The Security Fund

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Written by Atty. Dennis B. Funa

CHAPTER 5 of the Amended Insurance Code deals with the Security Fund. Under Section 378, a Security Fund was created "which shall be used in the payment of allowed claims against an insurance company authorized to transact business in the Philippines remaining unpaid by reason of the insolvency" of the insurance company.

In other jurisdictions, the Security Fund is more widely known as the Guaranty Fund. For purposes of our discussion, we shall refer to it as the Security Fund. While recourse may be made to the Security Fund ("Fund") by allowed claims, it may also "be used to reinsure the policy of the insolvent insurer in any solvent insurer" (Section 378). The law also provides limitations to its disbursement, no payment can be made to any person owning or controlling 10 percent or more of the voting shares of stock of the insolvent insurer. Moreover, there is a cap of P20,000 per claim (Section 378).

There are two accounts in this Fund. The Life Account exclusively for life-insurance companies; and the Non-Life Account exclusively for the nonlife insurers. They are both "administered" by the insurance commissioner. However, the "custodian" is the Treasurer of the Philippines and any disbursement is to be made by him to the insurance commissioner upon vouchers signed by the latter (Section 382). They are kept in the form of government bonds (Section 382).

Each account aggregates P5 million collected from all insurance companies. Both accounts shall not exceed P10 million. The contribution of each company is in direct proportion to the ratio of a company's net worth to the aggregate net worth of all companies. Contributions are considered as admitted assets (Section 380).

The earnings of the Fund shall be delivered to each company in proportion to their contribution. Every disbursement from the Fund, as well as any deficiency, shall be subject to replenishment. In case any insurer is unable to contribute, the Insurance Commissioner is authorized to seek judicial recourse to recover any deficiency (Section 381). In addition, he may impose a penalty of 5 percent plus 1 percent of such amount for each month of delay, as well as suspend or revoke the license of any insurance company (Section 381).

The Security Fund is maintained “to protect policyholders in the event that an insurer becomes insolvent or is unable to meet its financial obligations.” It is a “consumer protection system” that protects policyholders. In the United States the guaranty fund system has paid $17 billion in claims on 200 insolvencies since 1969, according to the National Conference of Insurance Guaranty Funds. Most state guaranty funds were created by law in 1969, and are nonprofit systems. There are limits to the coverage. In New York the limit is $1 million. The cap on claims varies in every state. Mostly, it is $300,000. In liquidation, claims are paid from what funds and assets are available. The guaranty fund supplements whatever funds are available, subject to the guaranty fund’s cap. The Fund can raise the amounts “by collecting contributions to build up a reserve in anticipation of future liabilities [ex ante funding], or by levying contributions when required to cover the costs of failures that have occurred [ex post funding].”

In a study done by A.M. Best in November 2005 on insolvencies from 1969 to 2005, the leading cause of insolvency was inadequate reserves for claims accounting for 38 percent of impairments. Most insolvencies involved some form of mismanagement.

In the Philippine experience, the Security Fund has never been tapped and no payment has ever been made from it.

Dennis B. Funa is currently the deputy insurance commissioner for Legal Services of the Insurance Commission. E-mail: dennisfuna@yahoo.com.