KEY RISKS

Regulatory Framework

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

The operations of the Company are subject to the regulatory requirements of the IC. Such regulations not only prescribe approval and monitoring of activities but also in imposing certain restrictive provisions (e.g., minimum statutory networth and risk-based capital requirements).

Capital Management Framework

The Company maintains a certain level of capital to ensure sufficient solvency margins and to adequately protect the policyholders.

The Company reviews the capital requirements by monitoring the minimum statutory networth and the RBC which is regularly communicated to the major shareholders. With this procedure, shareholders are forewarned in anticipation of the IC requirements of additional capital infusion. Shareholders are well updated with these externally imposed capital requirements since these are being discussed during the annual BOD meeting.

Minimum Statutory Networth

On August 15, 2013, the President of the Philippines approved Republic Act No. 10607 to be known as the "New Insurance Code" which provides the new capitalization requirements for all existing insurance companies based on net worth on a staggered basis starting June 30, 2013 up to December 31, 2022.

The following presents the amount of required networth and the schedule of compliance per Amended Insurance Code:

Networth	Compliance date
P250,000,000	June 30, 2013
P550,000,000	December 31, 2016
P900,000,000	December 31, 2019
P1,300,000,000	December 31, 2022

On January 13, 2015, the IC issued the Circular Letter (CL) No. 2015-02-A which provides for the clarification of minimum capital requirements under sections 194, 197, 200 and 289 of the New Insurance Code. The said circular supersedes the Department Order Nos. 27-06 and 15-2012 and CL Nos. 22-2008 and 26-2008.

Based on its latest synopsis issued by the Insurance Commission as of December 31, 2015, the audited statutory networth of the Company amounted to P1,081,625,663 as of December 31, 2015.

Solvency Requirement

Under the revised Insurance Code (RA 10607), an insurance company doing business in the Philippines shall, at all times, maintain the minimum paid-up capital and net worth requirements as prescribed by the Commissioner. Such solvency requirements shall be based on internationally accepted solvency frameworks and accepted only after due consultation with the insurance industry association.

The amounts of estimated non-admitted assets, as defined in the Code, are as follows:

	2016 (Estimated)	2015 (Actual)
Accounts receivables	P53,183,870	P37,740,250
Premiums receivables	17,132,751	28,427,277
Property and equipment and investment Properties	12,785,876	5,794,752
Other Investments	-	1,131,859,662
Cash on hand	-	7,038,986
Investments	-	1,758,581
Reinsurance assets	-	5,598,340
Other assets	26,770,583	27,983,428
	P109,873,080	P1,246,201,276

If an insurance company failed to meet the minimum required capital, the Insurance Commission is authorized to suspend or revoke all certificates of authority granted to such companies, its officers and agents, and no new business shall be done by and for such company until its authority is restored by the Insurance Commission.

The final amount of the networth as of December 31, 2016 can be determined only after the accounts of the Company have been examined by the Insurance Commission, specifically as to admitted and non-admitted assets as defined under the Code.

Risk-based Capital Requirements

IMC No. 7-2006 provides for the RBC framework for the nonlife insurance industry to establish the required amounts of capital to be maintained by the companies in relation to their investment and insurance risks. Every non-life insurance company is annually required to maintain a minimum RBC ratio of 100% and not fail the trend test. Failure to meet the minimum RBC ratio shall subject the insurance company to the corresponding regulatory intervention which has been defined at various levels.

The RBC ratio shall be calculated as networth divided by the RBC requirement. Networth shall include the Company's paid-up capital, contributed and contingency surplus and unassigned surplus. Revaluation and fluctuation reserve accounts shall form part of networth only to the extent authorized by the IC.

The table below shows how the RBC ratio as of December 31, 2016 and 2015 was determined by the Company:

	2016 (Estimated)	2015 (Estimated)
Networth	P1,294,125,663	P1,081,625,663
RBC requirement	239,242,367	232,819,626
RBC Ratio	**541%**	**465%**

The final RBC ratio can be determined only after the accounts of the Company have been examined by IC.

If an insurance company failed to meet the minimum required statutory networth and RBC requirements, the IC is authorized to suspend or revoke all certificates of authority granted to such companies, its officers and agents, and no new business shall be done by and for such company until its authority is restored by the IC.

