsurance balances receivables amounted to P106,799,471 in 2006, P13,698,738 in 2005, and P12,948,738 in 2004 (see Note 5).

(c) *Realizable Amount of Deferred Tax Assets*

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

Deferred tax assets amounted to P28,198,157 as of December 31, 2006 (see Note 16).

(d) *Impairment of Non-financial Assets*

Except for intangible assets with indefinite useful lives, PFRS requires that an impairment review be performed when certain impairment indicators are present. The Company's policy on estimating the impairment of non-financial assets is discussed in detail in Note 2.13. Though management believes that the assumptions used in the estimation of fair values reflected in the financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable values and any resulting impairment loss could have a material adverse effect on the results of operations.

(e) *Retirement Benefits and Other Retirement Benefits*

The determination of the Company's obligation and cost of pension is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in Note 15.2 and include, among others, discount rates, expected return on plan assets and salary increase rate. In accordance with PFRS, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect the recognized expense and recorded obligation in such future periods.

The retirement benefit obligation and net unrecognized actuarial gains amounted to P33,803,697 and P2,465,688, respectively, in 2006; the retirement benefit asset and net unrecognized actuarial losses amounted to P162,062 and P5,364,282, respectively, in 2005; and the retirement benefit asset and net unrecognized actuarial gain amounted to P83,777 and P213,211, respectively, in 2004 (see Note 15.2).

4. CASH AND CASH EQUIVALENTS

This account consists of:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Time deposits	P 384,673,854	P -	P 14,066,750
Cash on hand and in banks	<u>62,160,490</u>	<u>141,980,545</u>	<u>54,737,580</u>
	<u>P 446,834,344</u>	<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 requirements of the Company and earn interest at short-term deposit rates. The Cash and Cash Equivalents account includes foreign currency denominated cash of US\$3,022,664 (P148,509,528) as of December 31, 2006, US\$286,208 (P15,188,200) as of December 31, 2005 and US\$329,132 (P18,519,249) as of December 31, 2004.

5. REINSURANCE BALANCES

The details of reinsurance balances are as follows:

	<u>2006</u>		<u>2005</u>		<u>2004</u>
Reinsurance balances receivable:					
Due from ceding companies	P 2,072,946,667	P	914,106,854	P	539,356,437
Reinsurance recoverable on losses	906,797,090		738,109,215		739,901,672
Funds held by ceding companies	<u>82,767,366</u>		<u>29,742,449</u>		<u>37,198,254</u>
	3,062,511,123		1,681,958,518		1,316,456,363
Allowance for impairment	(106,799,471)	(	13,698,738)	(	12,948,738)
	<u>P 2,955,711,652</u>	P	<u>1,668,259,780</u>	P	<u>1,303,507,625</u>
	<u>2006</u>		<u>2005</u>		<u>2004</u>
Reinsurance balances payable:					
Due to retrocessionaires	P 1,537,298,404	P	492,650,346	P	242,578,102
Claims payable	1,270,902,819		819,103,379		700,357,884
Funds held for retrocessionaires	<u>55,703,008</u>		<u>20,955,621</u>		<u>33,548,846</u>
	<u>P 2,863,904,231</u>	P	<u>1,332,709,346</u>	P	<u>976,484,832</u>

A reconciliation of the allowance for impairment at beginning and end of 2006, 2005, and 2004 is shown below:

	<u>2006</u>		<u>2005</u>		<u>2004</u>
Balance at beginning of year	P 13,698,738	P	12,948,738	P	12,198,738
Assumed relative to the merger	35,586,000		-		-
Impairment loss during the year	<u>57,514,733</u>		<u>750,000</u>		<u>750,000</u>
Balance at end of year	<u>P 106,799,471</u>	P	<u>13,698,738</u>	P	<u>12,948,738</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:

	<u>2006</u>		<u>2005</u>		<u>2004</u>
Bonds	P 2,903,086,959	P	1,556,903,010	P	621,610,456
Equity securities	437,785,083		18,723,035		13,768,559
Investment in Asian Re shares	66,987,944		81,192,510		28,133,500
Variou funds	<u>37,598,747</u>		<u>-</u>		<u>-</u>
	<u>P 3,445,458,733</u>	P	<u>1,656,818,555</u>	P	<u>663,512,515</u>

Bonds include investments reclassified from Held-to-maturity investments to Available-for-sale financial assets in 2006 including government securities totaling P33,996,443 which 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.

