

Regulatory Framework

Regulators are interested in protecting the rights of the members and maintain close observation to ensure that the Association is satisfactorily managing its affairs for the benefit of members. At the same time, the regulators are also interested in ensuring that the Association maintains appropriate solvency position to meet liabilities arising from claims and that the risks are at acceptable levels.

The operations of the Association 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 [e.g. net worth requirements and risk-based capital (RBC) requirements].

Such restrictive provisions minimize the risk of default and insolvency on the part of the insurance companies to meet the unforeseen liabilities as these arise.

Capital Management

The Association's objective in managing fund balance is to maintain high growth by applying free cash flow to selective investments that would preclude the Association's need of additional financing. The Association sets strategies with the objective of establishing a versatile and resourceful financial management and fund balance structure. Management has overall responsibility for monitoring of fund balance in proportion to risk. Profiles for ratios are set in the light of changes in the Association's external environment and the risks underlying the Association's business operations and industry.

The Association's capital includes guaranty fund reserves, general fund balance, funds assigned for members' benefits and for capacity building.

The Association monitors fund balance on the basis of the debt-to-equity ratio which is calculated as total debt divided by total fund balance. Total debt is equivalent to claims payable, accrued expenses and other liabilities, due to related party, aggregate reserves and equity value reserves. Total equity comprises the fund balance.

Debt-to-equity ratio as at December 31 is as follows:

	2019	2018
Total debt	P300,003,773	P329,493,619
Total equity	962,664,387	740,030,444
Debt-to-equity ratio	31.16%	44.52%

There were no changes in the Association's approach to fund balance management during the year.

The Association is subject to imposed capital requirements set by IC. Compliance with these requirements is discussed below.

Net Worth Requirement

Under the Insurance Code, mutual benefit associations must have available total member's equity in an amount to be determined by the IC above all liabilities for losses reported as net worth requirement.

As at December 31, 2019 and 2018, the Association is compliant with the required net worth requirement based on the Association's calculations. However, the final amount of the net worth requirement can be determined only after the accounts of the Association have been examined by the IC, specifically as to admitted and non-admitted assets as defined in the Insurance Code.

The estimated amounts of non-admitted assets as defined in the Insurance Code included in the Association's statements of assets, liabilities and fund balance, which are subject to final determination by the IC are as follows:

	2019	2018
Property, equipment and computer software - net	P945,843	P1,391,615
Receivables	503,764	190,641
Other assets	607,366	967,344
	P2,056,973	P2,549,600

RBC Requirements

As per IC's Memorandum Circular (IMC) No. 6-2006, every mutual benefit entity is annually required to maintain an RBC ratio of at least one hundred percent (100%) and not to fail the trend test. RBC ratio is computed using the formula prescribed by the IC. The RBC requirement is determined after considering the admitted value of certain financial statement accounts whose final amounts can be determined only after the examination by the IC.

Failure to meet the minimum RBC ratio shall subject the Association to regulatory intervention which could be at various levels depending on the degree of the violation.

The following table shows how the RBC ratio at December 31, 2019 and 2018 were determined by the Association based on the Association's internal calculations:

	2019	2018
Net worth	P949,376,472	P634,626,570
Risk-based capital requirement	26,660,999	14,344,215
Risk-based capital ratio	3,561%	4,424%

On December 28, 2016, the IC released Circular Letter No. 2016-69, *Implementation Requirements for Financial Reporting, Valuation Standards for Insurance Policy Reserves, and Amended Risk-based Capital (RBC2) Framework*, which provides, among other things, that the level of sufficiency for the amended RBC 2 shall be at 95th percentile level of sufficiency for the year 2017, 97.5th percentile for the year 2018, and 99.5th percentile for the year 2019. RBC 2 Framework shall be made effective January 1, 2017.

As at December 31, 2019 and 2018, the Association is compliant with the required RBC ratio based on the Association's internal calculation.

Insurance Risk

The risk under any insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. The principal risk that the Association faces under its insurance contracts are that the actual claims and benefit payments exceed the carrying value of the insurance liabilities, which was the estimates, established using certain assumptions.

The table below sets out the concentration of life insurance contract by type of contract as at December 31, 2019 and 2018.

