

DEPARTMENT OF REGULATORY AGENCIES

Division of Insurance

3 CCR 702-3

REPEALED IN FULL REGULATION 3-3-2

CEDING REINSURANCE AGREEMENTS

I AUTHORITY

This regulation is promulgated under the authority of §§ 10-1-109(1), 10-3-118(7), 10-3-529(4), 10-6-129, 10-14-505 and 10-16-109 and provides standards regarding reinsurance agreements under §§ 10-3-118, 10-6-122, 10-11-119, 10-14-304, 8-44-204, 8-44-205, 8-45-121, 24-10-115.5, and 29-13-102, C.R.S.

II PURPOSE

Section 10-3-118, C.R.S. provides that a ceding insurer may establish an asset or reduce the amount of liabilities it must otherwise establish on its financial statements for its policy or contract obligations as a result of reinsurance, when the reinsurer is obligated to indemnify the ceding insurer for liabilities reinsured under a reinsurance agreement. It is improper for a ceding insurer to reflect an asset(s) or to reduce its liability(ies) for reinsurance arrangements if, in substance or effect, the expected potential liability of the ceding insurer remains basically unchanged by the reinsurance transaction, notwithstanding certain risk elements in the reinsurance agreement, such as catastrophic mortality or extraordinary survival.

The purposes of this regulation are to establish filing requirements for ceding insurers, and to establish requirements for acceptable reinsurance agreements to ensure that ceding insurers operate in a sound financial manner, correctly report their financial condition on required financial statements, and properly reduce liabilities or establish assets for reinsurance ceded. This will protect the ceding insurer's policy and contract holders and the people of this state.

III SCOPE

This regulation shall apply to all ceding (indemnity) reinsurance agreements entered into by Colorado domestic insurers. This regulation shall not apply to reinsurance agreements for the assumption of business pursuant to § 10-3-701, et seq., C.R.S.

IV DEFINITIONS

As used in this regulation and unless the context requires otherwise:

“Absolute transfer of risk” means the ceding of risk or liability in such a manner that there is no reasonable likelihood that the ceding insurer will not be indemnified for the risk or liability assumed by the reinsurer under the terms of the reinsurance agreement.

“Authorized reinsurer” means any insurer licensed or approved as a reinsurer in Colorado to write the type of risks transferred by the reinsurance agreement.

“Credit quality risk” means the risk that invested assets supporting the reinsured business will decrease in value. The main hazards are that assets will default or that there will be a decrease in earning power. It excludes market value declines due to changes in interest rates.

“Date of execution” means the date of the last party’s signature on a reinsurance agreement.

“Disintermediation risk” means the risk that interest rates will rise and policy loans and surrenders will increase or maturing contracts will not renew at anticipated rates of renewal. If asset durations are greater than the liability durations, the mismatch will increase. Policyholders will move their funds into new products offering higher interest rates. The company may have to sell assets at a loss to provide for these withdrawals.

“Excluded agreements” means yearly renewable term, or certain nonproportional reinsurance such as stop loss and catastrophic reinsurance, which are issued by life insurers or fraternal benefit societies.

“Insurer” means an insurance company; fraternal benefit society; title insurance company; captive insurance company; licensed self insurance pool; Colorado Compensation Insurance Authority; health maintenance organization; or a non-profit hospital, medical-surgical and health service corporation.

“Lapse risk” means the risk that a policy will voluntarily terminate prior to the recoupment of any statutory surplus strain experienced at issue of the policy.

“Reinsurance agreement” means any treaty, contract or amendment(s) to any treaty or contract, including any notice of termination, where some element of risk, contained in an underlying insurance contract(s) or insurer obligation(s), is transferred from a primary (ceding) insurer to a reinsuring (assuming) insurer (reinsurer) in return for some consideration.

“Reinvestment risk” means the risk that interest rates will fall and funds reinvested will therefore earn less than expected. If asset durations are less than liability durations, the mismatch will increase.