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

	<u>2006</u>		<u>2005</u>		<u>2004</u>
Due within one year	P 232,676,878	P	219,979,767	P	128,335,461
Due after one year through five years	1,105,566,963		525,900,802		471,593,613
Due after five years through ten years	1,467,978,035		804,947,236		16,669,813
Due after ten years	96,865,083		6,075,205		5,011,569
	<u>P 2,903,086,959</u>	P	<u>1,556,903,010</u>	P	<u>621,610,456</u>

Bonds earn interest at annual rates ranging from 2.0% to 18.0% in 2006, 5.6% to 19.0% in 2005 and 5.6% to 20.5% in 2004. Changes in fair values of these bonds amounted to P127,349,513 (net increase), P96,435,469 (net increase), P40,739,143 (net decrease) in 2006, 2005 and 2004, respectively, and are shown as part of Revaluation Reserves account in the statements of changes in equity.

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

	<u>2006</u>		<u>2005</u>		<u>2004</u>
Cost:					
Quoted in the stock exchange	P 316,553,415	P	15,716,756	P	15,548,205
Not quoted in the stock exchange	<u>44,811,521</u>		<u>1,694,500</u>		<u>1,635,000</u>
	361,364,936		<u>17,411,256</u>		<u>17,183,205</u>
Fair value gains (losses):					
Quoted in the stock exchange	78,990,824		2,246,779	(	2,419,646)
Not quoted in the stock exchange	<u>(2,570,677)</u>	(	<u>(935,000)</u>	(	<u>(995,000)</u>
	76,420,147		<u>1,311,779</u>		<u>(3,414,646)</u>
	<u>P 437,785,083</u>	P	<u>18,723,035</u>	P	<u>13,768,559</u>

Equity securities mainly consist of investments in companies listed in the Philippine Stock Exchange.

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 equity. The fair value of investments in Asian Re shares amounted to P66,987,944, P81,192,510 and P28,133,500 as of December 31, 2006, 2005, and 2004, respectively. Changes in fair value recognized as part of Revaluation Reserves in the equity section of the balance sheets amounted to P27,574,264, net of deferred taxes amounting to P14,847,681 in 2006, P35,528,356, net of deferred taxes amounting to P19,130,654 in 2005 (see Note 16).

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

	<u>2006</u>		<u>2005</u>		<u>2004</u>
Balance at the beginning of the year	P 1,656,818,555	P	663,512,515	P	862,619,432
Additions	2,791,711,468		1,152,671,083		140,312,710
Disposals	(1,138,510,274)	(	281,579,875)	(	293,041,273)
Fair value gains (losses)	201,554,055		155,886,547		46,727,354)
Foreign currency gains (losses)	<u>(66,115,071)</u>	(	<u>(33,671,715)</u>		<u>349,000</u>
	<u>P 3,445,458,733</u>	P	<u>1,656,818,555</u>	P	<u>663,512,515</u>

The fair values of available-for-sale financial assets have been determined directly by reference to published prices in the active market.

6.2 Held-to-Maturity Securities

Held-to-maturity securities consist of fixed rate treasury notes, retail treasury bonds, and corporate bonds with 1 to 10 years term and interest rates ranging from 8.87% to 12.37%.

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

	<u>2006</u>		<u>2005</u>		<u>2004</u>
Due within one year	P -		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	<u>-</u>		<u>111,288,876</u>		<u>171,558,143</u>
	<u>P -</u>		<u>P 188,337,735</u>		<u>P 199,604,939</u>

Government securities totaling P18,750,000 in both 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.

In 2006, the Company reclassified all of its Held-to-maturity investments to Available-for-sale financial assets.

6.3 Others

Other investments in 2006 pertain to investment properties consisting of a piece of land and building and improvements which are owned for investment purposes only. No income or loss or direct operating expenses were recognized during the current year.

