



Republic of the Philippines  
Department of Finance  
**INSURANCE COMMISSION**  
1071 United Nations Avenue  
Manila

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**CIRCULAR LETTER**

**TO :** ALL NON-LIFE INSURANCE AND PROFESSIONAL REINSURANCE COMPANIES DOING BUSINESS IN THE PHILIPPINES

**SUBJECT :** VALUATION STANDARDS FOR NON-LIFE INSURANCE POLICY RESERVES

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Pursuant to Sections 219 and 220 of the Amended Insurance Code (Republic Act No. 10607) which require every insurance company other than life to maintain a reserve for unearned premiums and other special reserves required by the Commissioner, attached is the new set of Valuation Standards for Non-Life Insurance Policy Reserves.

  
**EMMANUEL F. DOOC**  
Insurance Commissioner  


# **VALUATION STANDARDS FOR NON-LIFE INSURANCE POLICY RESERVES**

## **1 Introduction**

- 1.1 Every non-life insurance company or professional reinsurance company supervised by the Insurance Commission (IC) shall maintain reserves for its written policies, which shall be charged as a liability in any determination of its financial condition, as required by the IC, in accordance with Sections 219 and 220 of the Amended Insurance Code (Republic Act No. 10607), as well as this Valuation Standards for Non-Life Insurance Policy Reserves.

## **2 Scope and Application**

- 2.1 This Valuation Standards shall apply to all policies issued by non-life insurance companies and professional reinsurance companies except policies covering migrant workers which is covered under IC CL No. 2015-06.
- 2.2 This Valuation Standards is intended to cover both direct and assumed reinsurance business, whether treaty or facultative, of non-life insurance companies.

## **3 Key Definitions**

- 3.1 In this Valuation Standards, unless the context otherwise requires:
  - 3.1.1 "Company" refers to a non-life insurance company or professional reinsurance company supervised by the IC.
  - 3.1.2 "Actuary" refers to an in-house actuary of the Company or an external consulting actuary accredited by the IC.
  - 3.1.3 "Policy Reserves" refers to the aggregate of Premium Liabilities and Losses and Claims Payable both defined below;
  - 3.1.4 "Premium Liabilities" refers to all future claim payments arising from future events after the valuation date that are insured under unexpired policies, as well as expenses for policy management

and claims settlement, and is computed as the higher of the UPR and URR at a designated level of confidence, on both gross and net of reinsurance basis;

3.1.4.1 "UPR" means Unearned Premium Reserves, and is the reserve for that portion of the premium received which is attributable to a period of risk falling beyond the valuation date;

3.1.4.2 "URR" means Unexpired Risk Reserves, and is an estimate of the total liability (including expenses), at a designated level of confidence, in respect of the risk after the valuation date of policies written prior to that date including expenses for policy management and claims settlement costs.

3.1.4.3 A computation should be performed to determine whether the unexpired risk reserve required is greater or less than the unearned premium reserve at the gross of reinsurance basis. If the unexpired risk reserve is greater, then the difference should be booked as an additional reserve on top of the unearned premium reserve.

3.1.5 "Losses and Claims Payable" refers to claims filed or reported to the Company but not yet paid as of the end of the accounting period, for both the Company's direct business and assumed reinsurance business, whether treaty or facultative. It includes claims due and unpaid, claims in the course of settlement, resisted claims and those which are incurred but not reported at a designated level of confidence, as well as direct and indirect expenses related to settling all outstanding claims, whether reported and unreported, as of valuation date;

3.1.5.1 "Outstanding Claims" refers to the amount at the end of a particular accounting period which is the sum of the individual amounts for which the Company has already received notice of claim but which, for one reason or another, final action has not been taken either approving the claims for payment in full or rejecting it in part or in full;

3.1.5.2 "IBNR" means Incurred But Not Reported, and refers to the amount at the end of a particular accounting period which is an estimate of the sum of the individual claims that already occurred but which notice has not yet been received by the Company;

