Mercantile Insurance

RELATED PARTY TRANSACTIONS POLICY

INTRODUCTION

In the ordinary course of business, The Mercantile Insurance Company, Inc. (hereinafter referred to as "Mercantile") may engage in transactions with related parties. This policy outlines the parameters for identifying related party transactions (RPTs) and establishes the standards for their review, approval, and disclosure.

In line with IC Circular 2017-29, the Insurance Commission underscores the importance of instituting robust policies and procedures governing RPTs to ensure that such dealings are conducted on an arm's length basis. These measures aim to safeguard the financial, commercial, and economic interests of Mercantile (CI) and its group. All CIs, including their subsidiaries and affiliates, are expected to exercise prudent oversight and implement effective internal controls to manage RPT exposures, thereby preventing potential abuses that could harm Mercantile and its stakeholders, such as policyholders, members, claimants, creditors, fiduciary clients, and other concerned parties.

I. OBJECTIVES

This policy is established to ensure the following objectives are met:

1. Clear definitions of related parties and related party transactions (RPTs), including the scope and applicability of the policy;
2. Assurance that all RPTs are conducted on an arm's length basis;
3. Prevention or effective management of potential or actual conflicts of interest arising from RPTs;
4. Proper review and approval of RPTs by duly authorized bodies; and
5. Full and transparent disclosure of RPTs in compliance with relevant legal and regulatory requirements.

II. DEFINITIONS

1. **Related Parties** – This term encompasses the Mercantile's subsidiaries, affiliates, and special purpose entities over which Mercantile exercises direct or indirect control, or which in turn exert significant influence over Mercantile. It also includes Mercantile's directors, officers, stockholders, and their related interests, as well as their close family members. Additionally, the definition extends to counterparts in affiliated companies and any other individuals or juridical entities whose interests may give rise to a potential conflict with those of Mercantile and are therefore considered related parties under this policy.

   Related Parties (as defined under PAS 24):

   Related parties include the following:
   - The entity's parent company;
   - Entities that have joint control of, or significant influence over, the reporting entity;
   - Subsidiaries;
   - Associates and joint ventures in which the entity is a venturer;
   - Key management personnel of the entity or its parent; and

- Any other parties that meet the definition of a related party under applicable financial reporting standards.

Significant Influence:

Significant influence refers to the power to participate in the financial and operating policy decisions of an entity, without having control over those policies. Such influence may arise through share ownership, statutory provisions, or contractual arrangements. Indicators of significant influence include representation on the board of directors, participation in policy-making processes, material intercompany transactions, the interchange of managerial personnel, and reliance on technical information provided by the influencing party.

2. **Close Family Members -** Close family members refer to individuals related to the directors, officers, or stockholders (DOS) of Mercantile within the second degree of consanguinity or affinity, whether legitimate or common-law. This includes, but is not limited to, the DOS's spouse, parents, children, siblings, grandparents, grandchildren, parents-in- law, sons-/daughters-in-law, brothers-/sisters-in-law, grandparents-in-law, and grandchildren-in-law.

3. **Corresponding Persons in Affiliated Companies** - This term refers to the directors, officers, and stockholders (DOS) of affiliated companies, including their close family members, as defined above. These individuals are considered related parties when their interests may influence, or be influenced by, their relationship with Mercantile.

4. **Control** - As provided under Section 290 of the Insurance Code, as amended by Republic Act No. 10607, *control* is presumed to exist when a person directly or indirectly owns, controls, or holds with the power to vote **forty percent (40%) or more** of the voting securities of another entity. However, a person shall not be considered to have control solely by virtue of holding a position as an officer or director of the other entity.

5. **Control of an Enterprise** - Control of an enterprise exists when a person or entity has the power to govern the financial and operating policies of another entity in order to obtain benefits from its activities. This may occur through various means, including but not limited to:

   a. An affiliate of, or affiliated with, a specified person refers to any person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the specified person. Control may be evidenced by:

      i. Ownership, either solely or in combination with affiliated persons, of more than 40 **%** of the outstanding capital stock of a legal entity; and/or

      ii. Holding a position as an officer or director of that legal entity.

   b. Possession of power—whether by statute, agreement, or other means—to govern the financial and operating policies of the entity;

c. Power to appoint or remove a majority of the board of directors or an equivalent governing body;
d. Power to cast the majority of votes in meetings of the board or governing body; or
e. Any other arrangement that confers similar decision-making authority or influence.

