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California Department of Insurance Regulation File: RH 01015731

## UPDATE OF INFORMATIVE DIGEST

The proposed Reinsurance Oversight Regulations have been significantly revised in response to comments. There have been no changes in the laws related to the proposed action or to the effect of the proposed regulations from the laws and effects described in the Notice of Proposed Action except as noted below. (Subdivisions and paragraphs that were reorganized to accommodate additions or deletions are not specially noted unless the text was revised.)

### **§2303.2 Definitions**

The definition of "liabilities" [former Subdivision (o)] has been deleted from this section and moved to §2303.15.

The definition of "material reinsurance agreement" [former Subdivision (q)] has been deleted.

The definition of "materially deficient" (former Subdivision (r)) has been deleted.

The definition of "volume insurer" [former Subdivision (z) relabeled as Subdivision (w)] has been revised to use the same calculations as those used to determine whether an insurer is commercially domiciled for purposes of California Insurance Code ("CIC") §1215.13.

### **§2303.3 Credit for Reinsurance Ceded to Admitted Insurer**

The requirement that a licensed reinsurer must notify the Commissioner when it has become the subject of a regulatory order or regulatory oversight based on a hazardous financial condition has been moved to §2303.18.

### **§2303.4 Credit for Reinsurance Ceded to Accredited Reinsurer**

The requirement that an accredited reinsurer must notify the Commissioner if it become the subject of a regulatory order or regulatory oversight based on a hazardous financial condition has been moved without substantive change to §2303.18.

Paragraph (b)(4) was revised to delete the language, "whether formal, informal or voluntary" regarding the reporting of regulatory orders or proceedings.

### **§2303.7 Credit for Reinsurance Secured by a Single Beneficiary Trust**

Paragraph (e)(5) requiring that an unauthorized reinsurer of a domestic ceding insurer must appoint an agent for service of process and submit to California jurisdiction has been deleted.

Subdivision (i) relating to the conditions for permitting credit for reinsurance claimed by foreign insurers has been deleted and moved without substantive revision to §2303.10.

**§2303.8 Credit for Reinsurance Secured by Letter of Credit**

Former paragraph (c)(7) requiring that California law must govern a letter of credit issued to a domestic insurer has been deleted.

Former subdivision (d) giving the Commissioner the discretion to allow a letter of credit issued to a domestic insurer to be governed by the law of another state if he determines that state's law on letters of credit is substantially similar to California law has been deleted.

Subdivision (f) requiring that an unauthorized reinsurer must appoint an agent for service of process and submit to California jurisdiction has been deleted.

Subdivision (h) relating to the conditions for permitting credit for reinsurance claimed by foreign insurers has been deleted and moved without substantive change to §2303.10.

**§2303.9 Credit for Reinsurance Secured by Funds Withheld**

Subdivision (b) has been revised to allow funds withheld for the purpose of claiming statement credit to be deposited in an escrow or trust account if either (1) the ceding insurer has the sole right to withdraw the funds or (2) the funds are held to secure a cession to an affiliate. The subdivision provides that the form of the trust or escrow agreement shall be satisfactory to the Commissioner.

Former subdivision (c) relating to the conditions for permitting credit for reinsurance claimed by foreign insurers has been deleted and moved without substantive change to §2303.10.

**§2303.10 Credit for Reinsurance of Foreign Insurers**

Subdivision (a) has been revised for clarity to specify that credit for reinsurance will not be allowed a foreign insurer unless the reinsurance agreement meets the applicable requirements of §2303.11 through §2303.13 of this article as well as the requirements of CIC §923.

Subdivision (b) has been revised for clarity to emphasize that credit for reinsurance allowed by a foreign insurer's home state shall not be denied unless the Commissioner has made the finding authorized by CIC §922.6(b).

Former subdivision (c) has been relabeled as (d) and revised to clarify that the unauthorized reinsurer evaluated in the review of a claim for statement credit pursuant to CIC §922.6(b) need only meet the *financial standards* for licensing or accreditation in California.

The Commissioner and the industry supported legislation, AB 2400, to, *inter alia*, amend CIC §922.6(b) to clarify that an unauthorized reinsurer need only meet the "financial" condition of licensed or accredited reinsurers, and to clarify that security provided for reinsurance need only meet the California standards for like security "in substance." AB 2400 was passed by the California Legislature unanimously on August 28, 2006, and is awaiting the signature of the Governor. There is no known opposition to the bill. The Commissioner expects that on or before September 30, 2006 the Governor will sign the bill.