Contract Type	2019		2018	
	Gross of Reinsurance (Note 24)	Net of Reinsurance	Gross of Reinsurance (Note 24)	Net of Reinsurance
Credit life	P80,271,494	P80,211,224	P108,834,166	P108,748,396
Basic life	59,430,982	59,387,437	70,190,371	70,129,911
Life maximum benefit	52,532,964	52,482,549	58,716,428	58,657,059
Life plus benefit	19,397,987	19,353,257	21,811,389	21,760,760
Mortgage redemption benefit	1,730,295	1,724,505	913,938	906,266
GLIP optional	1,194,518	1,194,518	910,952	910,952
Members' fees and dues	1,109,320	1,109,320	-	-
GLIP basic	636,127	636,127	956,175	956,175
	P216,303,687	P216,098,937	P262,333,419	P262,069,519

The Association's exposure to insurance risk as at December 31, 2019 and 2018 are as follows:

	Note	2019	2018
Aggregate reserves	16, 23	P42,706,809	P53,536,552
Equity value reserves	17, 23	84,733,721	75,511,008
		P127,440,530	P129,047,560

Key Assumptions

The principal assumption underlying the estimates is the Association's past claims development experience. This includes assumptions in respect of average claim costs and claim numbers for each year. Additional qualitative judgments are used to assess the extent to which past trends may not apply in the future. For example, one off occurrence, changes in market factors such as public attitude to claiming, economic conditions, as well as internal factors such as portfolio mix, policy conditions and claims handling procedures. Judgment is further used to assess the extent to which external factors such as judicial decisions and government legislation affect the estimates.

Sensitivity Analysis for Insurance Risk

As at December 31, 2019 and 2018, it is estimated that a general increase of one percent (1%) in aggregate and equity value reserves, with all other variables held constant, would decrease the Association's net income and equity by approximately P1.27 million and P1.29 million, respectively. An equal change in the opposite direction would have increased net income and equity by an equal but opposite amount.

Financial Risks

The Association has significant exposure to the following financial risks and from its use of financial instruments:

- Credit Risk
- Liquidity Risk
- Market Risk

There has been no change to the Association's exposure to financial risks (i.e. credit risk, liquidity risk and market risk) or the manner in which it manages and measures the risks since prior financial year.

(a) *Credit Risk*

Credit risk is the risk of financial loss to the Association if the counterparty to a financial instrument fails to meet its contractual obligations, and arises primarily from the Association's financial assets.

Except for HTM and AFS investments which mature on various dates, all of the Association's financial assets are current. Thus, the credit risk relating to these financial assets is considered small due to the short settlement period involved. The Association's HTM and AFS investments consist primarily of government debt securities. Since these are backed by the full faith and credit of the Philippine Government, these are generally considered to be free of credit risk.

The carrying amounts financial assets represent the maximum credit exposure. The maximum exposure to credit risk at the reporting dates are as follows:

	<i>Note</i>	2019	2018
Cash and cash equivalents*	7	P38,820,296	P13,847,036
Short-term investments	8, 23	3,257,609	3,218,401
Receivables	9, 23	7,740,452	7,512,272
AFS financial assets**	10	938,333,306	771,059,475
HTM investments	11, 18, 23	183,434,094	183,987,885
Other assets***	23	58,149	330,778
		P1,171,643,906	P979,955,847

*Excluding cash on hand.

**Excluding equity securities.

***Excluding prepaid expenses and fidelity bond deposits.

The Association's concentration of credit risk arises from its investments in government debt securities since the said investments amounted to P748.40 million and P650.06 million which represent 63.88% and 66.36% of its total financial assets as at December 31, 2019 and 2018, respectively (see Notes 10 and 11).

The table below provides information regarding the credit risk exposure of the Association as at December 31, 2019 and 2018 by classifying assets according to the Association's credit grading of counterparties.

	2019				Total
	Neither Past Due nor Impaired		Total Financial Assets Neither Past Due nor Impaired	Past Due and Impaired	
	Investment High-grade	Non-investment Grade - Satisfactory			
Cash and cash equivalents*	P38,820,296	P -	P38,820,296	P -	P38,820,296
Short-term investments	3,257,609	-	3,257,609	-	3,257,609
Receivables	-	7,740,452	7,740,452	-	7,740,452
AFS financial assets**	938,333,306	-	938,333,306	-	938,333,306
HTM investments	183,434,094	-	183,434,094	-	183,434,094
Other assets***	-	58,149	58,149	-	58,149
	P1,163,845,305	P7,798,601	P1,171,643,906	P -	P1,171,643,906

*Excluding cash on hand.

**Excluding equity securities.

***Excluding prepaid expenses and fidelity bond deposits.

2018					
	Neither Past Due nor Impaired		Total Financial Assets Neither Past Due nor Impaired	Past Due and Impaired	Total
	Investment High-grade	Non-investment Grade - Satisfactory			
Cash and cash equivalents*	P13,847,036	P -	P13,847,036	P -	P13,847,036
Short-term investments	3,218,401	-	3,218,401	-	3,218,401
Receivables	-	7,512,272	7,512,272	-	7,512,272
AFS financial assets**	771,059,475	-	771,059,475	-	771,059,475
HTM investments	183,987,885	-	183,987,885	-	183,987,885
Other assets***	-	330,778	330,778	-	330,778
	P972,112,797	P7,843,050	P979,955,847	P -	P979,955,847

*Excluding cash on hand.