A reconciliation of the carrying amounts at the beginning and end of the year 2006 and the gross carrying amounts and the accumulated depreciation of investment properties are shown below:

Balance at January 1, 2006, net of accumulated depreciation	P -
Additions	66,907,090
Disposals	(9,613,300)
Depreciation charge for the year	<u>(1,990,584)</u>
Balance at December 31, 2006, net of accumulated depreciation	<u>P 55,303,206</u>
December 31, 2006	
Cost	P 72,384,818
Accumulated depreciation	<u>(17,081,612)</u>
Net carrying amount	<u>P 55,303,206</u>

Other investments in 2005 pertain to the capitalized expenses, specifically filing and professional fees, incurred for the planned merger with UMRC which amounted to P4,041,020. These capitalized expenses were subsequently treated as costs directly attributable to the merger in 2006.

7. LOANS AND RECEIVABLES

This account includes the following:

	<u>2006</u>		<u>2005</u>		<u>2004</u>
Current:					
Accrued interest receivable	P 62,701,350	P	40,959,954	P	21,645,995
Term loans	30,000,000		-		-
Others	4,517,086		181,097		39,669
Non-current:					
Term loans	40,000,000		-		
Loans receivable	17,682,411		2,049,246		637,145
	P 154,900,847	P	43,190,297	P	22,322,809

Loans and receivables are usually due within 1 to 20 years. These financial assets are subject to credit risk exposure. However, the Company does not identify specific concentrations of credit risk with regard to loans and receivables since most of the loans and receivables are secured by collaterals.

Term loans pertain to the Company's participation in syndicated loans of other Companies. These loans are interest bearing. The effective interest rate on these loans ranges from 9% to 12.4% in 2006.

Loans receivable includes Mortgage, Housing, and Car loans which have an annual effective interest rate of 14% to 28%, 10% to 22%, and 7% to 13%, respectively, in 2006.

The fair value of these financial assets is not individually determined as the carrying amount is a reasonable approximation of fair value since the interest rates are approximately the same as the market interest rate.

8. PROPERTY AND EQUIPMENT

Presented below is a reconciliation of the carrying amounts at the beginning and end of 2006, 2005, and 2004 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, 2006, net of accumulated depreciation and impairment	P 39,063,320	P 1,598,215	P 511,636	P 6,253,721	P 1,761,260	P 49,188,152
Additions	39,961,310	3,046,312	36,277	4,466,137	1,072,851	48,582,887
Disposals	-	-	-	(1,094,229)	-	(1,094,229)
Depreciation charge for the year	(2,746,403)	(807,765)	(261,183)	(1,887,702)	(986,187)	(6,689,240)
Balance at December 31, 2006, net of accumulated depreciation and impairment	P 76,278,227	P 3,836,762	P 286,730	P 7,737,927	P 1,847,924	P 89,987,570
December 31, 2006 Cost	P 104,227,734	P 12,669,559	P 8,624,279	P 11,091,338	P 11,277,865	P 147,890,775
Accumulated depreciation	(27,949,507)	(8,832,797)	(8,337,549)	(3,353,411)	(9,429,941)	(57,903,205)
Net carrying amount	P 76,278,227	P 3,836,762	P 286,730	P 7,737,927	P 1,847,924	P 89,987,570

	Condominium Units	Office Improvements	Office Furniture and Equipment	Transportation Equipment	EDP Equipment	Total
Balance at January 1, 2005, net of accumulated depreciation and impairment	P 40,402,634	P 2,152,292	P 830,502	P 2,170,937	P 2,391,013	P 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, 2005, net of accumulated depreciation and impairment	<u>P 39,063,320</u>	<u>P 1,598,215</u>	<u>P 511,636</u>	<u>P 6,253,721</u>	<u>P 1,761,260</u>	<u>P 49,188,152</u>
December 31, 2005 Cost	P 53,572,553	P 5,540,763	P 2,518,419	P 9,652,950	P 4,494,715	P 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>P 39,063,320</u>	<u>P 1,598,215</u>	<u>P 511,636</u>	<u>P 6,253,721</u>	<u>P 1,761,260</u>	<u>P 49,188,152</u>
Balance at January 1, 2004, net of accumulated depreciation	P 41,741,948	P 2,706,368	P 1,051,507	P 3,518,277	P 2,322,987	P 51,341,087
Additions	-	-	203,281	-	970,720	1,174,001
Depreciation charge for the year	(1,339,314)	(554,076)	(424,286)	(1,347,340)	(902,694)	(4,567,710)
Balance at December 31, 2004, net of accumulated depreciation and impairment	<u>P 40,402,634</u>	<u>P 2,152,292</u>	<u>P 830,502</u>	<u>P 2,170,937</u>	<u>P 2,391,013</u>	<u>P 47,947,378</u>
December 31, 2004 Cost	P 53,572,553	P 5,540,763	P 2,469,339	P 7,205,370	P 4,301,115	P 73,089,140
Accumulated depreciation	(13,169,919)	(3,388,471)	(1,638,837)	(5,034,433)	(1,910,102)	(25,141,762)
Net carrying amount	<u>P 40,402,634</u>	<u>P 2,152,292</u>	<u>P 830,502</u>	<u>P 2,170,937</u>	<u>P 2,391,013</u>	<u>P 47,947,378</u>