Former subdivision (d) has been relabeled as (c) and revised to clarify that the Commissioner will request information from a foreign insurer concerning a claim for statement credit only if he has a reason to question the claim.

**§2303.11 Transfer of Risk - Life & Disability**

Paragraph (c)(7) has been revised to conform to the revisions to §2303.9(b). The paragraph allows statement credit and recognizes risk transfer for funds withheld and deposited in an escrow or trust account if either (1) the reinsurer is an affiliate of the ceding insurer, or (2) the ceding insurer has the sole right to withdraw funds from the account. The paragraph provides that the form of the trust or escrow agreement shall be satisfactory to the Commissioner.

Former subdivision (i) has been relabeled as subdivision (k) and revised to narrow the scope of review to determine risk transfer; the Commissioner may review all contracts between the ceding insurer, its affiliates and the reinsurer.

New subdivision (i) has been added to require that both parties must execute the agreement, amendment or letter of intent not later than the "as of date" of the first financial statement claiming credit for the reinsurance.

New subdivision (j) has been added to require that a reinsurance agreement shall expressly state that it constitutes the entire agreement between the parties and that there are no understandings between the

parties except as expressed in the agreement. The subdivision allows the entire agreement clause to state that it shall not be construed to limit the admissibility of evidence concerning the formation, interpretation, purpose or intent of the agreement.

### **§2303.12 Transfer of Risk - Property & Casualty**

Subdivisions (a) and (b) have been combined to clarify that transfer of risk shall be determined by application of the requirements of the NAIC Accounting Guidance, and that the Commissioner may review all contracts between the ceding insurer, the reinsurer and their respective affiliates to evaluate provisions which may limit the amount of risk assumed by the reinsurer or delay the timely reimbursement of claims by the reinsurer.

Former subdivision (c) relating to the manner of denial of statement credit has been relabeled subdivision (b) and revised for clarity without substantive change.

### **§2303.13 Contract Requirements for Statement Credit**

New subdivision (a) clarifies that credit for reinsurance may be claimed only for agreements that meet the requirements of this section.

Former subdivision (a) has been relabeled subdivision (b) and revised to state that a reinsurance agreement of a domestic insurer or volume insurer covering property and casualty business shall expressly state that it constitutes the entire agreement between the parties. The subdivision now also provides that the entire agreement clause may state that it shall not be construed to limit the admissibility of evidence concerning the formation, interpretation, purpose or intent of the agreement. All the remaining provisions of former subdivision (a) have been deleted.

Former subdivision (b) interpreted and implemented the unique language in the insolvency clause provisions in CIC §922.2(a)(2) as prohibiting offsets. The industry strongly disagreed with the interpretation. In order to provide uniformity as to financial statement credit and to avoid adverse affects on domestic insurers, the Commissioner and the industry agreed to support AB 2400 to conform the statute to the same insolvency clause requirement as that used in the other 49 states. AB 2400 passed the California Legislature unanimously on August 28, 2006, and is awaiting the signature of the Governor. There is no known opposition to the bill. The Commissioner expects that the Governor will sign the bill on or before September 30, 2006.

Former subdivision (b) has been relabeled as subdivision (d) and revised to require insolvency clauses in the agreements of all licensed insurers. It states that the insolvency clause in the reinsurance contracts of domestic insurers shall comply with the requirements of CIC §922.2(a)(2); the specific contract provisions required to meet the "in substance" requirement of the statute have been deleted. The revised subdivision also states general insolvency clause requirements to be included in the reinsurance agreements of foreign insurers, including that payment to a receiver shall be made without diminution because the receiver has failed to pay a claim, and allowing the reinsurer to intervene in a proceeding adjudicating the claim.

Former paragraph (a)(5) relating to NAIC Accounting Guidance requirements for statement credit has been relabeled as subdivision (e) and revised to delete the provision allowing the Commissioner to substitute a provision from the then current NAIC Accounting Guidance for requirements included in the subdivision, since the related requirements in the subdivision have been deleted.