If a Covered Institution (CI) seeks to disclaim or rebut the presumption of control, it must submit sufficient factual evidence demonstrating the absence of control. Additionally, the CI must provide a written commitment that:

i. Shares held are strictly for investment purposes;
ii. CI-stockholder will maintain only limited, customary contacts with management;
iii. Transactions with the entity will be conducted on normal and customary terms; and
iv. Shares acquired will not be pledged as collateral for any loan.

6. **Related Party Transactions (RPTs)** –

RPTs refer to any transactions or dealings between Mercantile and its related parties, regardless of whether consideration is exchanged. These transactions are interpreted broadly and include, but are not limited to:

- On- and off-balance sheet credit exposures, claims, and write-offs;
- Investments or subscriptions to debt or equity instruments;
- Consulting, professional, agency, and service contracts;
- Purchases or sales of tangible and intangible assets (e.g. technology, trademarks, licenses);
- Construction and lease contracts;
- Trading and derivatives transactions;
- Borrowings, guarantees, fund transfers, and other commitments;
- Sale, purchase, or supply of goods or materials; and
- Formation of joint ventures.

RPTs include not only transactions with existing related parties but also existing transactions with entities that subsequently become related parties.

7. **Insurance Group** - An insurance group refers to a corporate structure comprising two or more insurers under common control or significant influence, whether directly or indirectly.

8. **Arm's Length Transaction** - An arm's length transaction is one conducted under terms and conditions that would apply between independent and unrelated parties, each acting in their own best interest. Such transactions are presumed to be free from conflict of interest or undue influence.

III. DUTIES AND RESPONSIBILITIES OF THE BOARD OF DIRECTORS

The Board of Directors holds the ultimate responsibility for ensuring that all transactions with related parties are conducted in a sound, prudent, and transparent manner, consistent with principles of integrity, good governance, and full compliance with applicable laws and regulations. These responsibilities aim to protect the best interests of the company's policyholders, claimants, creditors, and other stakeholders.

To this end, the Board shall perform the following key duties and responsibilities:

1. **Establishment and Approval of the RPT Policy**

- Ensure the adoption and periodic review of a comprehensive RPT policy that sets out clear guidelines for the identification, evaluation, approval, and monitoring of related party transactions.
- Ensure that all RPTs are conducted on an arm's length basis, with terms comparable to those available in similar transactions with non-related parties under similar circumstances.
- Oversee compliance with all relevant laws, rules, and regulations, and ensure that no stakeholder is unduly disadvantaged by any RPT.

2. **Guidelines for Determining Arm's Length Terms**

In evaluating the business rationale and fairness of significant RPTs—especially those outside the company's ordinary course of business—the Board may consider the following indicators:

a. **Transaction Characteristics:**
   i. Whether the transaction structure is unusually complex or involves multiple related entities within a group;
   ii. Whether the terms deviate from market norms, such as unusual pricing, commissions, interest rates, fees, duration, or collateral requirements compared to similar transactions with unrelated parties;
   iii. Whether the transaction lacks a clear and reasonable business justification;
   iv. Whether it involves newly identified or previously undisclosed related parties;
   v. Whether the transaction was processed outside of normal procedures or governance channels.

b. **Governance Considerations:**

Whether the transaction has been adequately discussed with those charged with governance, including the Audit or Risk Committee, if applicable.

c. **Price Discovery and Transparency:**

Ensure that there is an effective price discovery mechanism to validate that the terms of the transaction serve the best interest of the company and its stakeholders, and are not biased in favor of any related party.

d. **Accounting Substance vs. Form:**

Evaluate whether management is placing undue emphasis on a particular accounting treatment, rather than focusing on the underlying economic substance and risk of the transaction.