“Reserve” means the statutory balance sheet liability(ies) established to support underlying insurance obligations.

“Reserve credit” means any statutory balance sheet credit taken by the ceding insurer, whether as an asset or as a deduction from liability, on account of reinsurance ceded.

V FILING REQUIREMENTS

- A. All ceding insurers are required to submit the following filings, which shall be directed to the Corporate Affairs Section of the Colorado Division of Insurance.
1. All ceding insurers, excluding pure captive insurance companies and licensed public entity self insurance pools, shall file a summary sheet(s) prescribed by the Commissioner (form available upon request from the Corporate Affairs Section of the Division of Insurance), executed by an officer or responsible individual of the ceding insurer, for each ceded reinsurance agreement within 30 calendar days of execution. This filing requirement shall not apply to excluded agreements or facultative cessions, unless such facultative cession also modifies any terms or conditions of an underlying reinsurance agreement.
 2. If one or more of the following conditions occur, the filing must include: i) the reinsurance agreement, ii) the required summary sheet, as referenced in Section V(A)(1) above, and iii) a summary of the financial impact of the transaction on the ceding insurer, sufficient for the Commissioner to understand the transaction, which includes the impact on the ceding insurer’s balance sheet, surplus account(s), and income statement:
 - a. the proposed reinsurance transaction meets the conditions of § 10-3-805(4)(a)(III), C.R.S. The filings must be made at least 30 calendar days prior to its date of execution. This filing, if accompanied by the information and form

prescribed by Colorado Insurance Regulation 3-4-1, shall comply with the filing requirements of both Colorado Insurance Regulations 3-4-1 and 3-3-2;

- b. the proposed reinsurance transaction has an effective date prior to the date of the most recently filed annual statement. The insurer must receive written approval from the Commissioner prior to implementation of such transaction. The financial impact information shall include the effect of the transaction at both the date of execution and at the date of the prior annual financial statement. Approval may require the ceding insurer to amend any previously filed financial statement(s) and file such amended statement(s) in all states in which the original statement had been filed;
 - c. the reinsurance transaction transfers existing business or risks. The agreement or binding commitment, whichever is applicable, shall be filed within 30 calendar days after its date of execution. For life insurers and fraternal benefit societies, existing business is defined as business written in a calendar year prior to the year of execution of the agreement or adoption of a binding commitment to effect a reinsurance agreement. For other insurers, existing business or risk is defined as retroactive reinsurance contracts as defined in the NAIC Accounting Practices and Procedures Manual, and any exposure to a loss, whether known or unknown, in effect prior to the date of execution of the agreement, for exposures which would exceed the insurers maximum retention as defined by Section 10-3-102(3), C.R.S. The cession of existing business requires additional accounting requirements and limitations as set forth in Appendix A; or
 - d. the reinsurance transaction, other than excluded agreements, results in a net increase to the ceding insurer's surplus upon execution and settlement as of the effective date of the agreement. The filing shall be made within 30 calendar days after its date of execution.
3. A ceding insurer shall file an annual summary of all ceding reinsurance agreements within 20 calendar days of request by the Commissioner. The annual summary shall identify: each reinsurer; each reinsurance agreement by the unique identifying number as set forth in Section VII.A.2.; the type of agreement; the in-force business or premiums written on each agreement; and any reserve credits taken on the annual financial statement filed (suggested format contained in Appendix C). The reserve credits included in the annual summary must include all reinsurance credits taken whether or not they are detailed or disclosed on ceded reinsurance schedules of the annual financial statement. This summary is in addition to any reinsurance schedules contained within the annual financial statement filed.
- B. The following penalties shall apply:
- 1. ceding insurers failing to comply with the filing requirements of Sections V.A.1. or V.A.2. may be assessed up to a \$500.00 penalty for an initial violation and up to \$5,000.00 for each subsequent violation; and
 - 2. ceding insurers filing annual summaries required by Section V.A.3. which are received after the required filing date may be assessed a penalty up to \$100.00 per day for each day after the date the summary is due.