3.1.5.3 "IBNER" means Incurred But Not Enough Reported, and refers to the portion of the Losses and Claims Payable pertaining to expected changes (increases and decreases) in estimates for reported claims at the end of a particular accounting period;

3.1.5.4 "Loss Adjustment Expenses Payable" refers to adjustment expenses already incurred but not yet paid in connection with settlement of losses and claims for both direct business and assumed treaty and facultative reinsurance business;

#### **4 Data and Systems**

4.1 The Company's Chief Executive Officer (CEO), or responsible officer with a comparable rank, shall ensure that the Company's database is properly maintained so that the premiums and claims data provided to the Actuary is accurate and complete. The CEO or the responsible officer must furnish the data to the Actuary and must allow his/her Actuary reasonable access to the Company's database.

4.2 The Actuary shall apply reasonable tests to satisfy himself that the claims and premiums data is accurate and complete. A check for both integrity and completeness of data should precede the valuation work. Furthermore, the Company shall maintain a historical claims database of at least ten (10) years.

4.3 The Company shall create development triangles on both paid and incurred claims basis, on both gross and net of reinsurance basis, and by class of business. The length of historical data needed in creating the development triangles must be based on the Company's underlying business and on the long-term development of each class of business.

- 4.4 Companies or specific classes of business which have insufficient data as a result of business expansion or mergers and acquisitions shall be required to use as much data as they currently have until they have accumulated the appropriate length of historical claims data for valuation purposes.
- 4.5 The Company shall maintain a database of historical claims, on both gross and net of reinsurance basis, pertaining to large loss events incurred for as long a period as the development triangles, for the purpose of measuring and monitoring catastrophic risks, as described in Section 11 below.
- 4.6 The Company shall also maintain records on historical gross and net premiums, both earned and unearned, by class of business, as well as commissions and other expense information in relation to claims handling and policy maintenance (e.g., direct and indirect claims settlement costs), for the purpose of estimating future expenses for policy reserves valuation.
- 4.7 The Company shall determine the claims grouping for policy reserves valuation on either an accident year or underwriting year basis per class of business, whichever is more appropriate, and prepare the corresponding data for the determined basis.

## **5 Basis of Assumptions**

- 5.1 As much as practicable, the valuation of policy reserves shall be based on the Company's actual historical experience, and/or industry data. Any deviation and use of professional judgment must be supported by a strong rationale and must be documented in Section C of the Actuarial Valuation Report, as described in **Annex A**.
- 5.2 Premiums used in the policy reserves calculation shall be gross of expenses, commissions, taxes, etc. depending on the company's discretion.
- 5.3 Premiums and claims data used in the policy reserves calculation, as well as projection of future claims, shall be both gross and net of reinsurance.

- 5.4 The Actuary shall gather information from the Underwriting Department or its equivalent to provide information on the following areas: market outlook, changes in pricing levels, impact of historical and current catastrophes, level of reinsurance cover, policy inception profile, changes in the mix of business, renewal rates and changes in terms and conditions.
- 5.5 The Actuary shall gather information from the Claims Department or its equivalent to provide information on the following areas: typical claims process from notification to settlement, current key uncertainties with reaching settlement of claims, claims expense inflation, large loss experience, operational changes in the claims function, large loss concerns and uncertainties, and changes in initial case estimates.
- 5.6 The Company's projection of future claims shall be based on the loss development triangles per class of business, as described in paragraph 4.3, as well as the results of the information gathered from Underwriting and Claims Departments, or their equivalents, as described in paragraphs 5.4 and 5.5.
- 5.7 On an annual basis, the Company shall determine the major classes of business in its operations for reserving purposes by performing a risk assessment process. At a minimum, the Company shall define its lines of business as follows: Marine, Fire, Casualty, Motor Car and Suretyship. However, the Company can come up with a more granular classification based on its own risk assessment.

