Legal Opinion (LO) No.:	2022-17
Date:	06 December 2022

MR. MANUEL M. MALOLES
President and Chief Executive Officer
Fortune General Insurance Corporation
4F Citystate Centre,
709 Shaw Boulevard, Pasig City

SUBJECT: **Request for Confirmation / Certification of the Proposed Terms and Conditions of Preferred Shares Offering**

Dear **Mr. Maloles**:

This refers to your letters dated 04 November 2022 and 14 November 2022 requesting for confirmation of the proposed terms and conditions of the preferred shares offering of Fortune General Insurance Corporation (FGIC). The said request for confirmation is in relation to FGIC's capital build-up plan in compliance with the net worth requirement under Section 194 of the Insurance Code, as amended.

As part of its capital build-up plan, FGIC intends to convert its unissued common shares to preferred shares, the terms and conditions of which have been submitted to the Insurance Commission for consideration. In your 14 November 2022 letter, you further clarified your request, to wit:

> "In light of our intended sourcing of capital through private placement for which we have engaged the services of SB Capital Investment Corporation, may we request from your good office a **CERTIFICATION** confirming that subscriptions of the intended preferred share offering are considered **admitted assets for net worth purposes for both FGIC and its prospective investors – applicable to those as may likewise be regulated by the Insurance Commission**, subject to the limitations as set forth under the Insurance Code as well as the regulations issued and implemented by the Insurance Commission."

Anent your first query on whether subscriptions of the intended preferred share offering may be admitted for net worth purposes insofar as FGIC is concerned, please be informed that the proposed transaction shall result in the following relative to FGIC's books:

1. **Additional paid-up Preferred Shares shall be considered as additional equity for Net Worth Purposes;**

2. **Preferred Shares paid-up through cash shall be considered as an Admitted Asset for the value of the cash payment; and**

3. **Preferred Shares paid through forms other than cash shall be considered as an Admitted Asset, subject to applicable rules and regulations issued by the Commission.**

Item 57 of Circular Letter No. 2016-65 or the "Financial Reporting Framework Under Section 189 of the Amended Insurance Code (Republic Act No. 10607)" provides the instances when preferred shares may be classified as equity and as liability. As provided in Item 57.1:

> "57.1 *Preferred Stock* – This represents shares of stock which provide the stockholders preference as to dividends and upon liquidation. **The features of the preferred stocks are varying and should be carefully analyzed whether these qualify as capital stock or creates an obligation on the part of the company. In the latter case, the preferred stocks issued should be classified as part of liabilities.**" (Emphasis supplied.)

Meanwhile, Philippine Accounting Standard (PAS) 32 provides that a financial instrument may be classified as an equity instrument, instead of a financial liability, if and only if the following conditions are met:

"(a) **The instrument includes no contractual obligation:**

(i) **To deliver cash or another financial asset to another entity; or**

(ii) **To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.**

(b) If the instrument will or may be settled in the issuer's own equity instruments, it is:

(i) A non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or

(ii) A derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, for these purposes the issuer's own equity instruments do not include instruments that have all the features and meet the conditions described in paragraphs 16A and 16B or paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments." (Emphasis supplied.)

Based on the Indicative Terms and Conditions of the FGIC 2022 Preferred Shares Offering ("the Indicative Terms and Conditions"), FGIC is issuing "cumulative, non-voting, non-participating, peso-denominated, redeemable and perpetual preferred shares that are non-convertible into common shares." Insofar as redemption is concerned, the same shall be at the option of FGIC as the issuing company. The terms of optional redemption and purchase provide thus:

> "As and if approved by the Board, the **Company may redeem** the Preferred Shares in whole or in part on the first (1^{st}) anniversary from Issue date or on the last day of any Divided Period thereafter (each an **"Optional Redemption Date"**) x x x" (Emphasis supplied.)

Considering that the redemption of preferred shares is at the option of the issuing company, no obligation is created on the part of FGIC.