VI RESERVE CREDITS, ADJUSTMENTS AND LIMITATIONS

All ceding insurers are responsible for establishing appropriate statutory gross reserves and reflecting appropriate reserve credits, if any, for reinsurance ceded. A reinsurance agreement which does not

comply with this regulation will be considered as a valid contract, unless terminated or voided by the parties to the agreement, where all terms and obligations are in effect, but no reserve credit is permitted to be taken by the ceding insurer. The ceding insurer shall comply with the applicable provisions of law and this regulation before taking any reserve credits in any statutory financial statement for any particular reinsurance agreement. The filing of information or agreements with the Commissioner pursuant to this regulation does not relieve the insurer from this responsibility, nor does compliance with the filing requirements imply approval by the Division of Insurance of the terms of an agreement.

- A. A ceding insurer may take appropriate reserve credits for reinsurance ceded in any statutory financial statement filed with the Commissioner if:
1. the reinsurance agreement, or other evidence that coverage is bound, has been executed by all necessary parties and is in effect on the "as of date" of the financial statement. If other evidence that coverage is bound is used, the ceded reinsurance agreement must then be executed within a reasonable period of time; for life insurers and fraternal benefit societies this time must not exceed ninety (90) calendar days beyond the execution of the evidence of coverage;
 2. the reinsurance agreement results in the absolute transfer of risk or liability to the reinsurer for the portion of the business reinsured; and
 3. the reinsurance agreement contains all required clauses or provisions as set forth in Section VII. and does not contain any prohibited provisions indicated in Section VI.B. below.
- B. A ceding insurer shall not take any reserve credit, whether secured by methods provided in Section 10-3-118(6), C.R.S. or otherwise, for reinsurance ceded in any statutory financial statement filed with the Commissioner, if by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist. Paragraphs 1, 2, 3, 4, 6, 9 and 10 of this Subsection B shall not apply to excluded agreements.
1. The reinsurance agreement for life or health risks does not transfer to the reinsurer the liability of all the significant risks inherent in the portion of the underlying business being reinsured. Significant risks include mortality, morbidity, lapse, credit quality, reinvestment, and disintermediation. Paragraph A of Appendix B provides examples of which risks are generally considered to be significant for a variety of products;
 2. For life or health risks, the credit quality, reinvestment or disintermediation risk is significant for the business reinsured and the ceding company does not (other than for the classes of business exempted in Paragraph B of Appendix B): (i) transfer the underlying assets to the reinsurer; (ii) legally segregate such assets in a trust or escrow account; or (iii) otherwise establish a mechanism satisfactory to the Commissioner which legally segregates, by contract or contract provisions, the underlying assets;
 3. For other than life insurers or fraternal benefit societies, the reinsurance agreement does not transfer the timing and underwriting risks to the reinsurer;
 4. Life insurers or fraternal benefit societies are required to reimburse the reinsurer for losses or other negative experience under the reinsurance agreement. Neither offsetting experience refunds against current or prior years' losses, nor payment by the ceding insurer of an amount equal to current or prior years' losses upon voluntary termination of in-force reinsurance by the ceding insurer, shall be considered such a reimbursement to the reinsurer for negative experience. Voluntary termination does not include situations where termination occurs because of unreasonable provisions which allow the reinsurer to reduce its risk under the reinsurance agreement;