## **6 Valuation Methodology**

- 6.1 The Actuary, as set out in the Amended Insurance Code, shall be responsible to determine the level of policy reserves using bases no less stringent than that prescribed in Sections 7 to 10 below.
- 6.2 The reserves for a non-life insurance policy shall be composed of Premium Liabilities and Losses and Claims Payable determined using best estimate assumptions, and appropriate Margin for Adverse Deviation (MfAD) for expected future experience.

## 7 Premium Liabilities

- 7.1 Premium Liabilities for each class of business shall be determined as the higher of UPR and URR.
- 7.2 The UPR shall be calculated based on the 24<sup>th</sup> method for all classes of business. The Actuary shall provide sufficient basis for any material deviations from this methodology in Section C of the Actuarial Valuation Report, as outlined in **Annex A**.
  - 7.2.1 The computation for UPR-gross of reinsurance includes the unearned portion of premiums written by a non-life insurance company as at valuation date.
  - 7.2.2 The computation for UPR-net of reinsurance includes the deferred reinsurance premiums. Deferred reinsurance premiums refer to the unearned portion of premiums ceded to reinsurers by non-life insurance companies incurred from policies in-force as at valuation date.
- 7.3 The URR shall be calculated as the best estimate of future claims and expenses for all unexpired policies as of valuation date and for all classes of business, with MfAD as computed in Section 9. This best estimate relates to expected future payments arising from future events after the valuation date and includes any expenses expected to be incurred in administering the policies and settling relevant claims.
  - 7.3.1 Expected future claims shall include all claims which might occur during the unexpired period including: claims which are reported after the end of the unexpired exposure period, but have occurred within the unexpired exposure period; and claims which are reopened at any date, but have occurred within the unexpired exposure period.
  - 7.3.2 Expected future expenses shall include policy maintenance expenses and claims management expenses (i.e., direct and indirect claims settlement costs).

- 7.4 The URR may be estimated as the unearned premium for each class of business, multiplied by the ultimate loss ratio and adjusted for future expenses.
- 7.5 The Actuary may consider an adjustment of the ultimate loss ratio by allowing for large and catastrophic losses; however, these should be captured on a best estimate basis considering the severity apportioned by the expected frequency of such a loss.

## **8 Losses and Claims Payable**

- 8.1 Losses and Claims Payable for both direct business and assumed treaty and facultative reinsurance business shall be calculated as the sum of Outstanding Claims and IBNR, with MfAD as computed in Section 9.
- 8.2 Outstanding Claims shall be based on actual claims reported but have not been settled. The Company shall ensure integrity of the data inputs as well as minimize uncertainties in the claims processing, subject to paragraph 4.2.
- 8.3 The IBNR shall be calculated based on standard actuarial projection techniques or combinations of such techniques, such as but not limited to the chain ladder approach, the expected loss ratio approach, and the Bornhuetter-Ferguson (BF) method. The Actuary shall determine the appropriateness of the methodology considering the characteristics of the data, such as maturity of the business.
- 8.4 The Company shall incorporate IBNER, either as part of the IBNR provision, or as a separate liability account depending on the technique adopted. IBNER is relevant for classes of business which naturally exhibit a long claims settlement pattern.
- 8.5 The Losses and Claims Payable shall include a provision for Loss Adjustment Expenses Payable, which covers the estimated expenses of adjusting all claims, reported, unreported and outstanding as of valuation date.

- 8.6 The Actuary shall ensure the reliability of the expected loss ratio by obtaining estimates from various sources, such as underwriters, the business plan, pricing actuaries, market statistics, or from a historic view of profitability and loss ratios.
- 8.7 In valuing Losses and Claims Payable, the Actuary should consider other factors such as but not limited to: varying expense structure in run-off situations, large losses arising from significant past events, operational changes in claims management, underwriting changes such as business mix and premium rate changes, changes in reinsurance program and changes in claims handling process.
- 8.8 To ensure sufficiency of reserves, the Actuary shall conduct a back-testing exercise of the IBNR by comparing the previous year's IBNR of expected current year claim developments, with actual current year claim developments. The results of such shall be documented in Section D of the Actuarial Valuation Report, as outlined in **Annex A**. In cases where the IBNR has proven insufficient to cover actual claims development, the Actuary shall revisit the assumptions for IBNR valuation and document the rationale for this deterioration.