9. DEFERRED REINSURANCE PREMIUMS AND RESERVE FOR UNEXPIRED RISKS

The movement of these accounts is as follows:

	Deferred Reinsurance Premiums			Reserve for Unexpired Risks		
	2006	2005	2004	2006	2005	2004
Balance at beginning of year	P 543,471,360	P488,378,113	P510,331,952	P 840,144,577	P 716,796,802	P 719,675,053
Balance acquired relative to the merger	53,621,140	-	-	176,210,742	-	-
Increase (decrease) during the year	774,064,513	55,093,247	(21,953,839)	799,944,168	123,347,775	(2,878,251)
Balance at end of year	<u>P1,371,157,013</u>	<u>P543,471,360</u>	<u>P488,378,113</u>	<u>P 1,816,299,487</u>	<u>P 840,144,577</u>	<u>P 716,796,802</u>

Deferred Reinsurance Premiums pertains to the portion of reinsurance premiums ceded out that relate to the unexpired periods of the policies at balance sheet date.

Reserve for Unexpired Risks is the portion of reinsurance premiums assumed that relate to the unexpired periods of the policies at balance sheet date.

The difference between the increase in Deferred Reinsurance Premiums and Reserve for Unexpired Risks for the year is presented as Increase in Reserve for Unexpired Risks in the income statements.

10. OTHER ASSETS

The Other Assets account includes the following:

	Note	2006	2005	2004
Deferred withholding VAT	P	43,554,265	P 3,214,139	P -
Input VAT		23,553,408	213,774	-
Creditable expanded withholding tax		6,282,710	729,241	-
Prepayments		1,416,025	1,040,761	2,577,317
Deposit		358,147	251,200	203,200
Security fund		192,888	97,585	97,585
Defined benefit asset	15	-	162,062	83,777
Others		4,137,478	82,285	-
		<u>P 79,494,921</u>	<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.

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.

11. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

This account includes the following:

	Note	2006	2005	2004
Defined benefit liability	15	P 33,803,697	P -	P -
Withholding taxes payable		15,584,497	2,215,152	818,773
Accrued expenses		8,564,879	3,580,715	6,306,906
Accounts payable and others liabilities		1,228,721	9,910,418	2,275,196
		<u>P 59,181,794</u>	<u>P 15,706,285</u>	<u>P 9,400,875</u>

The fair values of accounts payable and accrued expenses have not been disclosed as, due to their short duration, management considers the carrying amounts recognized in the balance sheets to be a reasonable approximation of their fair values.

12. INVESTMENT AND OTHER INCOME

The details of this account follow:

	<u>2006</u>		<u>2005</u>		<u>2004</u>
Interest	P 253,234,383	P	152,883,075	P	111,966,698
Trading gain	52,673,670		-		-
Gain on acquisition	51,295,702		-		-
Dividend income	8,979,802		1,959,994		2,472,990
Gain on sale of stocks	6,353,449		-		-
Gain on sale of assets	2,208,334		-		-
Foreign exchange gain (loss)	(90,676,616)	(	45,952,689)		7,201,781
Miscellaneous	<u>20,354,012</u>		<u>73,555</u>		<u>416,511</u>
	P 304,422,736	P	108,963,935	P	122,057,980

13. UNDERWRITING DEDUCTIONS

13.1 Share in Claims and Losses

This account represents the aggregate amount of the Company's share in net losses and claims relative to its acceptances under treaty and facultative reinsurances.

