

IMC No.:	6-2006
Date:	October 5, 2006

## INSURANCE MEMORANDUM CIRCULAR

**TO : ALL LIFE INSURANCE COMPANIES**

**SUBJECT : ADOPTION OF RISK-BASED CAPITAL FRAMEWORK FOR THE PHILIPPINE LIFE INSURANCE INDUSTRY**

To establish the required amounts of capital to be maintained by life insurance companies in relation to their investment and insurance risks, the Insurance Commission, after consultation with the life insurance industry hereby approves the adoption of the Risk-Based Capital (RBC) Framework and issues the following rules and regulations pursuant to the powers vested in me by the provisions of Section 414 of the Insurance Code.

### I. RBC Ratio and Networth

The investments and insurance risks of the company shall be classified under four (4) major categories.

- A. Asset Default Risk, denoted by C-1;
- B. Insurance Pricing Risk, denoted by C-2;
- C. Interest Rate Risk, denoted by C-3; and
- D. General Business Risk, denoted by C-4.

The RBC requirement is given by the formula :

$$\mathbf{RBC\ Requirement} = \sqrt{(C1 + C3)^2 + C2^2} + C4$$

The RBC ratio of a company shall be calculated as Networth divided by the RBC requirement as determined in accordance with RBC Exhibit Instructions and Disclosures (See Annex A).

“*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 Insurance Commissioner.

Every life insurance company is annually required to maintain a minimum RBC ratio of 100% and not fail the Trend Test as stated in (II.A.2.) below.

## II. Levels of Regulatory Intervention

The following levels of regulatory intervention then follow based on this ratio:

RBC Ratio = Y	Event	Description
$100\% \leq Y < 125\%$	Trend Test	Linear extrapolation if next year's ratio < 100%. If so, move to Company Action Event
$75\% \leq Y < 100\%$	Company Action	Submit RBC plan and financial projections. Company implements the plan.
$50\% \leq Y < 75\%$	Regulatory Action	IC authorized to examine company and issue Corrective Orders.
$35\% \leq Y < 50\%$	Authorized Control	IC authorized to take control of the company.
$Y < 35\%$	Mandatory Control	IC required to take control of the company.

**A. Company Action Event** shall refer to any of the following events:

1. The RBC ratio of the company is less than 100% but not below 75%, or
2. The Trend Test has failed, which shall occur in the event that:
  - a. The RBC ratio is less than 125% but is not below 100%,
  - b. The RBC ratio has decreased over the past year, and
  - c. The difference between RBC ratio and the decrease in the RBC ratio over the past year is less than 100%.

**A.1.** In the event of a Company Action Event, the company shall file to the Commissioner within forty-five (45) days of the event a 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 (2) 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 the 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 sixty (60) 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 thirty (30) days of notice.

**B. Regulatory Action Event** shall refer to any of the following events:

1. The RBC ratio of the company is less than 75% but not below 50%; or
2. The company fails to submit a RBC plan satisfactory to the Commissioner, if any, within the filing deadline; or

3. The Commissioner notifies the company of its failure to adhere to its RBC plan, and wherein the failure shall adversely affect the company's ability to eliminate the Company Action Event in accordance to its RBC plan.

**B.1.** In the event of a Regulatory Action Event, the Commissioner is authorized to

- a. Require the company to submit a RBC plan within forty-five (45) days of the event;
- b. Perform such examination or analysis, as deemed necessary, of the company's accounts, operations and RBC plan; and
- c. Subsequent to the examination or analysis, issue a Corrective Order specifying corrective actions the company is required to undertake.

The Commissioner may retain actuaries and other consultants as necessary to review the company's accounts, operations and RBC plan and to formulate the necessary corrective orders, the fees and costs of which shall be borne by the affected company.

**C. Authorized Control Event** shall refer to any of the following events:

1. The RBC ratio of the company is less than 50% but not below 35%; or
2. The Commissioner notifies the company of its failure to satisfactorily respond to a Corrective Order as stated in (B.1.c.).