## **9 Margin for Adverse Deviation (MfAD)**

- 9.1 The Company shall include an MfAD to allow for inherent uncertainty of the best estimate of the policy reserves. The purpose of the MfAD is to consider the variability of claims experience within a class of business, the diversification between classes of business and conservatism in the best estimate.
- 9.2 For the parallel runs, MfAD shall be set at 10% across all classes of business. On the first year of full implementation of this Valuation Standard, MfAD values shall be computed by the industry and approved by the IC, subject to the requirements in paragraph 13.2 below.
- 9.3 For subsequent periods of reporting, the company shall be allowed to estimate MfAD to achieve at least 75% level of sufficiency using internal models and company-specific data, and considering the particular characteristics of each class of business. The level of sufficiency applied in estimating MfAD shall be used consistently

and shall be approved by the IC. The internal models used in estimating MfAD shall also be subject to the IC's policy review.

- 9.4 To ensure appropriateness of assumptions, the IC shall provide companies with updated MfAD values annually.

## **10 Discounting**

- 10.1 The Actuary shall determine the materiality of discounting the cash flows in calculating the policy reserves. It shall be emphasized that cash flow timing is based on claims delay pattern and not on policy maturity.
- 10.2 If the Actuary deems it material to discount the cash flows in computing the policy reserves, the Actuary shall use current risk-free rates. The rates shall exactly match the duration of the policy and the currency of the cash flows and shall be prescribed by IC.

## **11 Monitoring of Severe and Catastrophic Risks**

- 11.1 As Sections 7 to 10 describe the valuation of policy reserves until the 75% level of sufficiency, companies shall take measures to ensure proper monitoring of risks beyond the 75% confidence level, such as internal modelling or performance of appropriate stress testing exercises.

## **12 Actuarial Valuation Report**

- 12.1 The actuarial valuation report shall be prepared on an annual basis and submitted to IC. The actuarial valuation report, at a minimum, shall contain the following information (see **Annex A** for details):
- (i) Scope of Report
  - (ii) Data Requirements
  - (iii) Valuation Methodologies and Assumptions
  - (iv) Analysis of Experience
  - (v) Valuation Results
  - (vi) Certification by the Actuary
  - (vii) Certification by the CEO or Responsible Officer

12.2 The Certifications to be provided by the Actuary and the CEO or responsible officer shall be duly notarized.

### **13 Transitional Provisions**

The Valuation Standards for Non-Life Insurance Policy Reserves introduced in this Circular, shall take effect after a transition period to allow parallel runs and thereby assess the impact of this new methodology. During the parallel runs, companies will submit to the IC an Actuarial Valuation Report, as outlined in **Annex A**, under the new valuation standards on dates prescribed in CL 2015-

13.1 During the transition period, companies will submit a soft copy of their development triangles by class of business for the purpose of computation of an appropriate value for MfAD. After consolidating the information from the individual companies and computing the MfAD value per class of business, the industry shall have the MfAD value approved by the IC prior to full implementation.

13.2 The details of the transition period and the full implementation of this Valuation Standards are presented in a separate Circular.

**Report on the Actuarial Valuation of Non-Life Insurance Policy Reserves**

**Name of Company:** \_\_\_\_\_

**For the period ended dd/mmm/yyyy**

Please provide information on the following:

**Section A: Scope of Review**

1. Purpose of report
2. Name of Actuary, professional qualifications, whether the Actuary is an employee of the insurance company or an external consultant, and the capacity in which he is carrying out the valuation of reserves
3. Confirmation from the Actuary of compliance with requirements with this Valuation Standards, and reasons, if any, for not complying fully with any requirements