3. **Conflict of Interest Management**

- The policy shall provide for the identification, prevention, and management of both potential and actual conflicts of interest.
- Directors, officers, and stockholders must promptly disclose to the Board any direct or indirect financial interest, including those made on behalf of third parties, in any transaction or matter affecting the Company.
- Any director or officer with a personal interest in a proposed transaction must abstain from participation in the discussion, approval, and management of said transaction to ensure objectivity and preserve the integrity of the decision-making process.

4. **Materiality Thresholds and Exposure Limits for Related Party Transactions (RPTs)**

To ensure effective oversight and risk management of related party transactions, the Company shall adopt materiality thresholds and aggregate exposure limits that reflect the nature, complexity, and risk of transactions with related parties.

a. **Materiality Threshold for RPTs**

- The materiality threshold for related party transactions shall be defined as a level where omission or misstatement could pose a significant risk to the Company or influence the economic decisions of the Board of Directors.
- The standard threshold shall be 15% of the average projected statutory net income of the Company over the next three (3) years.
- Materiality thresholds may be customized per type of transaction and per related party group, considering the specific risks and financial impact involved.

b. **Maximum Total Annual Aggregate Exposure to a Related Party**

The Company shall observe the following maximum annual aggregate exposure limits:

- 15% of the Net Asset Value (NAV) of the Company, where Net Asset Value is defined as the book value of total assets less total liabilities, based on the Company's audited financial statements from the immediately preceding fiscal year.

c. **Internal Limits and Risk-Based Controls**

- The Company may set internal limits or sub-limits for individual and aggregate exposures:
  - Per related party;
  - Per type of RPT;
  - For all related parties in aggregate.

- These thresholds must be consistent with the Company's risk appetite, risk profile, and capital strength.
- Any breach of these limits must be immediately escalated to the appropriate oversight body (e.g., Risk Committee, Audit Committee, or Board).

5. **Whistle-blowing Mechanism**

To promote transparency and ethical conduct in handling related party transactions, this policy adopts and upholds the procedures set forth in Mercantile's Anti-Fraud, Bribery, and Whistleblowing Policy.

- Employees and stakeholders are encouraged and protected in reporting any suspicious, unethical, or potentially abusive RPTs or related misconduct.
- All reports shall be treated confidentially, and whistleblowers shall be protected against any form of retaliation.
- Allegations shall be subject to independent investigation, and appropriate corrective measures shall be taken when necessary.

IV. EXCLUSIONS FROM MATERIALITY THRESHOLD AND REVIEW REQUIREMENTS

The Company's RPT Policy may provide for specific exclusions from the materiality threshold and review requirements, particularly for transactions that are considered part of the usual course of business and executed at arm's length.

1. **Excluded Transactions**

The following transactions may be excluded from the materiality threshold requirement and the related review and approval process, provided that they are undertaken on substantially the same terms as those prevailing at the time for comparable transactions with unrelated parties:

a. Employment arrangements and compensation packages of directors and officers, duly approved by the Corporate Governance Committee;

b. Employee incentive programs and fringe benefits provided to all qualified employees, including senior officers, as part of approved company-wide plans;

c. Leasing of commercial space, real property, equipment, or other assets, whether the Company is acting as lessee or lessor, under standard commercial terms;

d. Banking, finance, and insurance-related transactions including, but not limited to:
   - Cash investments
   - Bank loans
   - Dividend income from investments
   - Insurance policies issued under standard terms

e. Services rendered under approved Service Level Agreements (SLAs) or cost reimbursement arrangements relating to manpower, utilities, construction, engineering, procurement, property management, and other similar operational support services conducted in the ordinary course of business.

Note: Even if excluded from materiality thresholds, such transactions must still be properly documented and monitored to ensure ongoing compliance with arm's length principles and fair market practices.

V. REVIEW AND APPROVAL PROCESS FOR MATERIAL RELATED PARTY TRANSACTIONS

All material RPTs—excluding those covered under Usual Course of Business—shall undergo a rigorous review and approval process, as follows:

1. Referral to the Related Party Transactions Committee (RPT Committee)

All proposed material RPTs must first be evaluated by the RPT Committee to determine:

- The legitimacy and business rationale of the transaction;
- The fairness of the transaction terms;
- The presence of any conflict of interest or risk exposure;
- Compliance with regulatory requirements and internal limits.