In the event of an Authorized Control Event, the Commissioner is authorized to place the company under regulatory control under Sec. 247 of the Insurance Code, should the Commissioner deem it to be in the best interests of the company's policyholders and creditors and of the general public. The Authorized Control Event shall be deemed sufficient grounds for the Commissioner to take action under Sec. 247 of the Insurance Code.

**D. Mandatory Control Event** shall occur if the RBC ratio of the company is less than 35%. Should this event occur, the Commissioner is required to place the company under regulatory control under Sec. 247 of the Insurance Code. The Mandatory Control Event shall be deemed sufficient grounds for the Commissioner to take action under Sec. 247 of the Insurance Code.

### **III. Transition Period**

The company shall be given a maximum of twenty-four (24) months from date of effectivity of this Insurance Memorandum Circular to improve the RBC ratio.

### **IV. Submission of RBC Exhibits and Items**

Every life insurance company shall annually accomplish and file the relevant RBC Exhibits and Items that shall form part of the Annual Statements in accordance with the instructions provided.

**V. Confidentiality**

With the exception of the RBC Exhibits that shall form part of the Annual Statements, all other disclosures and RBC Plans filed with the Commissioner shall be kept confidential in the same manner as the Annual Statement Schedules and other confidential reports required by the Commission.

**VI. Compliance with Minimum Statutory Networth and Minimum Paid-up Capital, Margin of Solvency and RBC Requirements**

The company shall, in addition to the Minimum Statutory Networth and Minimum Paid-up Capital required under Department Order No. 27-06 and Margin of Solvency required under Section 194 of the Insurance Code, comply with the RBC requirement.

**VII. The RBC Framework shall be subject to review at least once every three (3) years.**

This Insurance Memorandum Circular shall take effect on immediately.

Signed on October 5, 2006.

**(SGD.) EVANGELINE CRISOSTOMO-ESCOBILLO**  
Insurance Commissioner

**Approved:**

**(SGD.) MARGARITO B. TEVES**  
Secretary  
Department of Finance

**RISK BASED CAPITAL (RBC) EXHIBIT INSTRUCTIONS AND DISCLOSURES****Exhibit 17: Aggregate RBC calculations**

	RBC Requirement
(1) C-1: Asset Default Risk (Exh 18, col 4 total)	
(2) C-2: Insurance Pricing Risk (Exh 20, Part 1, col 5 total)	
(3) C-3: Interest Rate Risk (Exh 21, col 10 total)	
(4) C-4: General Business Risk (Exh 20, Part 1, col 5 total)	
(5) Sum of C-1 to C-4 requirements	
(6) Aggregate RBC requirement: $\sqrt{((1) + (3))^2 + (2)^2} + (4)$	
(7) Networth (from p.3)	
(8) RBC Ratio: (7) / (6)	
(9) RBC Ratio, previous year	

- Exhibit 17 outlines the calculation of aggregate RBC and the RBC ratio. Calculations of RBC requirements for C-1, C-2, C-3 and C-4 are found in Exhibits 18 to 21. In general, items (1) to (4) are calculated as various percentages of exposures to risk. Aggregate RBC requirement, (6), is then calculated inclusive of a covariance adjustment as follows:

$$RBC = \sqrt{(C1 + C3)^2 + C2^2} + C4 < (C1 + C2 + C3 + C4)$$

From this, RBC Ratio is equal to Networth divided by Aggregate RBC. "Networth" shall be as shown in page 3 of the Annual Statements, and shall consist of

- Paid-Up Capital
  - Special Surplus Funds (fluctuation and revaluation reserves), to the extent allowed by the Commissioner
  - Contributed and Contingency Surplus, and
  - Unassigned Surplus.
- Treatment of Variable Life products.** Only the general account and cost of insurance components of insurance benefits, premiums, assets and liabilities will be subject to RBC requirements. Separate account assets and liabilities equal to such separate accounts shall be exempt from C-1 and C-3 requirements. Only a C-4 requirement of 0.1% of separate account assets will be required. Nevertheless, the pertinent Variable Life entries in the RBC Exhibits should be accomplished.

**Exhibit 18: C-1 Requirements**

- In general, C-1 requirements are calculated by multiplying the RBC factor with the corresponding net admitted asset value in the Annual Statements (or with the appropriate exposure measure for foreign exchange, derivatives and off-balance sheet items; see Exhibit 19).