13.2 Commissions – net

This account consists of the following:

	<u>2006</u>		<u>2005</u>		<u>2004</u>
Commission expense	P 574,122,238	P	436,859,074	P	363,639,692
Reinsurance revenues	<u>387,681,600</u>		<u>262,341,290</u>		<u>227,954,317</u>
	P 186,440,638	P	174,517,784	P	135,685,375

Commission expense refers to fees deducted by ceding companies from reinsurance premiums assumed during the period under treaty and facultative agreements.

Reinsurance revenues pertain to fees charged by the Company related to reinsurance premiums retroceded during the period under treaty and facultative agreements.

14. GENERAL AND ADMINISTRATIVE EXPENSES

The details of this account follow:

	Note	2006	2005	2004
Salaries and employee benefits	15	P 78,354,821	P 47,313,412	P 41,413,691
Provision for impairment	5	57,514,733	750,000	750,000
Retirement	15	35,601,366	1,702,402	1,620,490
Depreciation	6, 8	8,679,824	4,661,906	4,567,710
Representation and entertainment		5,902,040	6,242,040	7,009,402
Professional fees		5,278,745	2,905,924	28,817,281
Transportation and traveling		3,446,644	2,996,757	3,279,950
Repairs and maintenance		3,263,955	1,757,509	1,939,897
Taxes, licenses and fees		3,221,350	1,406,021	1,258,688
Documentary stamps		2,943,312	1,941,938	795,186
Light and water		2,535,206	1,466,494	1,351,761
Printing and office supplies		2,111,219	1,373,869	1,571,183
Communication and postages		1,709,917	1,143,631	1,125,883
Insurance		957,337	676,663	609,495
Donations and contributions		701,324	469,250	507,057
Bank charges		608,161	168,705	72,794
Fringe benefit taxes		484,704	322,771	310,686
Professional and technical development		190,755	482,070	555,211
Miscellaneous		5,653,350	3,296,723	2,051,879
		P 219,158,763	P 81,078,085	P 99,608,244

15. EMPLOYEE BENEFITS

15.1 Short-term Benefits

Expenses recognized for employee benefits are presented below (see Note 14):

	2006	2005	2004
Salaries and wages	P 45,201,343	P 26,666,537	P 25,473,514
Allowances and bonus	18,554,657	12,266,129	10,968,498
Compensated absences	5,731,876	3,872,326	1,217,460
Separation benefits	1,593,946	-	-
Social security costs	1,407,106	1,130,122	1,060,670
Others	5,865,893	3,378,298	2,693,549
	P 78,354,821	P 47,313,412	P 41,413,691

15.2 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 2006, 2005 and 2004 amounted to P35,601,366, P1,702,402 and P1,620,490, respectively (see Note 14).

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 regularly to update the retirement benefit costs and the amount of contributions.

In 2006, the Company aligned the retirement benefit plan for all its employees, including the employees absorbed from UMRC as a result of the merger. The amounts of defined benefit liability (asset) recognized in the balance sheets as part of Accounts Payable and Accrued Expenses account (Other Assets account) are determined as follows (see Note 11):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Present value of the obligation	P 51,174,809	P 24,158,148	P 15,244,406
Fair value of plan assets	(19,836,800)	(18,955,928)	(15,541,394)
Deficiency (excess) of plan assets	31,338,009	5,202,220	(296,988)
Unrecognized actuarial gains (losses)	2,465,688	(5,364,282)	213,211
Defined benefit liability (asset)	P 33,803,697	(P 162,062)	(P 83,777)

The movements in present value of the retirement benefit obligation recognized in the books are as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Balance at beginning of year	P 24,158,148	P 15,244,406	P 14,284,819
Actuarial adjustment	16,276,913	-	-
Current service cost and interest cost	11,795,895	2,942,031	2,606,341
Past service cost	19,768,521	-	-
Actuarial (gains) losses	(13,299,169)	5,971,711	(1,646,754)
Adjustment for curtailment	6,291,542	-	-
Benefits paid by the plan	(13,817,041)	-	-
	P 51,174,809	P 24,158,148	P 15,244,406

The movement in the fair value of plan assets is presented below.

