Capital Management and Management of Insurance and Financial Risks

Although life insurance companies are in the business of taking risks, the Company limits its risk exposure only to measurable and quantifiable risks. The main objective of the Company's risk management policies is to ensure that the Company remains financially viable and capable in paying
its liabilities.

There are many risks associated in the life insurance business such as insurance risks, investment risks, asset depreciation, and other business risks. These risks are managed separately to ensure that the Company is not exposed to risks that are unnecessary or risks with no commensurate expected benefits or returns.

Governance framework
The Company has established a risk management function with clear terms of reference and with the
responsibility for developing policies on market, credit, liquidity, insurance and operational risks. It also supports the effective implementation of policies at the overall company and individual business unit levels. The risk management committee performs procedures to identify various risks. The result of the procedures is reported to the BOD and necessary actions are taken to mitigate the risks identified.

The policies define the Company's identification of risk and its interpretation, limit structure to ensure the appropriate quality and diversification of assets and alignment of underwriting and reinsurance strategies to the corporate goals and specific reporting requirements.

Regulatory framework
Regulators are interested in protecting the rights of the policyholders and maintain 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 risks 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 impose certain restrictive provisions to minimize the risk of default and insolvency on the part of the insurance companies to meet the unforeseen liabilities as these arise, such as fixed capitalization requirements and risk-based capital (RBC) requirements.

Capital management
The Company manages its capital in accordance with the mandates of the IC being its regulator. Under the requirements of the IC and the Code, the Company should meet the minimum levels set for the following capital requirements: Minimum Statutory Net Worth and Paid-up Capital,

and RBC. The Company regularly monitors its compliance with these capital requirements. Further, government bonds amounting to at least 25% of the Minimum Paid-up Capital are free from liens and encumbrances, and deposited under the IC, in accordance with Section 203 of the Code.

RBC requirement
Insurance Memorandum Circular (IMC) No. 6-2006 provides for the risk-based capital framework for the life insurance industry to establish the required amounts of capital to be maintained by the companies in relation to their investment and insurance risks. Every 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 net worth divided by the RBC requirement. Net worth shall include the company's paid-up capital, contributed and contingency surplus and unassigned surplus. Revaluation and fluctuation reserve accounts shall form part of net worth only to the extent authorized by the IC. The RBC requirement is the amount of required capital computed by taking into consideration the following major risks enumerated by IC guidelines; asset default risk, insurance pricing risk, interest rate risk and general business risk.

Consolidated compliance framework – IMC 10-2006 integrated the compliance standards for the fixed capitalization and risk-based capital framework.

Subsequent to year 2006, the fixed capitalization requirement for a given year may be suspended for insurers that comply with the required RBC hurdle rate, provided that the industry complies with the required Industry RBC Ratio Compliance Rate. The IMC provides the annual schedule of progressive rates for the Industry RBC Ratio Compliance Rates and the RBC Hurdle Rates from 2007 to 2011. Failure to achieve one of the rates will result in the imposition of the fixed capitalization requirement for the year under review.

Risk Based Capital 2 update
On December 28, 2016, IC CL No. 2016-68 was issued to supersede IC CL No. 2015-30. This circular provides solvency requirements based on accepted solvency frameworks, requires insurance companies to at all times shall hold the RBC requirement determined in accordance with the rules and guidelines set forth by the circular plus any additional supervisory adjustments that may be required by the IC, and requires the satisfaction of the minimum statutory ratio.

Unimpaired capital requirement
IC CL No. 2015-02-A which supersedes IC CL No. 22-2008 was issued to ensure compliance with the minimum capitalization and net worth requirements set in Sections 194, 197, 200 and 289 of Republic Act No. 10607.

As of December 31, 2017 and 2016, the Company has complied with the unimpaired capital requirement.

Insurance Risk

Nature of risk

The risk under any one insurance contract is the possibility that the insured event occurs. This event may be death, or in the case of some riders, disability, accidental injury, or contraction of critical illness. By the very nature of an insurance contract, this risk is random and unpredictable.