2. Board Review and Approval

- Upon endorsement by the RPT Committee, the proposed material RPT shall be submitted to the Board of Directors for final approval.
- The Board shall ensure that:
  - The transaction is in the best interest of the Company and its stakeholders;
  - It adheres to arm's length principles;
  - Any risks, especially reputational and financial, are well-managed.

3. Disclosure to Shareholders

All material RPTs approved by the Board shall be disclosed to shareholders during the annual or special shareholders' meeting as required by applicable regulations.

4. Abstention from Participation

Any director or member of the RPT Committee with a personal or financial interest in the transaction under review must abstain from any deliberation, decision-making, and voting related to that transaction, to preserve the integrity and impartiality of the process.

VI. RESTITUTION OF LOSSES AND REMEDIES FOR ABUSIVE RPTs

The Company shall adopt measures to mitigate and recover losses or opportunity costs resulting from Related Party Transactions (RPTs) that are not conducted on arm's length terms or are deemed abusive or disadvantageous to the Company.

Remedial actions shall include:

- Restitution or reimbursement for damages or opportunity costs incurred;
- Nullification or revision of the transaction, if legally and commercially feasible;
- Pursuit of legal remedies where warranted;

- Application of internal sanctions, disciplinary actions, or administrative measures against officers, employees, or directors found to have breached their fiduciary duties or failed to exercise due diligence in the handling of RPTs.

Officers and directors who are remiss in their responsibilities regarding RPTs shall be held accountable in accordance with the Company's Code of Conduct, Whistleblowing Policy, and applicable civil, criminal, or administrative laws.

VII. ROLES OF SENIOR MANAGEMENT AND OVERSIGHT FUNCTIONS

To ensure effective implementation of this Policy, key internal stakeholders shall fulfill the following responsibilities:

1. **Senior Management**
   - Develop and implement appropriate internal controls to manage and monitor RPTs on both a per-transaction and aggregate exposure basis;
   - Ensure that exposures to related parties are tracked on a continuous basis;
   - Guarantee that transactions comply with the RPT Policy and relevant Insurance Commission (IC) regulations.

2. **Internal Audit Function**
   - Conduct periodic formal audits of the RPT control framework and processes;
   - Evaluate the consistency of implementation with Board-approved policies and internal procedures;
   - Report audit findings, including exceptions, violations, or breaches of thresholds, directly to the Audit Committee.

3. **Compliance Function**
   - Ensure adherence to applicable regulatory requirements and internal policies governing RPTs;
   - Monitor regulatory updates and inform management and the Board of any relevant changes;
   - Assist in the review and assessment of RPTs and determine if such transactions require evaluation by the Board or RPT Committee;
   - Maintain and periodically update the RPT Policy and ensure its effective dissemination and implementation across the organization.

VIII. DISCLOSURE AND REGULATORY REPORTING

The Company shall ensure transparency and regulatory compliance through proper disclosure and reporting of RPTs, as follows:

1. **Annual Report Disclosures**
   The Company shall disclose in its Annual Report:
   a. The overarching RPT policy, procedures for managing conflicts of interest, and the responsibilities of the RPT Committee;
   b. Details of material RPTs, including:
      - Nature of the transaction

- Terms and conditions
- Names of related parties
- Original and outstanding balances
- Off-balance sheet commitments, if any

2. **Group Structure Reporting**
   Insurance companies that are part of a group or conglomerate must submit the full conglomerate/group structure, including all affiliated entities.

   Deadline: Within 30 calendar days after the end of each calendar year.

3. **Quarterly Material RPT Reporting**
   - All material exposures to related parties;
   - All material RPTs of non-financial subsidiaries and affiliates.

   Deadline: Within 20 calendar days after the end of each reference quarter.

IX. POLICY REVISION AND AMENDMENTS

Revisions or supplements to this Related Party Transactions Policy shall be:

- Recommended by the Related Party Transactions Committee (RPTC); and
- Subject to the approval of the Board of Directors.

All revisions shall be properly documented, communicated, and implemented in accordance with applicable corporate governance policies and regulatory standards.#