Admitted assets shall be listed in Exhibit 18 in the same sequence as in page 2 and Exhibit 12. Totals in Exhibit 18, columns (1) and (2) should agree with results in the Audited Financial Statements and in page 2, respectively.

**Fixed Income Securities: Bonds, Treasury Bills and Short Term Investments**

	RBC Factor
1. Bonds, Treasury Bills	
1.1. Government, local currency	0%
1.2. Government, foreign currency	1.6%
1.3. Investment Grade	1.6%
1.4. Below Investment Grade	10%
1.5. Near default	30%
10. Short -term investments	
10.1. Government, local currency	0%
10.2. Government, foreign currency	1.6%
10.3. Investment Grade	1.6%
10.4. Below Investment Grade	10%
10.5. Near default	30%

4. Items 1.1, 1.2, 10.1 and 10.2 shall cover fixed income securities issued by the Philippine government, the Bangko Sentral ng Pilipinas (BSP), OECD governments and OECD central banks.

All other fixed income securities shall initially be under item 1.4 or item 10.4, Below Investment Grade, until otherwise classified as Investment Grade or Near Default.

5. The following fixed income securities shall be classified under item 1.3 or item 10.3, Investment Grade:
- a. Securities issued by multilateral development banks recognized by the BSP.<sup>1</sup>
  - b. Securities rated Baa or better (or its equivalent; see below) or better by a rating agency recognized by the Commission. All publicly available ratings for the security shall be utilized. When two or more ratings differ the second best rating shall be utilized.

Rating Agency	Bond	Short-term
Moody's	Baa3 or better	P3 or better
Standard and Poor's	BBB- or better	A3 or better
Fitch	BBB- or better	F3 or better
A M Best	Bbb-/B+ or better	AMB-3 or better
PhilRatings	PRS Baa or better	PRS 3 or better

6. Fixed income securities issued by a corporation or government agency for which no ratings are available may also be classified under item 1.3 or item 10.3, Investment Grade, based on the yield spread of the quoted market value of the issuer's securities in a fixed income exchange, using the instructions below.

<sup>1</sup> These include, among others: International Bank for Reconstruction and Development, Inter-American Development Bank, Asian Development Bank, African Development Bank, European Investment Bank and European Bank for Reconstruction and Development.

Market data presented as evidence for each issuer shall include the closing price of all its securities for the period stated below, the corresponding yield to maturity, yields of risk-free Treasury bonds of equivalent maturity, and the difference between issuer and Treasury yields (the yield spread), and calculations, if applicable.

Corporate and government agency issuers whose securities in a particular currency all have yield spreads (after striking out the highest spread) not exceeding 250 basis points based on closing price from 16 to 31 December shall be deemed Investment Grade. In the absence of such, market data from 1 to 15 December shall be utilized; yet in its absence, bid rates for the security from 1 to 31 December shall be utilized. Should none of these be available, all of the issuer's securities shall be deemed as Below Investment Grade.

7. A security shall be classified under item 1.5 or item 10.5, Near Default, in the event of
  - a. An actual default by the issuer, or
  - b. A rating below B (or its equivalent; see below) by at least one recognized rating agency.

<b>Rating Agency</b>	<b>Bond</b>	<b>Short-Term</b>
Moody's	Worse than B3	N/A
Standard and Poor's	Worse than B-	C or worse
Fitch	Worse than B-	C or worse
A M Best	Worse than B-	D
PhilRatings	Worse than PRS B	Worse than PRS 5

### **Stocks and Real Estate**

	RBC Factor
2. Stocks	
2.1. Common Stocks	30%
2.2. Preferred Stocks	
2.2.1. Traded and Rated	15%
2.2.2. Non-traded or Non-rated	30%
3. Real estate (net of encumbrances)	
3.1. Company-occupied, up to quota	8%
3.2. Company-occupied, above quota	15%
3.3. Acquired in satisfaction of debt/foreclosed	30%
3.4. Investments in real estate	15%

8. The issuing company of preferred stocks can be classified as Rated if its rating is two (2) notches higher than the country rating.
9. Company-occupied real estate shall be declared under item 3.1 up to a quota equal to the greater of: (a) 250 square meters or (b) 10 square meters per employee or officer counted in page 1 of the Annual Statement. The balance shall be declared under item 3.2.