Former subdivision (c) relating to the interpretation of the insolvency clause required by CIC §922.5(a)(2) has been deleted.

New subdivision (c) has been added to clarify that a volume insurer shall not be denied credit for reinsurance for failure to include an entire agreement clause in the agreement if either (1) it was not a volume insurer on the date of execution of the agreement, or (2) it was not a volume insurer in the year preceding execution of the agreement, and the agreement was executed within 120 days of the "as of" date of the insurer's most recent annual statement.

Former subdivision (f) has been relabeled as subdivision (g) and revised to clarify that any denial of statement credit shall be made in the manner prescribed in §2303.19(c).

New subdivision (f) has been added to except facultative certificates from the "entire agreement" requirement now included in subdivision (b) of this section.

**§2303.14 Form of Agreements**

New subdivision (a) has been added to explain that the failure to include a contract provision required by this section does not result in a denial of statement credit, but rather a determination that the contract is deficient as to form. It also specifies that one or more deficient reinsurance contracts may result in a determination that the insurer's reinsurance arrangements are materially deficient for purposes of CIC §§700(c) and 717(d).

Former subdivisions (a) and (b) have been relabeled as subdivision (b) and were revised to apply to all licensees (instead of only domestic and volume insurers) and to require two contract provisions in specified circumstances. All the paragraphs of former subdivision (a) have been deleted. Former paragraph (b)(4) has been relabeled as paragraph (b)(1) and specifies requirements if the agreement contains an "early termination" clause, including the requirement that prior notice of at least sixty days is required if the early termination is by the reinsurer. Former paragraph (b)(5) has been relabeled paragraph (b)(2) and specifies requirements if the agreement provides for payments between the parties to be transmitted through an intermediary, including specific contract language placing the risk of loss by a defaulting intermediary upon the reinsurer. The remaining paragraphs of former subdivision (b) relating to required contract provisions and the establishment of an escrow account for unpaid reinsurance receivables have been deleted.

Former subdivision (c) that pertained to the escrow account required by subdivision (b)(6) was deleted (subdivision (b)(6) was also deleted).

New subdivision (c) has been added to clarify that the reinsurance agreement of a volume insurer shall not be determined to be deficient as to form for failure to meet the requirements of this section if either (1) it was not a volume insurer on the date of execution of the agreement, or (2) it was not a volume insurer in the year preceding execution of the agreement, and the agreement was executed within 120 days of the "as of" date of the insurer's most recent annual statement.

Former subdivision (d) that pertained to the escrow account required by subdivision (b)(6) was deleted (subdivision (b)(6) was also deleted).

New subdivision (d) has been added to provide that the reinsurance arrangements of a domestic or volume ceding insurer may be materially deficient for purposes of CIC §§700(c) and 717(d) if (1) the arrangements include one or more deficient reinsurance agreements and (2) the aggregate amount of business ceded under the deficient agreements equals or exceeds 25% of the insurer's business.

Former subdivision (e) relating to agreements that were not subject to the requirements of former subdivisions (a) or (b) has been deleted.

New subdivision (e) has been added to provide that facultative certificates need not comply with the requirements of relabeled subdivision (b).

Former subdivision (f) relating to additional provisions in reinsurance agreements has been deleted.

New subdivision (f) has been added to provide that this section shall not be construed as stating the only bases for a determination that a reinsurance agreement is deficient or that reinsurance arrangements are materially deficient.

Former subdivision (g) relating to consent for an agreement not in compliance with this section has been deleted.

**§2303.15 Oversight of Reinsurance Transactions**

Subdivision (a) has been revised to expressly list the factors from CIC §1215.5(f) that are considered in evaluating whether the policyholder surplus of a licensee is reasonable in relation to its outstanding liabilities and is adequate to its financial needs.

Former subdivision (b) has been relabeled as subdivision (c) and has been revised as follows: The definitions of "total premium" and "total liabilities" were moved to new subdivision (h). The definition of "one party" has been revised to make clear that the reference to a "group of insurers" means a group of *affiliated* insurers, and the definitions of "assumption" and "sale" and "purchase" that were included in former subdivision (e) have been moved to this subdivision.

Former subdivision (c) has been relabeled as subdivision (d) and was revised for clarity and to delete the definitions of "assumption" and "sale" and "purchase" which were moved to relabeled subdivision (c).