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Balance at beginning of year	P 18,955,928	P 15,541,394	P 12,622,083
Actuarial adjustment	1,647,591	-	-
Contributions paid into the plan	1,635,607	1,787,057	1,557,670
Benefits paid by the plan	(13,817,041)	-	-
Actuarial gains (losses)	9,766,433	387,848	351,874
Expected return on plan assets	1,648,282	1,239,629	1,009,767
	P 19,836,800	P 18,955,928	P 15,541,394

The amounts of retirement expense recorded as part of General and Administrative Expenses account in the income statements are as follows (see Note 14):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Current service costs	P 5,173,501	P 1,265,146	P 1,249,283
Interest costs	6,622,394	1,676,885	1,357,058
Expected return on plan assets	(1,648,282)	(1,239,629)	(1,009,767)
Net actuarial gain recognized during the year	(606,310)	-	23,916
Past service cost	19,768,521	-	-
Curtaiment cost	6,291,542	-	-
	P 35,601,366	P 1,702,402	P 1,620,490

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

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Discount rates	11%	11%	9.5%
Expected rate of return on plan assets	8%	8%	8%
Expected rate of salary increase	8%	8%	8%

16. TAXES

16.1 Current and Deferred Income Taxes

The major components of tax expense for the years ended December 31, 2006, 2005, and 2004 are as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
<i>Reported in income statements</i>			
Current tax expense:			
Final tax (at 20% and 7.5%)	P 38,077,014	P 20,895,482	P 19,356,307
Minimum corporate income tax (MCIT) (at 2%)	3,325,133	1,020,169	-
Regular corporate income tax (RCIT) (at 35% in 2006 and 2005, and at 32% in 2004)	-	-	5,858,902
Deferred tax expense (income)			
Deferred tax resulting from an increase in RCIT rate	-	1,741,334	-
Deferred tax relating to origination and reversal of temporary differences	(44,080,565)	(19,280,838)	(2,108,014)
	(44,080,565)	(17,539,504)	(2,108,014)
	<u>(P 2,678,418)</u>	<u>P 4,376,147</u>	<u>P 23,107,195</u>
<i>Reported in statements of changes in equity</i>			
Deferred tax relating to origination and reversal of temporary difference	P 14,847,681	P 19,130,654	P 65,643
	<u>P 14,847,681</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>2006</u>		<u>2005</u>		<u>2004</u>
Tax on pretax income (at 35% in 2006 and 2005, and 32% in 2004)	P 95,288,537	P	36,064,109	P	39,374,551
Adjustment for income subjected to lower income tax rates	38,077,014		20,895,482		19,356,307
Tax effect of:					
Increase in deductible temporary difference due to change in RCIT rate	-		1,741,334		-
Derecognized deferred tax assets	1,780,753		-		-
Non-deductible expenses	1,231,609		188,261		416,679
Separation pay deductible in 2006	(11,393,461)		-		-
Non-taxable income	(41,279,761)	(	714,051	(	2,265,470)
Interest income subjected to final tax	(86,383,109)	(	53,798,988)	(	33,774,872)
 Tax expense (income) reported in income statements	 (P 2,678,418)	 P	 4,376,147	 P	 23,107,195

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 2006 and 2005, the Company incurred NOLCO amounting to P375,098 and P5,087,865, respectively. The NOLCO incurred in 2006 can be used as deduction against taxable income until 2009. The NOLCO incurred in 2005 was derecognized because it can no longer provide future benefit for the Company as a result of the merger.

MCIT for 2006 and 2005 amounted to P3,325,133 and P1,020,169, respectively, and is recorded as part of Deferred Tax Assets account in the balance sheets.

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

	<u>Balance Sheets</u>			<u>Income statements</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Deferred tax liabilities:						
Deferred acquisition costs	P10,875,589	P 17,936,778	P15,378,773	P 7,061,190	(P 2,558,005)	P 2,029,576
Revaluation reserves on available-for-sale investments	14,847,681	19,130,654	65,643	-	-	-
Excess of reserves for unexpired risk per books over tax basis	9,176,803	2,734,101	(1,850,572)	(6,442,702)	(4,584,673)	(4,032,668)
Deferred tax assets:						
Unrealized foreign exchange gain (loss)	(20,671,901)	(10,950,775)	10,708,183	9,721,125	21,658,958	478,929
Allowance for doubtful accounts	(24,924,715)	(4,794,558)	(4,143,596)	20,130,157	650,962	(240,000)
MCIT	(4,345,302)	(1,020,169)	-	3,325,133	1,020,169	-
NOLCO	(131,284)	(1,780,753)	-	(1,649,469)	1,780,753	-
Accrued leave benefits	(963,245)	(888,431)	(1,334,087)	74,814	(445,656)	(347,464)
Past service cost	(12,061,783)	(201,466)	(184,470)	11,860,317	16,996	3,613
Deferred Tax Income				P44,080,565	P17,539,504	(P 2,108,014)
Net Deferred Tax Liabilities (Assets)	(P28,198,157)	P 20,165,381	P18,639,874			