### **Mortgage and Policy Loans**

	RBC Factor
5. Mortgage loans and purchase money mortgages	
5.1. In good standing	10%
5.2. Others	30%
6. Policy loans	0%

10. Mortgage loans and purchase money mortgages classified under item 5.1, In Good Standing, shall include loans for residential purpose, fully secured by first mortgage on residential property to be occupied or leased out by the borrower, that are not overdue for more than 90 days. All other mortgage loans shall be classified under item 5.2.

**Cash on hand and in banks**

	RBC factor
13. Cash and Bank Deposits	
13.1. Cash on hand	20%
13.2. Deposits in banks and trusts	0.3%
13.3. Others (not in good standing)	20%

11. Item 13.2 shall include demand deposits, certificates of deposit and money market placements with banks, quasi-banks and trust companies. It shall initially be deemed under item 13.2 unless the solvency status of the relevant institution or instrument is found by the Commissioner to be unsatisfactory, in which it shall be declared under 13.3, Not in Good Standing.

**Foreign Currency Exposure, including Gold (XAU):**

Currency - ISO Code	PHP per Unit	Admitted assets	Liabilities	Derivatives, net	Net Position (3)-(4)+(5)	RBC Factor
(1)	(2)	(3)	(4)	(5)	(6)	(8)
1. PHP	1.00					0%
2. USD, (6) ≥ 0	53.08					0%
3. USD, if (6) < 0	53.08					10%
4. EUR	67.00					10%
5. JPY	0.4500					10%
6. XAU	27,000					10%
7.1. AAA	10.00					10%
7.2. BBB	0.01000					10%
10. Total	- x -	0	0	- x -	- x -	- x -

12. RBC requirements are calculated in Exhibit 19, Part 1 and carried into Exhibit 18. With the exception of PHP and net long positions in USD, the RBC factor for each distinct currency shall be 10% of the absolute value of the net position initially calculated in the foreign currency and reported in PHP under columns (3), (4) and (5).

“*Net position*” means the aggregate value of admitted assets less liabilities denominated in each currency, inclusive of amounts receivable or payable on derivatives, as well as net positions in derivative contracts discussed below.

Long futures, forwards, call options and short put options are treated as a long position in the commodity currency and a short position in the term currency at the notional value. Long put options and short futures, forwards, and call options are treated as a short position in the commodity currency and a long position in the term currency at the notional value.



## Counterparty Factors

	RBC factor
9. Collateral, Guaranteed and Other Loans	
9.1. Of best security	0%
9.2. Adequately secured	10%
9.3. Others	30%
17. Amounts due and receivable from ceding co.; receivables from life insurance pools	
17.1. Of best security	0%
17.2. Adequately secured	10%
17.3. Others	30%

13. All other claims and receivables shall be assigned RBC factors based on the nature of the counterparty guaranteeing or collateralizing the obligation.

Claims subject to counterparty factors shall include

- a. Collateral, guaranteed and other loans
- b. Amounts due and recoverable from authorized life insurance companies, authorized reinsurance companies and life insurance pools
- c. Derivatives and off-balance sheet liabilities, excluding those considered under Foreign Exchange exposure.

There are three counterparty RBC factors to be adopted:

- a. 0% for counterparty, collateral or guarantee of best security
- b. 10% for counterparty, collateral or guarantee of adequate security
- c. 30% for all others.

14. Claims from authorized life and non-life insurance and reinsurance companies and claims from life insurance pools shall initially be assigned a 10% factor (or 0% upon providing collateral of best security) or unless the solvency or security status of these claims is deemed by the Commission to be unsatisfactory<sup>2</sup> (30% factor).