**Excluding equity securities.

***Excluding prepaid expenses and fidelity bond deposits.

The Association has no past due and impaired financial assets as at December 31, 2019 and 2018.

The Association uses a credit grading system based on the borrowers and counterparties overall credit worthiness, as described below:

Investment High - Grade - This pertains to accounts with a very low probability of default as demonstrated by the borrower's strong financial position and reputation. The borrower has the ability to raise substantial amounts of funds through credit facilities with financial institutions. The borrower has a strong debt service record and a moderate use of leverage.

Non-investment Grade - Satisfactory - This pertains to current accounts with no history of default or which may have defaulted in the past, but the conditions and circumstances directly affecting the borrower's ability to pay has abated already. The borrower is expected to be able to adjust to the cyclical downturns in its operations. Any prolonged adverse economic conditions would however ostensibly create profitability and liquidity issues. The use of leverage may be above industry or credit standards but remains stable.

Past Due and Impaired - This pertains to the allowance for impairment loss that the Association recognizes due to the uncertainty of the collectability of the Association's receivables.

(b) *Liquidity Risk*

Liquidity risk is the risk that the Association will not be able to meet its financial obligations as they fall due. The Association's approach in managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Association's reputation.

The Association prepares weekly cash position report and weekly check disbursement forecast, which assists in monitoring cash flow requirements. Typically, the Association ensures that it has sufficient cash on demand to meet expected operational expenses for a period of 60 days, including servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot be predicted.

The maturity profile of the Association's financial liabilities has contractual maturities of one year or less as at December 31, 2019 and 2018 are as follows:

		2019	
	Note	Carrying Amount	Contractual Cash Flow
Accrued expenses and other liabilities*	14, 23	P23,082,520	P23,082,520
Claims payable	15, 23	139,432,485	139,432,485
Equity value reserves	17, 23	84,733,721	84,733,721
Due to related party	23, 24	9,457,645	9,457,645
		P256,706,371	P256,706,371

*Accrued expenses and other liabilities shown above exclude payables to government agencies amounting to P0.59 million and P3.23 million as at December 31, 2019 and 2018, respectively.

		2018	
	Note	Carrying Amount	Contractual Cash Flow
Accrued expenses and other liabilities*	14, 23	P27,535,228	P27,535,228
Claims payable	15, 23	134,912,396	134,912,396
Equity value reserves	17, 23	75,511,008	75,511,008
Due to related party	23, 24	34,770,038	34,770,038
		P272,728,670	P272,728,670

*Accrued expenses and other liabilities shown above exclude payables to government agencies amounting to P0.59 million and P4.23 million as at December 31, 2018 and 2017, respectively.

(c) *Market Risk*

Market risk is the risk that causes changes in market prices, such as interest rate and equity price risks. This will affect the Association's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market exposures within acceptable parameters, while optimizing the return. The Association's exposure to currency risk was assessed by management to be insignificant.

Interest Rate Risk

There are two types of interest rate risk:

- *Fair Value Interest Rate Risk* - the risk that the value of a financial instrument will fluctuate because of changes in market interest rates; and
- *Cash Flow Interest Rate Risk* - the risk that future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Significant portion of the Association's investments is composed of interest-bearing debt instruments carried at fair value. As a result, the Association is exposed to fair value interest rate risk. The Association's interest-bearing financial instruments as at December 31, 2019 and 2018 are as follows:

	Note	2019	2018
Cash and cash equivalents*	7	P38,820,296	P13,847,036
Short-term investments	8, 23	3,257,609	3,218,401
AFS financial assets**	10	938,333,306	771,059,475
HTM investments	11, 18, 23	183,434,094	183,987,885
		P1,163,845,305	P972,112,797

*Excluding cash on hand.

**Excluding equity securities.

The following table demonstrates Association's best estimate of the sensitivity to reasonable possible change in interest rates, with all other variables held constant, to the Association's net income and equity as at December 31:

	Change in Basis Points (bps)	Effect on Net Income/Equity
2019	Increase by 13 bps	P1,512,999
	Decrease by 13 bps	(1,512,999)
2018	Increase by 13 bps	1,263,747
	Decrease by 13 bps	(1,263,747)

The Association does not carry debt instrument with variable interest rate and, thus, is not exposed to cash flow interest rate risk.