As to the payment of dividends, the Indicative Terms and Conditions provide that:

> "The declaration and payment of Dividends will be subject to the sole and absolute discretion of the Board of Directors, to the extent permitted by and upon compliance with applicable laws and regulations such as the requirements under the Revised Corporation and issuances of the Securities and Exchange Commission ("SEC") on the presence of unrestricted retained earnings and the relevant approvals, and x x x the covenants (financial or otherwise) in the agreements to which the company is a party. Accordingly, **the Company has full discretion at all times to defer declaration of Dividends on the Preferred Shares**.

The Board of Directors will not declare and pay dividends for any Dividend Period where, among other possible circumstances, declaration or payment of such dividends would cause the Company to breach any applicable regulations or any of its covenants (financial or otherwise), or where the Company is unable to comply with the requirements for declaration of dividends under the relevant IC and other governmental issuances." (Emphasis supplied.)

With respect to the conditions for the declaration and payment of dividends provided in the Indicative Terms and Conditions, there is no obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the issuer. It is expected that FGIC, in its dividend declarations, shall always comply with the applicable rules and regulations relative to maintaining the required Net Worth and Solvency requirements. For instance, any exercise of redemption right by FGIC should not result in any impairment of its net worth and solvency requirements.

Hence, based on the Indicative Terms and Conditions, subscriptions of the intended preferred share offering may be considered as equity in relation to FGIC's capital build-up plan, subject to FGIC's compliance with applicable rules and regulations on net worth requirements. Please note, however, that the resulting increase in FGIC's Net Worth shall be **limited to the number of shares actually paid-up and shall not include mere subscriptions without actual payment**.

Additionally, please be informed that the increase in FGIC's Net Worth through paid-up Preferred Shares shall likewise result in an increase in its assets. However, the valuation of the asset investment shall vary depending on the type of payment to subscribe to the Preferred Shares. If the Preferred Shares are paid-up through cash payments, the entire amount shall be considered as an increase in FGIC's assets. For payments made through forms other than cash, relevant rules and regulations issued by the Commission shall apply.

With respect to your second query on the purchase of preferred shares by an insurance company, Sections 206 and 211 of the Insurance Code, as amended, are instructive, to wit:

"**Section 206. (b) An insurance company may purchase, hold, and own the following**: x x x

(5) **Preferred or guaranteed stocks of any solvent corporation or institution created or existing under the laws of the Philippines**: *Provided*, That if the stocks are guaranteed, the amount of stocks so guaranteed is not in excess of fifty percent (50%) of the amount of the preferred or common stocks, as the

> case may be, of the guaranteeing corporation: Provided, *finally*, That no life insurance company shall invest in or loan upon obligations of any one institution in the kinds permitted under this subsection an amount in excess of ten percent (10%) of the total admi9tted assets of such insurer as of December thirty-first next preceding the date of such investment. x x x
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> **Section 211.** After satisfying the requirements contained in Sections 197, 199, 209 and 210, **any non-life insurance company may invest any portion of its funds representing earned surplus in any of the investments described in Sections 204, 206 and 207**, or in any securities issued by a registered enterprise mentioned in the preceding sections: Provided, That no investment in stocks or bonds of any single entity shall in the aggregate, exceed twenty percent (20%) of the net worth of the insurance company as shown in its latest financial statement approved by the Commissioner or twenty percent (20%) of the paid-up capital of the issuing company, whichever is lesser, unless otherwise approved by the Commissioner." (Emphasis supplied.)

Hence, **insurance companies may purchase FGIC's preferred shares, subject to the limitations set forth in Sections 206 and 211 of the Insurance Code, as amended, without prejudice to the application of Circular Letter No. 2017-29 or the "Guidelines on Related Party Transactions for Insurance Commission's (IC) Covered Institutions (CIs)" and Circular Letter No. 2022-23 or the "Guidelines on Domestic Investments that Do Not Require Prior Approval".**

Please note that the above opinion rendered by this Commission is based solely on the particular facts disclosed in the query and relevant solely to the particular issues raised therein and shall not be used, in any manner, in the nature of a standing rule binding upon the Commission in other cases whether for similar or dissimilar circumstances.

For your information and guidance.

DENNIS B. FUNA
Insurance Commissioner