POWER SECTOR ASSETS & LIABILITIES MANAGEMENT CORPORATION

SIGNIFICANT RISKS EXPOSURE TO PSALM

As of 31 December 2021

As a result of the risk management activities, the following were identified as the risks which PSALM has significant exposure to and must closely monitor and manage:

<table>
<tr><th>Source of Risk</th><th>Risk Exposure</th><th>Existing Management Measures</th></tr>
<tr><td>Market Risk</td><td>PSALM's financial obligations are mostly linked with various financial indicators such as the foreign exchange rates, interest rates, commodity prices and price indices. Any unfavorable movements on these indicators exposes PSALM to financial losses.</td><td>PSALM implements measures to manage this risk within its corporate powers and within the bounds of its relevant regulatory environment. However, it only executes measures mostly on a natural and atomic approach rather than on a wholistic approach. These programs are identified below to which risk they tend to address.</td></tr>
<tr><td>Foreign Currency Risk</td><td>PSALM's financial obligations are mostly denominated in foreign currency. As of 31 December 2021, 62% of PSALM's financial obligations is denominated in foreign currency thereby exposing PSALM to foreign exchange fluctuations. Sensitivity analysis of PSALM's financial obligations showed that PSALM's risk exposure amounts to PHP4.31 billion for every 1 Peso depreciation in foreign exchange.

Provided below is the currency mix profile of PSALM's financial obligation:
<table>
<tr><th>Currency</th><th>Amount in Billion PHP Equivalent*</th><th>Percentage Share</th></tr>
<tr><td>USD</td><td>202.26</td><td>57.48%</td></tr>
<tr><td>JPY</td><td>16.33</td><td>4.64%</td></tr>
<tr><td>PHP</td><td>133.30</td><td>37.88%</td></tr>
<tr><td>Total</td><td>351.89</td><td>100.00%</td></tr>
</table>
* translated using PHP50.77 per USD1.00</td><td>PSALM's objective is to increase the percentage share of peso denominated financial obligations to at least 50%. In order to achieve this objective, PSALM has implemented several measures to manage the foreign currency risk through natural hedging approach:

• Exercised prepayment/buyback clauses of foreign currency denominated loans/bonds and IPPs;
• Refinanced in peso for repayment of maturing foreign currency financial obligations;
• Utilized hedging instruments such as the Principal Only Swap; and
• Addressed the asset-liability currency mismatch through imposing the payment of privatization receivables/deferred payments to be denominated in foreign currency to match the foreign currency denominated payables.</td></tr>
</table>

<table>
<tr><th>Source of Risk</th><th>Risk Exposure</th><th>Existing Management Measures</th></tr>
<tr><td>Interest Rate Risk</td><td>Interest rates likewise affect PSALM's financial performance.

<table><tr><th>Interest Rate</th><th>Amount in PHP Equivalent</th><th>Percentage Share</th></tr><tr><td>Fixed*</td><td>232.22</td><td>65.99%</td></tr><tr><td>Floating</td><td>119.66</td><td>34.01%</td></tr><tr><td>Total</td><td>351.88</td><td>100.00%</td></tr></table>* Including IPP Lease Obligations

Although PSALM has unconditional and irrevocable guarantee from the National Government, in terms of pricing PSALM's debentures, a spread/premium over relevant benchmark is still being imposed by creditors to PSALM which adds to the financial burden of PSALM.

The dilemma in interest rates is that PSALM cannot ascertain the optimum interest rate mix. If it contracts fixed rate liabilities, PSALM faces opportunity losses on interest rate savings when rates fall. On the other hand, floating rate liabilities face losses if rate rise.</td><td>PSALM's main objective is to bring down the current blended borrowing cost which is at 4.02% as of 31 December 2021. To achieve this objective, PSALM has implemented the following measures:

• Exercised prepayment/buyback clauses of high coupon bearing foreign currency loans and bonds; and
• Refinanced from Government Financial Institutions (GFIs) which offer low interest rates to Government-Owned and Controlled Corporations (GOCCs) such as PSALM.

Moreover, PSALM has imbedded in its domestic loans an option to convert the interest rates from floating to fixed or vice versa to take advantage of the low interest rates.</td></tr>
<tr><td>Credit Risk</td><td>PSALM's total collection efficiency as of 31 December 2021 is at 93.53%. High credit risk comes from power customers in the Mindanao Grid specifically from LASURECO[1] and MAGELCO[2] with 0% collection efficiency.

PSALM increased temporarily the allocation of power for LASURECO (from 6.8 MW to 42 MW) and MAGELCO (10 MW to 17.88 MW) to ensure stability of power in Mindanao and to avoid power outages during the enhanced community quarantine. The estimated revenues to PSALM for the increased power allocation may not be realized since said electric cooperatives have not been paying PSALM for the</td><td>PSALM has been implementing aggressive collection strategies, some of which are the following:
• Issuances of Final Demand Letters
• Filing of Collection Case
• Restructuring/Special Payment Program
• Reconciliation/ consultation/ validation with concerned customers
• Prepayment of restructured balance through loan assistance from banks that offer lower interests compared to the rate of interest currently being imposed by PSALM</td></tr>
</table>

[1] *Lanao del Sur Electric Cooperative*
[2] *Maguindanao Electric Cooperative*

<table>
<tr><th>Source of Risk</th><th>Risk Exposure</th><th>Existing Management Measures</th></tr>
<tr><td></td><td>power they consume. However, if PSALM does not provide the increased allocation, there is a high likelihood that the Mindanao grid will experience power outages.