On December 28, 2016, IC has released a new guideline thru its Circular Letter no. 2016-68, amending the Risk-Based Capital (RBC2) Framework. In the new framework, IC adopted the three (3) pillar risk-based approach to solvency which comprised the following:

a) Pillar 1 includes the quantitative requirement in relation to the calculation of capital requirements and recognition of eligible capital. Unlike the old RBC framework whereby the networth was used to divide the RBC requirement, in the new framework it is the total available capital (TAC). It is the capital that is required to be held appropriately to the risks an insurance company is exposed to.
b) Pillar 2 covers the governance and risk management requirement that consist of a supervisory review process which may include supervisory adjustment to capital; and
c) Pillar 3 comprises the disclosure requirements designed to encourage market discipline

Same as the financial reporting framework and valuation, the insurance company is required to accomplish and submit three (3) quarterly reports due two (2) months after the end of each quarter and 30th of April for the 31st December annual reporting.

All insurance companies are required to maintain the minimum RBC ratio of 100% and not fail the trend test based on their quarterly and annual submissions. Failure to meet the minimum RBC will be required to submit a report explaining the cause of failure and a management plan of actions.

Under Section 3 of the Circular, Company Action Event shall occur if the RBC ratio of the company is less than 100% but not below 75%. Should this event occur, the company shall file to the Commissioner within fifteen (15) days of the event an RBC plan that shall:

a) Identify the conditions that contributed to the event;
b) Contain proposals of corrective action that the company intends to take and that would be expected to result in the elimination of the event;
c) Provide projections of the company's Annual Statements for at least two years with and without the proposed corrective actions; including but not limited to projections on the balance sheets, analysis of operations (total), surplus accounts, RBC Exhibits and lines of business information relevant to the RBC plan;
d) Identify the key assumptions impacting the company's projections and sensitivity of the projections to the assumptions; and
e) Identify the quality of, and problems associated with, the company's business, including but not limited to its assets, anticipated business growth, surplus strain, extraordinary exposure to risk, mix of business and use of reinsurance, if any, in each case.

The Commissioner shall notify the company within thirty (30) days upon submission of the RBC plan whether it shall be implemented or is unsatisfactory. In the latter case the Commission shall include reasons for the determination and proposed revisions to the RBC plan, and the company shall resubmit the RBC plan within ten (10) days of notice.

The final RBC ratio can only be determined after the accounts of the Company have been examined by IC.

Insurance Risk

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

The variability of risks is improved by diversification of risk of loss to a large portfolio of insurance contracts as a more diversified portfolio is less likely to be affected across the board by change in any subset of the portfolio. The variability of risks can also be improved by careful selection and implementation of underwriting strategy and guidelines.

The majority of reinsurance business ceded is placed on a quota share basis with retention limits. Amounts recoverable from reinsurers are estimated in a manner consistent with the assumptions used for ascertaining the underlying policy benefits and are presented in the statement of financial position as reinsurance assets.

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

The Company's placement of reinsurance is diversified such that it is neither dependent on a single reinsurer nor are the operations of the Company substantially dependent upon any single reinsurance contract.

The business of the Company mainly comprises of short-term nonlife insurance contract. The Company principally issued the following types of general insurance contracts: fire, engineering, marine, motor car, personal accident and miscellaneous casualty.

The table below sets out the concentration of the claims liabilities by type of contract (see Note 14):

	Gross Contract Liabilities	Reinsurers Share of Liabilities	Net	Gross Contract Liabilities	Reinsurers Share of Liabilities	Net
Property	P125,065,606	P73,244,208	P51,821,398	P119,383,809	P100,585,213	P18,798,596
Motor Car	28,515,886	-	28,515,886	27,176,232	35,244	27,140,988
Casualty	7,474,441	2,290,464	5,183,977	9,527,561	4,747,112	4,780,449
Marine	4,005,217	35,430	3,969,787	2,388,941	727,123	1,664,818
	P165,061,150	P75,570,102	P89,491,048	P158,476,543	P106,091,692	P52,384,851

The most significant risk arises from climate changes and natural disasters. These risks vary significantly in relation to the location of the risk insured by the Company, type of risks insured and in respect of commercial and business interruption insurance, by industry.