### **0% factor – Of Best Security for:**

- a. Claims guaranteed by or collateralized by securities issued by the Philippine government, the BSP, and central governments and central banks of foreign countries with the highest credit quality *as per Subsec. X116.3 of BSP Circular 280*.
- b. Loans or acceptances under letters of credit to the extent covered by margin deposits

### **10% factor – Adequately Secured for:**

- a. Claims guaranteed by or collateralized by securities issued by non-central government public sector entities of foreign countries with the highest credit quality *as per Subsec. X116.3*

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<sup>2</sup> For instance, if the relevant institution submits RBC results triggering the Authorized Control Event as defined in the IMC on RBC.

- b. Claims guaranteed by Philippine banks, Philippine quasi-banks, and Foreign banks with the highest credit quality *as per Subsec. X116.3*
- c. Claims on or portions of claims guaranteed by or collateralized by securities issued by multilateral development banks *as per Subsec. X116.3*

**30% factor** is assigned to all other claims from non-insurance institutions.

**Derivatives and Other Off-Balance Sheet Items:**

(Excluding positions already considered under Foreign Exchange)

Description of instrument / item and maturity date	Type	Notional Principal	Marked-to-Market Value	Add-on	Credit Equiv't Amount	RBC Factor
(1)	(3)	(4)	(5)	(7)	(8)	(9)
11.1. (Instruments w/ RBC done in Part 1)				- x -	- x -	- x -
12.1. (Exchange-traded & requiring daily margins)				- x -	- x -	- x -
13.1. (FX contracts w/ maturity up to 14 days)				- x -	- x -	- x -
14.1. (Other derivatives)						
15.1. (Off-BS item)			- x -			
16. Total	- x -	- x -	0	- x -	- x -	- x -

15. Exhibit 19, Part 2 calculates RBC requirements for derivatives and other off-balance sheet items; results are carried into Exhibit 18. The calculation excludes derivatives already considered in Part 1, but entries for these contracts are required in Part 2.

Item (3), Type, shall be filled up in the format [Underlying], [Type], [Position]. Select one of the following entries:

- a. [Underlying]: Interest Rate, Currency, Equity, Commodity, Contingent Liability, Other Derivative or Other Off-BS.
- b. [Type]: Forwards, Futures, Swap, Call Option, Put Option or Others.
- c. [Position]: Long or Short (except if Swap or Off-BS). Swaps may be clarified further as Pay-Fixed, Pay-Floating, etc.

RBC requirements for derivatives and off-balance sheet items are detailed in Annex B and are calculated using a two-step process. First, we compute the Credit Equivalent Amount (CEA) by multiplying the notional principal with the appropriate credit conversion factor. Second, the CEA is treated like any on-balance sheet asset and shall be assigned the appropriate RBC counterparty factor (0%, 10%, 30%, or 10% in the case of derivatives), i.e. according to the obligor, or if relevant, the qualified guarantor or the nature of collateral.

**Other Miscellaneous Assets**

	RBC factor
11 Security fund	0 %
12 Other investments	20%
12.1. AAA	
12.2. BBB	
14. Electronic data processing machines	
14.1 Hardware	20%
14.2 Software	10%
18. Life insurance premiums and annuity consideration due and uncollected	8%
19. Accident and health premiums due and Uncollected	8%
20. Investment income due and accrued*	
20.1. Overdue investment income	20%
20.2. AAA	
20.3. BBB	
22 Other assets (give items and amounts)	30%
22.1. AAA	
22.2. BBB	

*\* Investment income due and accrued shall assume the RBC factors of the assets where they originate (Bond, Mortgage Loan, etc.) on the condition that these are not overdue. In all other cases a 20% factor is applied.*

Due and uncollected premiums in items 18 and 19 are understood to be those due within the grace period or within the allowed payment period.

Any tax credits shall be classified under Other Assets and have 0% RBC factor if the same are certified by the BIR Commissioner.

In general, all other admitted assets and investments not easily classified above shall initially be assigned a 20% RBC factor until the Insurance Commissioner classifies the asset into either (a) an existing category, (b) a new category with its own RBC treatment or (c) a non-admitted asset.