16.2 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:

- 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;
- 10% VAT rate is increased to 12% effective on February 1, 2006;
- 12% VAT is now imposed on certain goods and services that were previously zero-rated or subject to percentage tax;
- 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
- Creditable input VAT is capped at a maximum of 70% of output VAT per quarter which is effective until the third quarter of 2006 (this cap was removed effective for quarters ending on December 31, 2006 and onwards).

17. EQUITY

17.1 Capital Stock

Capital stock consists of:

	Shares			Amount		
	2006	2005	2004	2006	2005	2004
Common shares – P100 par value						
Authorized – 30,000,000 shares						
Issued:						
Balance at beginning of year	10,000,000	6,142,365	4,552,185	P1,000,000,000	P 614,236,500	P 455,218,500
Issuance during the year	5,885,583	3,857,635	-	588,558,300	385,763,500	-
Stock dividends issued during the year	-	-	1,590,180	-	-	159,018,000
Balance at end of year	15,885,583	10,000,000	6,142,365	P1,588,558,300	P1,000,000,000	P 614,236,500

To consummate the merger, the Company issued 5,885,583 shares of capital stock in order to acquire the net assets of UMRC (see Note 1).

17.2 Treasury Shares

Treasury shares pertain to the Company's shares of stock held by First Quezon City Insurance Co., Inc. (FQCICI) reacquired in 2005, and those held by UMRC and the dissenting stockholders reacquired in 2006. The total cost of the treasury shares acquired from FQCICI, UMRC, and dissenting stockholders amounted to P174,126, P243,855,340, and P10,610,169, respectively (see Note 1).

17.3 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 P5,000,000 was initially appropriated from retained earnings for this purpose on April 30, 1989. Subsequently, at December 31 of each year where there is profit, ten percent (10%) of such profit shall be set aside as additional reserve for contingencies. The reserve balance, which is shown as Appropriated 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 amounted to P150,949,099, P123,455,961, and P113,589,545 as of December 31, 2006, 2005, and 2004, respectively.

17.4 Shareholders Owning at Least 100 Shares

In compliance with SRC Rule 68, the Company has 159 shareholders owning 100 or more shares of stocks of the Company.

18. RELATED PARTY TRANSACTIONS

The Company's related parties include its principal stockholders, the Company's key management personnel and other related parties with which the Company had transactions carried out on an arm's length basis.

18.1 Reinsurance Contracts with Related Parties

The Company accepts and cedes insurance business under various reinsurance contracts with related parties. The details of which follow:

Premiums	P	1,680,287,858
Retrocessions		782,802,736
Commission income		165,394,272
Commission expenses		255,411,579
Losses incurred		239,823,078
Loss recoveries		52,040,257

As a result of the above transactions, reinsurance balances receivable from and payable to related parties are as follows:

Due from ceding companies	P	760,626,683
Reinsurance recoverable on losses		54,624,018
Funds held by ceding companies		40,449,783
Due to retrocessionaires		558,356,875
Funds held for retrocessionaires		198,182

The balance of due from ceding companies pertaining to related parties is presented net of P10,788,045 allowance for impairment which was provided in 2006.

18.2 Bank Accounts

The Company maintains savings and current accounts and time deposits with Bank of the Philippine Islands (BPI). The details of which follow:

Time deposits	P	19,133,027
Savings and current accounts		<u>8,187,161</u>
	P	<u>27,320,188</u>

18.3 Investment Management and Custodianship

The Company has entered into agreements known as "Investment Management Agreement" and "Custodianship Agreement" with BPI for the management and custodianship of substantially all investments of the Company subject to terms and conditions in the said agreements. For the services rendered, the Company pays BPI service fees equivalent to 0.175% of the market value of the investments. Total Service fees paid for the year ended December 31, 2006 amounted to P1,215,043.