The Company also enforces a policy of actively managing and promptly pursuing claims, in order to reduce its exposure to unpredictable future developments that can negatively impact the Company.

The Company also has limited its exposure level by imposing maximum claim amounts on certain contracts as well as the use of reinsurance arrangements in order to limit exposure to catastrophic events. The purpose of these underwriting and reinsurance strategies is to limit exposure to catastrophes to a predetermined maximum amount based on the Company's risk appetite as decided by management.

Assumptions

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

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

Sensitivities

In insurance, as a rule, there may be claims filed in the current year that would attach policies issued in the previous years. This in effect makes claims provision highly sensitive as represented by the table below. Other unpredictable circumstances like legislative uncertainties make it.

impossible to quantify claims. Also, due to delays arising between occurrence of claims and their subsequent reporting to and settlement by the Company, the outstanding claim provisions cannot be ascertained with confidence at the end of the reporting period.

As a result, the final liabilities will change as a result of succeeding developments. Differences from recomputation of the final liabilities are taken up in subsequent financial statements.

The table below shows the impact of changes in certain important assumptions in general insurance business while other assumptions remain unchanged. The interrelation of these assumptions will have an important impact in the computation of the final liabilities. But these assumption changes should be done on an individual basis to show the effect on the claims liabilities. It is worthwhile mentioning that these assumptions are nonlinear and larger or smaller impacts cannot be seen from these results.

Financial Risk

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

Credit Risk

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

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

The credit policy group reviews all information about the counterparty which may include the counterparty's statement of financial position, statements of income and other market information. The nature of the obligation is likewise considered. Based upon this analysis, the credit analyst assigns the counterparty a credit rating to determine whether or not credit may be provided.

Credit risk limit is also used to manage credit exposure which specifies exposure limits for each intermediary depending on the size of its portfolio and its ability to meet its obligation based on past experience.

Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from either the inability to sell financial assets quickly at their fair values; or counterparty failing on repayment of a contractual obligation; or insurance liability falling due for payment earlier than expected; or inability to generate cash inflows as anticipated. The major liquidity risk confronting the Company is the daily calls on its available cash resources in respect of claims arising from insurance contracts.

The Company manages liquidity through a liquidity risk policy which determines what constitutes liquidity risk for the Company; specifies minimum proportion of funds to meet emergency calls; set up of contingency funding plans; specifies the sources of funding and the events that would trigger the plan; determines concentration of funding sources; reports liquidity risk exposures and breaches; monitoring compliance with liquidity risk policy and reviews liquidity risk policy for pertinence and changing environment.

Market risk

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

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

a) Currency risk

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

The following table shows the details of the Company's foreign currency-denominated monetary assets and their Philippine peso equivalents.

	2016		2015	
	Original Currency	Peso Equivalent	Original Currency	Peso Equivalent
Cash in bank:				

US dollar denominated	$175,940	P8,747,732	$129,486	P6,093,623
Euro denominated	602	31,225	602	31,157
AFS financial assets:				
US dollar denominated	$332,742	P16,543,927	$482,105	P22,67,874
Total foreign currency Denominated		**P25,322,884**		**P28,812,654**

The following table demonstrates the sensitivity to a reasonably possible change in the foreign exchange rates, with all other variables held constant, of the Company's income before tax.

2016

Currency	**Change in exchange rate**	**Impact on income Before tax Increase (decrease)**
US Dollar	+4%	P1,011,666
	-4%	(1,011,666)
Euro	+9%	2,810
	-9%	(2,810)

2015

US Dollar	+4%	P1,151,260
	-4%	(1,151,260)
Euro	+14%	4,362
	-14%	(4,362)

b) Interest rate risk

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

Floating rate instruments expose the Company to cash flow interest risk, whereas fixed interest rate instruments expose the Company to fair value risk. The Company's AFS debt securities in particular is exposed to fair value risk.

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

c) Price risk

The Company's price risk exposure at year end relates to financial assets and liabilities whose values will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or currency risk), principally, its AFS equity financial assets.

Such investment securities are subject to price risk due to changes in market values of instruments arising either from factors specific to individual instruments or their issuers or factors affecting all instruments traded in the market.