**Exhibit 20, Part 1: C-2 Requirements**

PART 1: C-2 Contingency	Exposure measure	Exposure, gross of reinsurance	Exposure, net of reinsurance	RBC Factor	RBC Requirement
(1)	(2)	(3)	(4)	(5)	(6) = (4)x(5)
1. Individual Life, non-par	NAR*			0.10%	
2. Individual Life, par or adjustable premium	NAR*			0.08%	
3. Group Life	NAR*			0.08%	
4. Life Annuity	Reserve			1.00%	
5. Disability – active	Premium			25.00%	
6. Disability – disabled	Reserve			10.00%	
7. Accident	Premium			20.00%	
8. Health	Premium			25.00%	
9. Accident and Health	Premium			20.00%	
10. Critical Illness	Premium			25.00%	
11. Claim Reserves	p.3, item 4			5.00%	
12. Other risks	Premium			25.00%	
12.1. AAA	Premium			25.00%	
12.2. BBB	Premium			25.00%	
13. Total C-2 Requirement	- x -	- x -	- x -	- x -	

\* *NAR stands for net amounts at risk, or death benefits minus policy reserves.*

16. Each contingency and risk exposure is itemized in (1) and (2). Enter the desired exposure measure amounts in (3) and (4) gross and net of reinsurance from Authorized and Unauthorized reinsurance companies.

By default, all other risks itemized in 11 shall be presumed to have an RBC requirement equal to 25% of premiums earned, unless the Commissioner determines another risk measure.

**Exhibit 20, Part 2: C-4 Requirements.** The sum of items 13 and 14 should reconcile with total premiums and considerations for the year. The sum of items 15 and 16 should reconcile with total admitted assets at the end of the year.

PART 2: C-4 Exposure Measure	Exposure, gross of reinsurance	Exposure, net of reinsurance	RBC Factor	RBC Requirement
(1)	(2)	(3)	(4)	(5) = (3)x(4)
13. Total Premiums and annuity considerations, excluding 14			0.50%	
14. Total Deposits made in variable life separate accounts			0.00%	
15. Total Admitted Assets, excluding 16	- x -		0.25%	
16. Total Variable Life Separate Account Assets	- x -		0.10%	
17. Total C-4 Requirement	- x -	- x -	- x -	

**Exhibit 21: C-3 Requirements**

Valuation Standard	Valuation Interest	Currency - ISO Code	C-3 Category	Reserves, net of reinsurance	Valuation spread	RBC factor
(1)	(2)	(3)	(4)	(6)	(8)	(9)
1980 CSO CRVM	6.00%	PHP	L2	1,000	2.50%	0.0%
1980 CSO CRVM	6.00%	USD	E1	500	-1.50%	6.0%
Group UPR	6.00%	PHP	S	1,000	2.50%	0.0%
Claims Reserves	- x -	- x -	- x -		- x -	0.0%
Liabilities matching Separate Acc't Assets	- x -	- x -	- x -		- x -	0.0%
TOTAL	- x -	- x -	- x -	2,500	- x -	- x -

17. C-3 requirements are determined as percentages of all policy reserves and deposits subject to liability valuation under Sec. 210 of the Code. RBC factors depend on two variables: the liability's C-3 category and the valuation spread (both discussed below). The "spread" component of C-3 serves to compensate for the conservatism in the valuation of policy reserves. The accompanying table and spreadsheet should provide further guidance in the assignment of RBC factors.

Entries shall be made in the same sequence as found in *Exhibit 7*, but broken down further by currency, (3), and C-3 category, (4). Add back reserve deficiencies or unearned premium reserves, and deduct deferred premiums to the liability entries in (5) and (6). Liabilities shall be reported gross and net of Authorized Reinsurers only, to the extent that asset receivables representing such amounts are not reported in page 2.

**C-3 classification rules**

- a. All liabilities shall be classified into five categories based on the type of plan / liability and the Guaranteed Duration (GD):
  - i. S: Short term deposits and unearned premium reserves with  $GD \leq 1$  year
  - ii. L1: Whole Life, Term and Insurance plans with  $1 \text{ year} < GD \leq 10$  years.
  - iii. L2: Whole Life, Term and Insurance plans with  $GD > 10$  years.
  - iv. E1: Endowment Plans, Annuities, Deposits with  $1 \text{ year} < GD \leq 10$  years.
  - v. E2: Endowment Plans, Annuities, Deposits with  $GD > 10$  years.
- b. **Guaranteed duration** shall be defined as the remaining number of years in which a plan is entitled to remain in-force or entitled to renewability under guaranteed premiums (or zero premiums), cost of insurance (COI) charges or credited interest.

