IMC No.:	7-2006
Date:	October 5, 2006

INSURANCE MEMORANDUM CIRCULAR

TO : ALL NON-LIFE INSURANCE COMPANIES

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

To establish the required amounts of capital to be maintained by non-life insurance companies in relation to their investment and insurance risks, the Insurance Commission, after consultation with the non-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 five (5) categories.

A. Fixed Income Securities, denoted by R_1;
B. Equity Securities, denoted by R_2;
C. Credit Risk, denoted by R_3;
D. Loss Reserves, denoted by R_4; and
E. Net Written Premiums, denoted by R_5.

The RBC requirement is given by the formula:

$$\textbf{\textit{RBC Requirement}} = \sqrt{\mathbf{R_1^2 + R_2^2 + (0.5 * R_3)^2 + (0.5 * R_3 + R_4)^2 + R_5^2}}$$

The RBC ratio of a company 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 Insurance Commissioner.

Every non-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% ≤ Y < 125%	Trend Test	Linear extrapolation if next year's ratio < 100%. If so, move to Company Action Event
75% ≤ Y < 100%	Company Action	Submit RBC plan and financial projections. Company implements the plan.
50% ≤ Y < 75%	Regulatory Action	IC authorized to examine company and issue Corrective Orders.
35% ≤ 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 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/or 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 non-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 in Annex A.

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 immediately.

Signed on October 5, 2006.

(SGD.) EVANGELINE CRISOSTOMO-ESCOBILLO
Insurance Commissioner

Approved:

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

Annex A

RISK BASED CAPITAL (RBC) EXHIBIT INSTRUCTIONS AND DISCLOSURES

Exhibit VII: Aggregate RBC calculations

	RBC Requirement
(1) R_1: Fixed Income Securities	
(2) R_2: Equity Securities	
(3) R_3: Credit Risk	
(4) R_4: Loss Reserves	
(5) R_5: Net Premiums Written	
(6) Sum of R_1 to R_5 requirements	
(7) Aggregate RBC requirement: $\sqrt{R_1^2 + R_2^2 + (0.5 * R_3)^2 + (0.5 * R_3 + R_4)^2 + R_5^2}$	
(8) Networth (from p.3)	
(9) RBC Ratio: (8) / (7)	
(10) RBC Ratio, previous year	

1. Exhibit VII outlines the calculation of aggregate RBC and the RBC ratio. Calculations of RBC requirements for R_1, R_2, R_3, R_4 and R_5 are found in Exhibits VIII - X. In general, items (1) to (5) are calculated as various percentages of exposures to risk. Aggregate RBC requirement, (7), is then calculated inclusive of a covariance adjustment as follows:

   RBC Requirement **=** $\mathbf{\sqrt{R_1^2 + R_2^2 + (0.5 * R_3)^2 + (0.5 * R_3 + R_4)^2 + R_5^2}}$

   From this, RBC Ratio is equal to Networth divided by Aggregate RBC. "Networth" shall be as shown in page 5 of the Annual Statements, and shall consist of:

   a. Paid-Up Capital
   b. Special Surplus Funds (fluctuation and revaluation reserves), to the extent allowed by the Commissioner
   c. Contributed and Contingency Surplus, and
   d. Unassigned Surplus.

Exhibit VIII: R_1, R_2, & R_3 Requirements

In general, R_1, R_2, R_3 requirements are calculated by multiplying the RBC factor with the corresponding net admitted asset value in the Annual Statement.

Admitted assets shall be listed in Exhibit VIII in the same sequence as in Exhibit II.

A. R_1 Requirements

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

	Net Admitted Value	RBC Factor	RBC requirement
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%	
2. Short -term investments			
2.1. Government, local currency		0%	
2.2. Government, foreign currency		1.6%	
2.3. Investment Grade		1.6%	
2.4. Below Investment Grade		10%	
2.5. Near default		30%	

2. Items 1.1, 1.2, 2.1 and 2.2 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 2.4, Below Investment Grade, until otherwise classified as Investment Grade or Near Default.

3. The following fixed income securities shall be classified under item 1.3 or item 2.3, Investment Grade:

   a. Securities issued by multilateral development banks recognized by the BSP.[1]
   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

4. 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 2.3, 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.

[1] 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.