Likewise, high credit risk comes from receivable from delinquent/overdue account which is at PHP70.24 billion, with details as follows:
<table><tr><th>Delinquent/Overdue Accounts</th><th>Amount in PHP billions</th></tr><tr><td>Restructured Power Accounts</td><td>3.10</td></tr><tr><td>Receivables from IPPA</td><td>40.36</td></tr><tr><td>Other Receivables</td><td>26.78</td></tr></table></td><td>Coordination with other government agencies such as DOE, NEA, etc.</td></tr>
<tr><td>Liquidity Risk</td><td>At the onset of the asset-debt transfer from the National Power Corporation in which PSALM assumed more liabilities than the assets, PSALM has been facing liquidity risk. Annually, there is a mismatch between debt maturities and collection of privatization proceeds.</td><td>PSALM implements the following measures to meet the annual maturities and to avert possible default on its financial covenants:
Fast track the privatization program with priority of selling losing plants
Implement various modes of real estate disposals in order to generate additional cash proceeds to be used solely to liquidate PSALM's financial obligations
Match the payment terms of the abovementioned privatization and disposal activities with the maturing financial obligations
Recover the stranded contract cost and stranded debts through imposition of the universal charge
Utilization of the Malampaya Fund through annual allocation of the National Government for the implementation of the Murang Kuryente Act
The abovementioned measures are the main objectives of PSALM in addressing its liquidity risk before it resorts to borrowing for any deficit amount.</td></tr>
<tr><td>Performance Risk</td><td>PSALM faces a risk that a product, service, program or project will not be delivered as much value as required.</td><td>PSALM's privatization and disposal of assets, as well as procurement of goods and services, requires the submission of</td></tr>
</table>

Source of Risk	Risk Exposure	Existing Management Measures
		performance security in acceptable forms to protect PSALM from compensation for undelivered value of the goods or services.
Disaster Risk (Natural or Man-made)	With the high value of generating assets, PSALM is also faced with high financial exposure due to loss, theft, earthquakes, sabotage, terrorism, fire, oil spill, etc.	To mitigate loss due to disaster risk either man-made or natural catastrophe, PSALM purchased various insurance covers such as but not limited to Industrial All Risk, Fire Insurance, Comprehensive General Liability, etc. with the Government Service Insurance System (GSIS) as required by law.
	However, since the GSIS is the lone insurer for the properties of the whole government, their financial capacity is limited to only up to PHP2.0 billion limit of liability which is not enough to sufficiently provide insurance cover to the properties of PSALM.	In order to provide sufficient insurance cover specifically on Industrial All Risk policy, PSALM requested the GSIS to increase its limit of liability to PHP8.0 billion. However, the increase in the limit of liability needs reinsurance support from other insurers. Hence, PSALM provided its approval for GSIS to procure for reinsurance support and to actively participate and monitor the developments of this activity.
Operational Risk	Relative to any disaster, and also due to the wear and tear of the power plant equipment, there is a risk of failure in the operation of the power plants.	To ensure the efficient and smooth operations of the power plants, timely and frequent preventive maintenance activity is being conducted in PSALM's owned power plants. Monitoring of the preventive maintenance is also conducted for the IPP owned power plants in order to ensure that the IPPs are regularly maintaining the good condition of the power plants under their administration. Moreover, PSALM will also include a Business Interruption line under the Industrial All Risk insurance cover with the GSIS relative to the abovementioned procurement in order to provide PSALM protection from loss of income in case of plant shutdown.
Political Risk	Inherent in political landscape of the Philippines is the change in the National Government administration which may cause changes in direction/priorities of the government. Moreover, political risks also cover those directions/priorities of the government which faces strong	PSALM's strategy in managing this risk differs depending on the group - national government, local government units and various units/ organizations. • Institutionalize the directions of the National Government in order to provide solid foundation for the continuous implementation of the plans/activities/projects (PAP);

<table>
<tr><th>Source of Risk</th><th>Risk Exposure</th><th>Existing Management Measures</th></tr>
<tr><td></td><td>opposition from the local government units or from various organizations.</td><td rowspan="2">• Constant coordination with the relevant agencies in order to provide clear justification/rationale for PSALM in implementing its PAP;
• Actively participate and provide comments in public consultations to put into record PSALM's position relevant in discharging its mandate; and
• Seek support from/collaborate with higher authorities/oversight agencies in communicating with the relevant political unit.</td></tr>
<tr><td>Regulatory Risk</td><td>PSALM's plans and programs likewise face regulatory risk by means of change/ amendments in laws, regulations or oversight directions which affect the implementation of its plans and programs.

This risk also entails delays in the approval from government regulatory bodies.</td></tr>
</table>

Prepared by:

JULIO JEROME C. COSICO
Financial Management Department

Approved by:

VIRGINIA C. REYES
Financial Management Department