Term and endowment plans of remaining term not exceeding ten years with or without guaranteed renewable options shall qualify under L1 or E1 only if no premium, COI or interest rates are guaranteed upon renewal. Universal and the term portion of variable contracts shall be categorized on the basis of the term in which future COI or interest rates are guaranteed.

c. **C-3 classification guidelines**, provided for avoidance of doubt:

- i. “S” shall include group Unearned Premium Reserves, Premium Deposit Funds, Dividend Accumulations and Adjustable Premium Policies where premium rates, cost of insurance charges and credit interest are all not contractually guaranteed beyond one year.
- ii. “L1, L2” shall include whole life, term, protection-only plans (like disability, accident, etc.), universal life and the term portion of variable contracts, where either premiums, COI charges or credited interest is guaranteed beyond one year.
- iii. “E1, E2” shall include all endowment plans, supplementary contracts, annuities and deposits that guarantee premiums, COI charges or credited interest beyond one year.
- iv. Non-guaranteed policy dividends are not counted as “endowments”.
- v. Riders shall be unbundled from the base contracts prior to classification.
- vi. Products with anticipated endowments shall be allowed to remain under L1 or L2 as long as the following conditions are met:
  - Each endowment shall not exceed 20% of the smaller of current death benefit or average death benefit at any time before age 95;
  - Total endowments paid from policy issue shall not exceed 4% of total death benefits provided;
  - “Averages” and “totals” as used here are reckoned on a plan anniversary basis from the year of plan issue.

A whole life plan with level 1000 death benefit can therefore pay a maximum anticipated endowment of 40 a year, or 200 every five years, without being classified under E1 or E2.

18. **RBC factors:** “S” liabilities shall have 0% factor. All other liabilities shall be assigned factors based on C-3 classification and valuation spread (see Exhibit 20 spreadsheet or table). This table was developed from a model of liability cash flows with corresponding assumptions as to interest rate shock and the duration of assets matching liabilities.

**Valuation Spread** is defined as the **Current Rate** minus the valuation rate of the liability, rounded down 0.50%. **Current Rates** shall be announced by the Commissioner before 15 January every year and shall be based on applicable Philippine, USA or foreign treasury bond yields as of 31 December of the previous year, net of taxes.

- a. Five-year yields are used for L1 and E1, ten-year yields for L2 and E2.
- b. For PHP liabilities, Current Rate is 80% of MART1 yields, 5-year and 10-year tenors, as published in [www.mart.com.ph](http://www.mart.com.ph);
- c. For USD liabilities, use 92.5% of 5-year and 10-year US Treasury yields.

Results are presented in Exhibit 20 as follows:

Currency - ISO Code	E1	E2	L1	L2
PHP: 80% of MART1	5-year yield	10-year yield	5-year yield	10-year yield
USD: 92.5% of Treasuries	5-year yield	10-year yield	5-year yield	10-year yield

**19. Other Disclosures**

The five-year historical data shall show Exhibit 17 items (6) and (8), aggregate RBC requirement and RBC ratio, respectively.

The Annual Statement Schedules (except Schedules F, M, R, T and V) shall contain an additional column with the heading *C-1 class*, with entry in the format [##.#], [*brief description*], as per Exhibit 17. For example: *1.3, Investment Grade*; or *2.1, Common*. These entries will be verified against totals in Exhibit 17.

Schedules A and J (Bonds, Short-Term Instruments) shall contain a second additional column with the heading *Investment Grade Evidence*. Investment grade securities are required to enter in the column either the security's second best rating or the issuer's second worst yield spread.