Former subdivision (d) has been relabeled as subdivision (e) and was revised to apply to all licensees (instead of only domestic and volume insurers) and to expressly state that a licensee that enters a transaction involving 75% or more of its business without obtaining the Commissioner's prior consent is subject to the initiation of a receivership proceeding. The subdivision also provides instructions specifying how to apply for consent to the transaction. The subdivision permits a licensee that is exempt from registration under the Insurance Holding Company System Regulatory Act (CIC §1215, *et seq.*, hereinafter "HCA") to make a limited "notice" filing of a reinsurance transaction with an affiliate and provides that the Commissioner's consent to the transaction shall be deemed to have been given if he has not objected within 90 days of receipt of the notice filing.

Former subdivision (e) relating to licensees that were not subject to the requirements of former subdivision (d) has been deleted.

Former subdivision (f) has been relabeled as subdivision (b) and revised to require that except for cessions to affiliates, domestic insurers and volume insurers shall retain at least 10% of direct premium written per line of business unless the Commissioner has consented to a lesser percentage. The subdivision also provides instructions to apply for consent to a lesser percentage and states that an application for consent shall satisfy any filing requirement for the transaction required by CIC §1215.5 (b)(3).

Former subdivision (g) has been relabeled as subdivision (f) and revised to provide that the 100% cession calculation is based on direct written premium instead of total premium. The reference to former subdivision (j) has been deleted and the subdivision has been revised to state that the Commissioner may condition consent on including provisions within the reinsurance agreement that the Commissioner deems necessary to protect the ceding insurer.

Former subdivision (h) has been relabeled as subdivision (g) and revised to apply to all licensees, except for filings made pursuant to CIC §§1011.5 or 1215.5(b)(3), and affiliate transactions if the licensee is exempt from registration under the HCA. The subdivision provides that the transaction shall be deemed to be not objectionable if the Commissioner has not objected within 90 days of its receipt.

New subdivision (h) has been added to define the terms "total premium" and "total liabilities". The definition of "total liabilities" includes the same items listed in §2303.5(g) with respect to the liabilities of multiple beneficiary trusts. The definition of "liabilities." that was previously included in §2303.2 has been moved to this subdivision.

Former subdivision (i) relating to filing procedures has been deleted.

Former subdivision (j) has been relabeled as subdivision (i) and revised for clarity. The subdivision now provides that the Commissioner may condition consent to a transaction of a domestic or volume insurer which involves 50% or more of its business by requiring the reinsurance agreement to include provisions the Commissioner deems necessary to protect the ceding insurer. The specific conditions listed for possible inclusion in a reinsurance agreement have been deleted.

Former subdivision (k) has been relabeled as subdivision (j) and revised to apply only to transactions involving 50% or more of the business of a domestic or volume insurer, and to permit the submission of specified financial documents by the intermediary in lieu of an examination report. The subdivision provides that if the Commissioner conditions consent to the payment arrangement upon the receipt of a satisfactory examination report of the intermediary, then the transmission of payments through the intermediary shall be deemed to be non-objectionable if the Commissioner has not objected on the grounds of an unsatisfactory examination report within 180 days after issuing the conditional consent.

New subdivision (k) has been added to provide for the coordination of reviews of transactions with other interested state regulators, and to require coordination where the transaction involves 75% or more of the licensee's business and the licensee is exempt from registration under the HCA.

Former subdivision (l) has been relabeled as subdivision (m) and revised for clarity to specify that proposed amendments to agreements that must be filed prior to execution include agreements that have been approved as well as agreements to which an objection was not issued. A copy of the prior consent, approval or non-objection letter must now be submitted with the proposed amendment. The terms

"consent" and "non-objection" are defined. The subdivision now includes a provision that no new application or filing need be made concerning the amendment if the Commissioner has not responded within 30 days of its receipt, however, the Commissioner retains the right to object to the amendment upon a subsequent renewal or amendment of the agreement.

New subdivision (l) is added to specify procedures relating to denials of consent or objections to transactions. The Department is required to issue a finding explaining the reasons for the determination. The determination may be appealed to the Chief of the Financial Surveillance Branch in a manner consistent with making a request for a permitted accounting practice, which is a standard industry procedure.

Former subdivision (n) has been relabeled as subdivision (r) and revised for clarity without substantive change.