18.4 Retirement Fund Investment Management

The Company has entered into a "Retirement Fund Investment Management Agreement" with BPI for the management of the investments of the Company's retirement funds subject to the terms and conditions in the said agreement.

18.5 Key Management Personnel Compensation

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Short-term benefits	P 53,959,458	P 22,011,260	P 18,781,767
Post-employment benefits	<u>970,130</u>	<u>793,425</u>	<u>678,004</u>
Balance at end of year	P <u>54,929,588</u>	P <u>22,804,685</u>	P <u>19,459,771</u>

19. 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 P907,301,940. This amount exceeds the required margin of solvency of P55,189,073 by P852,112,867.

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

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

	<u>2006</u>		<u>2005</u>		<u>2004</u>
PFRS net income	P 274,931,380	P	98,664,163	P	99,938,278
Difference in change in reserve for unexpired risk – net	(18,407,720)	(	13,594,754)	(	12,602,087
Deferred acquisition costs – net	20,174,827	(	3,189,272)	(	6,342,425)
Provision for catastrophe loss	-	(	17,077,303)	(	2,396,481)
Tax effect of the adoption of GAAP accounting	(618,487)		11,851,465		(1,236,218)
Statutory net income	P 276,080,000	P	76,654,299	P	102,565,241

21. EVENTS AFTER THE BALANCE SHEET DATE

21.1 *Amendment of the Articles of Incorporation*

On January 15, 2007, the SEC approved the amended articles of incorporation of the Company which includes a reduction of the par value of the Company's shares of stock from P100 to P1 per share. The reduction of the par value effectively increased the number of shares that are issued from 15,885,583 to 1,588,558,300 (see Note 22).

21.2 *Acquisition of Treasury Shares*

On February 21, 2007, the Company entered into a Compromise Agreement with certain stockholders to acquire 446,774 shares of the Company at an agreed exchange value of P100,077,376.

22. EARNINGS PER SHARE

The earnings per share amounts after the reduction of the par value of the Company's shares of stock (see Note 21) are as follows:

	<u>2006</u>		<u>2005</u>		<u>2004</u>
Net income available to common shareholders	P 274,931,380	P	98,664,163	P	99,938,278
Divided by the average number of outstanding common shares	1,400,893,200		949,365,200		613,079,000
	P 0.20	P	0.10	P	0.16

23. SUBSEQUENT REVISIONS OF PREVIOUSLY ISSUED 2006 FINANCIAL STATEMENTS

Subsequent to the issuance of the Company's 2006 financial statements, the Company included additional disclosures for its initial public offering. The additional disclosures pertain to Deferred Reinsurance Premiums and Reserve for Unexpired Risks (see Note 9), Underwriting Deductions (see Note 13), Acquisition of Treasury Shares (see Note 21.2), and Earnings Per Share (see Note 22).

24. 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.

25. RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company may be 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 may be exposed to are described below.

25.1 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 P90,676,616 in 2006 and P45,952,689 in 2005, and net foreign exchange gain of P7,201,781 in 2004.

25.2 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.

25.3 Cash Flow and Fair Value Interest Rate Risks

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

Officers



Office of the President

Standing left to right: Regina S. Ramos, VP; Noel M. Juan, VP
Seated left to right: Armando S. Malabanan, EVP; Wilfrido C. Bantayan, President



Life

Standing left to right: Augusto C. Cipriano, VP; Raymundo T. Bautista, SVP
Seated left to right: Editha B. Geronimo, AVP; Rosario V. Engracia, AVP



Non-Life

Left to right: Rodolfo M. Nayve, SVP; Danilo J. Cabero, VP; Buenaventura P. Duran, VP; Roberto S. de Leon II, AVP; Ma. Lourdes M. Santos, VP



Finance

Standing left to right: Amerfil V. Basco, VP; Marissa P. Aldeano, VP; Honorata S. Lucos, AVP
Seated left to right: Vicente B. Villarama, VP; John E. Huang, SVP

Corporate Services

Standing left to right: Raymundo T. Bautista, SVP; Edgar B. Villasenor, AVP
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