**RBC and Credit Equivalent Amount (CEA) Calculations for Derivatives and Off-Balance Sheet Items.**

**For Derivatives:** The CEA shall be calculated for all contracts except:

1. Instruments which are traded on exchange where they are subject to daily receipt and payment of cash variation margin;
2. Exchange rate contracts with original maturity of fourteen (14) calendar days or less; and
3. Exchange rate contracts already considered in Exhibit 19, Part 1.

The CEA is the sum of:

1. Current credit exposure (or replacement cost) – the positive mark-to-market value of the contract (zero if the mark-to-market value is negative or zero).
2. Potential future credit exposure (or add-on) – equal to the notional principal of the contract multiplied by the appropriate potential future credit conversion factor, as indicated below:

Residual Maturity:	Interest rate	Exchange rate, XAU	Equity	Precious metals	Other Commodities
1 year or less	0.0%	1.0%	6.0%	7.0%	10.0%
Over 1 year to 5 years	0.5%	5.0%	8.0%	7.0%	12.0%
Over 5 years	1.5%	7.5%	10.0%	8.0%	15.0%

Provided further that:

1. For contracts with multiple exchanges of principal, the factors are to be multiplied further by the number of remaining payments in the contract;
2. For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be set equal to the time until the next reset date, and in the case of interest rate contracts with remaining maturities of more than one (1) year that meet these criteria, the potential future credit conversion factor is subject to a floor of 0.5%.
3. No potential future credit exposure shall be calculated for single currency floating/floating interest rate swaps, i.e., the credit exposure on these contracts would be evaluated solely using mark-to-market values.

The CEA is then treated like any on-balance sheet asset, and assigned the appropriate RBC factor, according to the obligor, or if relevant, the qualified guarantor or the nature of collateral. However, the 20% RBC factor for other claims will be reduced to 10% for derivative contracts.

**For off-balance sheet items:** The CEA is equal to the notional principal amount by the appropriate credit conversion factor, as follows:

**100% credit conversion factor** – This shall apply to direct credit substitutes, e.g., general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances), and shall include:



1. Outstanding guarantees issued - foreign loans;
2. Outstanding guarantees issued – other than foreign loans and shipside bonds/airway bills; and
3. Export letters of credit – confirmed.

This shall also apply to sale and repurchase agreements and asset sales with recourse where the credit risk remains with the bank (to the extent not included in the balance sheet), as well as to forward asset purchases, forward deposits and partly-paid shares and securities which represent commitments with certain drawdown: *Provided*, That these items shall be weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.

**50% credit conversion factor** – This shall apply to certain transaction-related contingent items, e.g., performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions, and shall include:

1. Standby letters of credit - domestic (net of margin deposit) established as a guarantee that a business transaction will be performed; and
2. Standby letters of credit - foreign (net of margin deposit).

This shall also apply to:

1. Note issuance facilities and revolving underwriting facilities; and
2. Other commitments, e.g., formal standby facilities and credit lines with an original maturity of more than one (1) year. This shall include underwritten accounts unsold.

**20% credit conversion factor** - This shall apply to short-term, self-liquidating trade-related contingencies, e.g., documentary credits collateralized by the underlying shipments, and shall include:

1. Outstanding guarantees issued - shipside bonds/airway bills;
2. Domestic letters of credit outstanding (net of margin deposit);
3. Sight import letters of credit outstanding (net of margin deposit);
4. Usance import letters of credit outstanding (net of margin deposit);
5. Deferred letters of credit (net of margin deposit); and
6. Revolving letters of credit (net of margin deposit) arising from movement of goods and/or services.

**0% credit conversion factor** - This shall apply to commitments with an original maturity of up to one (1) year, or which can be unconditionally cancelled at any time, and shall include committed credit line for commercial paper issues. This shall also apply to those not involving credit risk, and shall include:

1. Inward bills for collection;
2. Outward bills for collection;
3. Items held for safekeeping/custodianship;
4. Trust department accounts
5. Late deposits/payments received;
6. Items held as collaterals;
7. Travelers' checks; etc.

Once the CEA is determined, it shall be treated like any on-balance sheet asset and shall be assigned the appropriate RBC factor (0%, 10% or 30%), i.e., according to the obligor, or if relevant, the qualified guarantor or the nature of collateral.