New subdivision (n) has been added to clarify that an amendment that is subject to prior review under subdivision (m) does not include a "special acceptance" which is defined as the extension of a reinsurance contract to embrace a specific risk that is not automatically included in the reinsurance agreement.

Former subdivision (p) has been relabeled as subdivision (o) and revised for clarity without substantive change.

New subdivision (p) has been added to provide that this article shall not be construed as limiting the type of reinsurance arrangements that may be determined to be materially deficient for purposes of CIC §717(d).

#### **Former §2303.16 Attestation Requirements**

Former §2303.16 has been deleted in its entirety.

#### **New §2303.16 List of Volume Insurers**

New subdivision (a) clarifies that the definition of "volume insurer" uses the same threshold test as that used for a "commercially domiciled" insurer under the HCA, but is not limited to members of holding company systems. New subdivision (b) provides that the Department shall publish on its public website by April 15 of each year a list of each licensee that has attained the status of volume insurer or commercially domiciled insurer for the year.

#### **§2303.17 Examination of Reinsurance Intermediaries**

Former subdivision (a) has been relabeled as subdivision (b). It has been revised for clarity and to delete the requirement for an intermediary to submit internal audit reports.

Former subdivision (b) has been relabeled as subdivision (c) and has been revised for clarity without substantive change.

Former subdivision (c) and (h) have been combined and relabeled as subdivision (a) and revised for clarity to provide that the Commissioner may examine an intermediary whenever he deems necessary or upon receipt of an application as provided for in the section.

Subdivision (d) has been revised to shorten the time from 30 days to 15 days for an intermediary to comment upon an examination report. The time for the Commissioner to adopt or reject an examination report was reduced from 30 days to 15 days.

Former subdivision (e) has been relabeled as subdivision (f) and revised to clarify that the examination expense shall be borne by the intermediary, unless an insurer has requested the examination, in which case it shall be at the expense of the insurer.

**Former §2303.18 Commissioner's Discretion**

The entire text of this section was moved to §2303.20.

**New §2303.18 Reporting of Regulatory Action**

The requirement in §§2303.3 and 2303.4(a) requiring reporting of regulatory actions were combined and moved to this section without substantive change.

**§2303.19 Denial of Statement Credit and Non-Admission of Assets**

Subdivision (c) was revised so that the Department and not the Commissioner shall issue the finding upon a determination of a denial of credit for reinsurance.

Subdivision (e) was added to require a foreign insurer to report any variance between the credit it claims for reinsurance in California and the credit it claims for reinsurance in its home state. The variance shall be reported on a form prescribed by the Department in the annual statement instructions. The subdivision provides that the Department may consider the variance in all financial strength evaluations of the insurer, including, but not limited to, whether to restrict the insurer's writing of new business in California.

**Former §2303.20 Sanctions for Non-Payment of Reinsurance**

The entire text of this section was deleted.

**Renumbered §2303.20 Commissioner's Discretion**

The text of former §2303.18 was moved to this section. One of the conditions for granting a waiver to a requirement under this article was changed; the condition that the variance request not be material was changed to provide that the variance request must be reasonable and justifiable in relation to the insurer's overall financial condition.

**§2303.21 Insurer Default for Failure to Comply**

Subdivision (a) was revised for clarity without substantive change. Subdivision (b) was deleted in its entirety.

**§2303.22 Required Deposits, Fees and Filing Offices**

The section was revised without substantive change for clarity, organization and to further specify procedures for the various applications or filings.

**§2303.24 Effective Date**

Subdivision (a) has been revised to change the Effective Date. In the Notice of Availability of Revised Text mailed June 14, 2006, subdivision (a) of this section was revised to provide an Effective Date of October 1, 2006, except that compliance with §§ 2303.7, 2303.8, 2303.13 and 2303.14 was not required until January 1, 2007. In the Notice of Availability of Revised Text mailed August 24, 2006, subdivision (a) of this section was revised to make January 1, 2007 the Effective Date for all Sections.

Subdivision (b) has been revised to provide that the regulations apply only to new or renewal agreements executed on or after the Effective Date.

Subdivision (c) has been revised to provide that all reinsurance agreements executed prior to the Effective Date shall continue to comply with Bulletin 97-5.

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