For a portfolio of insurance contracts where the theory of probability is applied to pricing, the principal risk that the Company faces under its insurance contracts is that future claims on death,accident, disability, and critical illness claims exceed the future premiums plus the carrying amount of the insurance liabilities. This could occur if the frequency and magnitude of claims is greater than the assumptions used in calculating the Company's liabilities. Occurrence of insured events is random and the actual number of claims will vary from year to year from the mortality assumptions made during product pricing. However, the law of large numbers is expected to be applicable as the pool of risk increases in volume and aggregate claims becomes morepredictable.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller is the relative variability compared to the expected. Insurance risks generally vary by gender and age of the insured as these factors correlate greatly with the incidence rates of the insured events.Because of this, a more diverse demographic profile of insured lives may be more desirable since a more diverse risk profile reduces variability.

To minimize insurance risks, the Company strictly adheres to prudent underwriting standards in assessing insurance applications. These underwriting standards include a schedule of medical and non-medical requirements for specific range of ages and sum assured. Some policyholders are charged with additional premium in the form of flat or multiple extra premiums due to extra risks resulting from the applicant's occupation, health, and lifestyle. Applications for insurance may be denied or postponed for certain substandard cases. To guard against anti-selection,insurance applications that do not establish insurable interest are rejected. Statements of assets and liabilities may also be required from the applicant to justify the sum assured applied for, and his ability to pay the premium.

Frequency of claims
For contracts where death is the insured risk, the most significant factors that could increase the overall frequency of claims are epidemics or wide spread changes in lifestyle resulting in earlier or more claims than expected. In the Philippines, higher-than-expected claims also arise from typhoons, landslides, and other geologic events.

For contracts with DPF, a portion of the insurance risk is effectively shared with the policy owner, as policy dividends may be reduced due to adverse claims and investment experience.

For unit linked insurance policies where the cost of insurance charges is not guaranteed, insurance risk is borne mostly by the policyholders. The Company has the right to alter the related charges based on its mortality experience and hence minimize its exposure to mortality risk. Delays in implementing increases in charges and market or regulatory restraints over the extent of the increases may reduce its mitigating effect.

The Company manages these risks through its underwriting strategy and reinsurance arrangements. The underwriting strategy is intended to ensure that the risks underwritten are pooled into a sufficiently large portfolio. Medical selection is also included in the underwriting procedures with premiums varied to reflect the health condition and family medical history of the applicants. The Company has a retention limit of P2.5 million on any individual standard risk. The Company reinsures the excess of the insured benefit over P2.5 million for standard risks (from a medical point of view) under an automatic reinsurance arrangement. For "group" lives reinsured, retention limit is P2 million, and the risk is reinsured under an excess of loss arrangement. The Company's risk retention is lower for medically impaired or substandard lives, which involves higher risks.

Sources of uncertainty in the estimation of future benefit payments and premium receipts
Uncertainty in the estimation of future benefit payments and premium receipts for long-term insurance contracts arises from the unpredictability of long-term changes in overall levels of mortality and the variability in policyholder behavior.

The Company uses appropriate tables of standard mortality for pricing and valuation of liabilities. An investigation into the actual mortality experience of the Company is carried out annually, but the experience is not yet considered statistically significant.

The Company maintains persistency statistics to monitor actual lapse experience against pricing assumptions and performance standards. Statutory reserves are calculated using mortality decrement
only, without considering possibility of lapses. This results in a more conservative liability as gains on surrender are not anticipated in the valuation method.

Investment risk
The investment risk represents the risks associated with changing interest rates. Whenever interest rates increase, market values of AFS financial assets decrease while interest income on

new investments increases. As interest rates decline, market values of AFS financial assets increase while interest income on new investments decreases.