Interest rate risk is mitigated by the Association's BOT by constructing a portfolio of debenture instruments with diversified maturities. Any excess cash of the Association are temporarily invested in time deposits with the term to maturity of 35 days up to 3 months and later placed in instruments with longer tenors.

The Association believes that the analysis above is considered to be representative of the interest rate risk.

(d) Equity Price Risk

Equity price risk is the risk that value of the instrument will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or currency risk), whether caused by factors specific to an individual investment, its issuer or all factors affecting all instruments traded in the market.

The Association's equity price risk exposure relates to equity securities designated as AFS financial assets with carrying amount of P26.99 million and P25.66 million as at December 31, 2019 and 2018, respectively (see Note 10). The value of these equity securities will fluctuate with changes in market conditions.

An average of 5.01% increase (2018: 2.84% decrease) in stock prices would have increased (decreased) equity by P1.35 million as at December 31, 2019 (2018: P0.73 million), with all variables remaining constant. An equal change in the opposite direction would have increased equity by an equal but opposite amount.

In 2019 and 2018, the Association determined the reasonably possible change in Philippine Stock Exchange (PSE) Index based on the historical fluctuation of equity securities the Association holds as of the reporting date.

6. Fair Value Measurements and Disclosures

A number of the Association's accounting policies and disclosures require the determination of fair values, for both financial assets and financial liabilities.

Fair values have been determined for measurement and/or disclosure purposes based on the methods as described below. Where applicable, further information about the assumptions made in determining fair values is disclosed in the notes to the financial statements specific to the assets or liability.

The carrying amounts of the Association's financial instruments such as cash and cash equivalents (excluding cash on hand), short-term investments, receivables, other assets (excluding prepaid expenses and fidelity bond deposits), accrued expenses and other liabilities (excluding government payables to agencies), claims payable, equity value reserves and due to related party approximate fair value at year-end due to the relatively short-term maturities of these financial assets and liabilities.

AFS financial assets is measured at fair value. The fair values of quoted equity securities were determined by reference to quoted market prices published by PSE. While for debt securities, the market price reference in determining the market value is derived from PHP Bloomberg Valuation Services (BVAL) and Philippine Dealings and Exchange (PDEX) as at December 27, 2019 and December 28, 2018, respectively.

If the market prices are not readily available, fair values are estimated using either values obtained from independent parties offering pricing services or adjusted quoted market prices of comparable investments or using the discounted cash flow methodology.

Investments in unquoted equity instruments for which no reliable basis for fair value measurement is available are carried at cost, net of any allowance for impairment losses.

The carrying amount of the Association's HTM investments approximate its fair value at year end. Management believes that the effect of discounting and future cash flows for these instruments using the prevailing market is not significant.

The recurring fair value of AFS financial assets are determined by reference to quoted market prices, at the close of business on the reporting date.

The fair value of AFS financial assets using Level 1 inputs is P965.32 million and P796.72 million as at December 31, 2019 and 2018, respectively (see Notes 4, 10 and 23).

The Association has no financial instruments measured at fair value that are categorized under Level 2 and 3. There has been no transfer between levels in 2019 and 2018.

7. Cash and Cash Equivalents

As at December 31, this account consists of:

	Note	2019	2018
Cash on hand		P426,998	P30,158
Cash in banks	5	17,583,017	13,611,753
Cash equivalents	5	21,237,279	235,283
	23	P39,247,294	P13,877,194

The Association's cash in bank earns annual interest at 0.75% to 1.25% in 2019 and 2018. Short-term placements represent a 90-day time deposit with an average annual interest rate of one percent (1%) in 2019 and 2018.

Interest income, net of final tax, recognized in profit or loss which is presented under "Interest income", amounted to P0.21 million and P0.06 million for the years ended December 31, 2019 and 2018.

8. Short-term Investments

Short-term investments amounting to P3.26 million and P3.22 million as at December 31, 2019 and 2018, respectively, represents certificate of deposit with local bank with 180-day maturity and earns interest of one percent (1%) per annum in 2019 and 2018 (see Notes 5 and 23).

Interest income on short-term investments amounted to P0.01 million and P0.02 million for the years ended December 31, 2019 and 2018, respectively.

9. Receivables

As at December 31, this account consists of:

	Note	2019	2018
Interest receivables		P7,236,688	P7,201,664
Advances to officers and employees		458,951	-
Others		44,813	310,608
	5, 23	P7,740,452	P7,512,272

Interest receivables pertain to accrued interest of debt instrument classified as AFS financial assets and HTM investments. Advances to officers and employees refers to receivables from loans and advances granted to the Association's officers and employees.

Interest income earned on advances to officers and employees amounted to P0.01 million and P0.03 million for the years ended December 31, 2019 and 2018, respectively.