5. A security shall be classified under item 1.5 or item 2.5, 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.

Rating Agency	Bond	Short-Term
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

Mortgage Loans

	Net Admitted Value	RBC Factor	RBC Requirement
3. Mortgage loans and purchase money mortgages			
3.1. In good standing		10%	
3.2. Others		30%	

6. Mortgage loans and purchase money mortgages classified under item 3.1, 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 3.2.

Counterparty Factors

	Net Admitted Value	RBC factor	RBC Requirement
4. Collateral, Guaranteed and Other Loans			
4.1. Of best security		0%	
4.2. Adequately secured		10%	
4.3. Others		30%	

7. 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

   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.

8. Claims from authorized non-life insurance and reinsurance companies 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[2] (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*
   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**.**

	RBC factor
5. Cash and Bank Deposits	
5.1. Cash on hand	20%
5.2. Deposits in banks and trusts	0.3%
5.3. Others (not in good standing)	20%
6. Security fund	0 %
7. Electronic data processing machines	
7.1 Hardware	20%
7.2 Software	10%

[2] For instance, if the relevant institution submits RBC results triggering the Authorized Control Event as defined in the IMC on RBC.

9. Item 5.2 shall include demand deposits, certificates of deposit and money market placements with banks, quasi-banks and trust companies. It shall be initially be deemed under 5.2 unless the solvency status of the relevant institutions or instrument is found by the Commissioner to be unsatisfactorily, in which case it shall be declared under 5.3 Others (not in good standing).

B. R_2 Requirements

Stocks and Real Estate

	Net Admitted Value	RBC Factor	RBC requirement
8. Stocks			
8.1. Common Stocks		30%	
8.2. Preferred Stocks			
8.2.1. Traded and Rated		15%	
8.2.2. Non-traded or Non-rated		30%	
9. Real estate (net of encumbrances)			
9.1. Company-occupied, up to quota		8%	
9.2. Company-occupied, above quota		15%	
9.3. Acquired in satisfaction of debt/foreclosed		30%	
9.4. Investments in real estate		15%	
10. Other investments		20%	
10.1. AAA			
10.2. BBB			

10. The issuing company of preferred stocks can be classified as Rated if its rating is two (2) notches higher than the country rating.

11. Company-occupied real estate shall be declared under item 9.1 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 9.2.

C. R_3 Requirements

	Net Admitted Value	RBC factor	RBC requirement
11. Premiums receivable			
11.1. Jumbo Policies		15%	
11.2. Others		30%	
12. Premiums due from ceding companies		30%	
13. Premium Reserve / Loss Reserve withheld by Ceding Companies		30%	
14. Reinsurance Recoverable on Losses		30%	
15. Other Reinsurance Recoverable on Losses		30%	
16.Commission, Accounts, Notes Receivable		10%	
17. Salvage Recoverable		20%	
18. Investment income due and accrued		*	
18.1. Overdue investment income		20%	

18.2. AAA			
18.3. BBB			
22 Other assets (give items and amounts)		20%	
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.*

12. Jumbo policies are those with at least ₱500,000 annual premiums.

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

14. 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 IX: R_4 Requirements

	Net Admitted Value	RBC factor	RBC requirement
Claims Reserves		15%	
Excessive Growth Charge * - Loss Reserves		45%	

Exhibit X: R_5 Requirements

	Net Admitted Value	RBC factor	RBC requirement
Written Premiums		20%	
Excessive Growth Charge * - Net Written Premiums		25%	

** Excessive growth charge is computed based on the RBC Average Growth Rate multiplied by the excessive growth RBC factor.*

Calculation of Excessive Growth Charge

Year	Gross Premiums Written	Growth Rate	Net Admitted Value	RBC Factor	RBC Requirement
2004					
2003					
2002					
2001					
RBC Average Growth Rate = Average Growth Rate capped to fall Between 0% and 30%					
Excessive Growth Charge Applied to Loss and LAE Reserves				(__% x 45%) = __%	
Excessive Growth Charge Applied to Net Premiums Written				(__% x 25%) = __%	

The RBC average growth rate is derived from the 3-year average growth rate on company's gross written premiums less 10%, and capped to fall between 0 to 30%.

The effect of mergers and consolidations will not be considered in the calculation of growth rate.