AFS financial assets are subject to declines in fair value. Generally, insurance regulations restrict the type of assets in which an insurance company may invest. When permitted by regulatory authorities and when deemed necessary to protect insurance assets, including invested assets, from adverse movements of foreign currency exchange rates, interest rates and equity prices, the Company may also enter into derivative transactions as end users.

To minimize these risks, the Company monitors the projected asset and liability cash flows to make sure that an acceptable level of matching exists. In purchasing fixed income instruments, the Company selects bonds with tenors that narrow the gap between asset and liability cash flows of the Company. Investment risks are reduced when assets and liability cash flows are adequately matched.

Financial Risk

The Company is exposed to financial risk through its financial assets, and financial liabilities. In particular, the key financial risk that the Company is exposed to 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

Credit risk represents the loss that would be recognized if counterparties to investment transactions are unable or unwilling to fulfill their payment obligations.

The credit risk arising from investment transactions is not significant as most of the Company's investments are in government securities, which are by definition risk-free. In addition, availability and trading of private debt securities are very limited. At present, the Company has exposure on two private debt securities. All purchases, especially private debt securities, goes through a stringent process of credit review by the Company's Investment Committee and are subject to approval of the IC. Credit valuations and review are performed on a regular basis. The Company does not have any credit risk concentrations other than to the Philippine National Government due to its government bond investments. Based on established investment policies of the Company, no issuer (except obligations of the government) will comprise more than 5% of the portfolio on a market value basis at purchase, unless otherwise approved by the Investment Committee.

Liquidity risk

The Company manages liquidity by forecasting cash flow requirements. Investments are made in assets with maturities or interest payments which are matched against expected payouts of claims and benefits (i.e., amount and duration of assets are matched against amount and duration of liabilities). In addition, significant outflows due to operating expenses (e.g., salaries, bonuses, IT expenditures, etc.) are scheduled based on an agreed budget timeline. It is unusual for a Company primarily transacting insurance business to predict the requirements of funding with absolute certainty since the theory of probability is applied on insurance contracts to ascertain the likely provision and the time period when such liabilities will require settlement. The amounts and maturities in respect of insurance liabilities are thus based on management's best estimate, based on statistical techniques and past experience. Repayments which are subject to notice are treated as if notice were to be given immediately.

Market risk
Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risks: foreign exchange rate (currency risk), market interest rate (fair value interest rate risk), and market price (equity price risk).

The following BOD approved policies and procedures are in place to mitigate the Company's exposure to market risk:

- Market risk policy on the assessment and determination of what constitutes market risk for the Company. Compliance with the policy is monitored and exposures and breaches are reported to the Company risk committee. The policy is reviewed regularly for pertinence and for changes in the risk environment.

- Asset allocation and portfolio limit structure to ensure that assets back specific policyholders liabilities and those assets are held to deliver income and gains for policyholders which are in line with expectations of the policyholders.

- Diversification benchmarks by type of instrument, as they are exposed to guaranteed bonuses, cash and annuity options when interest rates falls.

Currency risk
Currency risk is the risk that the value of the financial instrument will fluctuate because of changes in foreign exchange rates.

Assets and liabilities are denominated both in PHP and USD. The assets are sufficient to match the corresponding liabilities except when an intentional currency mismatch is suitable during times of rapidly depreciating currency. The surplus of the Company is invested in Philippine Peso.

Fair value interest rate risk
Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Company's fixed rate investments classified as AFS financial assets are particularly exposed to such risk.

The Company's investment policy requires it to buy and hold AFS financial assets, unless the need to sell arises, and to reduce the duration gap between financial assets and financial liabilities to minimize interest rate risk. Securities are also marked-to-market monthly to reflect and account for both unrealized gains and losses.

Equity price risk
The Company's equity price risk exposure at year-end relates to financial assets whose values will fluctuate as a result of changes in market prices, principally, of equity securities classified as AFS 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.

The Company's investment policy requires it to manage such risks by setting and monitoring objectives and constraints on investments; diversification plan; limits on investment in each country, sector and market.

Source: 2017 Audited Financial Statement