**Section B: Data Requirements**

1. The basis on which the analysis has been carried out (i.e., underwriting or accident year)
2. The source of the data and how it was extracted
  - a. Description of the company's current underwriting policies: specific market segments targeted, risk selection process, any major recent changes in premium rates and policy conditions, any recent changes in levels of underwriting authorities, any recent changes in key personnel and delegation of authority, and any changes in level of deductibles or policy limits
  - b. Description of the company's claims management policies: guidelines for case reserving and the use of loss adjusters, policies on opening and closing of claims, operational changes in claims function, large loss concerns and uncertainties
3. Documentation of any adjustments made to the data to allow for abnormal items such as large losses, catastrophe losses, etc. including the nature, amount and rationale for the adjustment
  - a. Description of significant events during the year affecting the claim experience and how these were taken into account in the valuation of the liabilities

- b. Description of other effects considered including economic, technological, medical, legislative environment, social trends, competition, court decisions, consumerism, etc.
4. Documentation of quantitative information which may have an impact on valuation, if applicable

### **Section C: Valuation Methodologies and Assumptions**

1. Detailed discussion on the valuation methods, assumptions, professional judgment used in the estimation of the following:
  - a. Premium liabilities
  - b. Losses and claims payable
  - c. Claims handling costs and related expenses
  - d. Discounting
  - e. Margin for adverse deviation
2. When more than one method is used, the basis for choice of results
3. Justification for key differences in assumptions between valuations of premium liabilities and losses and claims payable
4. Any material deviations from this Valuation Standards in terms of valuation methodologies and assumptions, and basis for these deviations

### **Section D: Analysis of Experience (starting 2017)**

1. Detailed analysis of the company's actual experience of both URR and losses and claims payable versus expected experience in previous valuations, including justifications for any material change observed. The experience analysis should cover claims payments and incurred cost movement.
2. Comparative analysis between current and previous valuation

### **Section E: Valuation Results and Discussion**

The summary of the valuation results shall follow the format shown in Annex B. Companies shall provide a short narrative discussing their valuation results for each class of business.

### **Section F: Certification by the Actuary**

The Actuary shall provide a certification as set out below:

"I hereby certify that I have conducted tests necessary to verify the reasonableness and integrity of the data, confirm that the information contained in this Report are accurate to the best of my knowledge and that I have calculated the policy reserves in accordance with the Valuation Standards prescribed by the Insurance Commission.

\_\_\_\_\_  
Signature over Printed Name of Actuary

Date: \_\_\_\_\_"

**Section G: Certification by the CEO or Responsible Officer**

The CEO/Responsible Officer shall provide the following certification:

"I hereby certify that the database is properly maintained and I have satisfied myself that the data provided to the certifying Actuary are accurate and complete.

\_\_\_\_\_  
Signature over Printed Name of  
Chief Executive Officer/Responsible Officer

Date: \_\_\_\_\_"

**Annex B**

Name of Company : \_\_\_\_\_

**Actuarial Valuation Results**

**Non-Life Insurance Policy Reserves in Philippine Peso**

For the period ended dd/mm/yyyy

**Summary of Valuation Results**

Lines of Business <sup>1</sup>	Fire	Marine	Motor Car	Casualty	Suretyship
Premium Liabilities					
(1) UPR: Gross of Reinsurance					
(2) URR: Best Estimate					
(3) MfAD					
(A) Total (MAX(1, 2 + 3))					
Losses and Claims Payable					
(4) Outstanding Claims					
(5) IBNR: Best Estimate <sup>2</sup>					
(6) Loss Adjustment Expenses Payable					
(7) MfAD					
(B) Total (4 + 5 + 6 + 7)					
Policy Reserves (A + B)					

This summary shall be accompanied by a short narrative discussing the valuation results for each class of business.

<sup>1</sup> The company may come up with a more granular categorization of its lines of business through its internal risk assessment.

<sup>2</sup> IBNER may already be incorporated in the IBNR line item, or may appear as a separate line item, depending on the Company's discretion.