5. The ceding insurer can be deprived of surplus or assets (i) at the reinsurer's option; or (ii) automatically upon the occurrence of some event, such as the insolvency of the ceding insurer; or (iii) upon the unilateral termination or reduction of reinsurance coverage by the reinsurer or by terms of the reinsurance contract. The termination of the reinsurance agreement by the reinsurer for non-payment of reinsurance considerations in compliance with Section VII.A.5., or the prospective termination of the cession of risks not previously ceded shall not be considered to be such a deprivation;
 6. Accounting settlements are made less frequently than quarterly, or net payments due from the reinsurer have not been provided to the ceding insurer in cash or cash equivalents no later than ninety (90) calendar days from the date the payment is due, which due date shall not extend beyond the end of the accounting quarter covering such activity;
 7. The ceding insurer is required to make representations or warranties not reasonably related to the business being reinsured, or about future performance of the business being reinsured;
 8. The ceding insurer must, at specific points in time scheduled in the agreement, terminate or automatically recapture all or part of the business being reinsured;
 9. The reinsurance agreement involves the possible payment by the ceding insurer to the reinsurer of amounts other than from income realized from the business being reinsured. For example, it is improper for a ceding company to pay reinsurance premiums, or other fees or charges to a reinsurer, which are greater than the direct premiums collected by the ceding company for the business reinsured;
 10. The reinsurance agreement is entered into for the principal purpose of producing significant surplus aid for the ceding insurer, typically on a temporary basis, while not transferring all of the significant risks inherent in the business reinsured and, in substance or effect, the expected potential liability to the ceding insurer remains basically unchanged; or
 11. The reinsurance agreement contains provisions whereby the obligation of the assuming insurer to pay claims is conditioned upon some other event, such as being a condition precedent upon the notification of a claim or the payment of reinsurance considerations. This does not preclude the reinsurers ability to terminate the agreement for breach or default of contract terms, subject to the provisions of Section VII.A.4.
- C. The following situations require the establishment of additional liabilities or limitations to reserve credits taken by the ceding insurer.
1. The reserve credit taken by the ceding insurer on the coinsurance plan, or plans functionally equivalent to the coinsurance plan, shall not exceed the actual reserve established by the reinsurer;
 2. The ceding insurer shall not take any reserve credit in excess of the gross reserve it has established for the portion of the business or risks being reinsured;
 3. Where a reinsurer, or each individual reinsurer in the case of a pooling arrangement, is not an authorized reinsurer, the reserve credit shall not exceed the amount of any security provided pursuant to § 10-3-118(6), C.R.S.;
 4. In so far as the reinsurance transaction is a separate indemnity agreement providing for reimbursement of some of the ceding insurer's obligations, the reserve credit taken shall

be separately calculated using methods and principles governing reserve calculations and shall appropriately reflect, and not exceed, (i) the present value, if permissible, of the future benefits to be received by the ceding insurer from the reinsurer over (ii) the present value, if permissible, of the future considerations required to be paid to the reinsurer from the ceding insurer under the terms of the reinsurance agreement for the business being reinsured;

5. Where renewal expense allowances provided or to be provided to the ceding insurer by the reinsurer in any accounting period are not sufficient to cover anticipated allocable renewal expenses of the ceding insurer for the business being reinsured, a liability shall be established, or a reduction shall be made to the otherwise allowable reserve credit, for the present value of the shortfall (using assumptions equal to the applicable statutory reserve basis on the business reinsured). Allocable renewal expenses include commissions, premium taxes and direct expenses including, but not limited to, billing, valuation, claims and maintenance expenses, which shall include an allocation for such things as salaries, computer usage, etc., expected by the ceding company at the time the business is reinsured. This provision shall not apply to excluded agreements;
6. A reinsurance agreement is not required to transfer all contract benefits contained in the underlying business reinsured. Transfer of less than all contract benefits is permitted if the reinsurance agreement is otherwise in compliance with this regulation and the benefits being reinsured: (i) are independent, distinct and severable from the contract benefits not transferred, and (ii) the reserves, and therefore the reserve credit available to be taken by the ceding insurer, for the benefits transferred are independently calculated, distinct and severable from the reserves of the remaining contract benefits not transferred;
7. If commissions or other similar allowances received or credited to the ceding insurer are required to be repaid to the reinsurer, other than from emerging profits of the portion of the business reinsured, based on contract provisions or on future experience of the reinsured business, a liability shall be established or reserve credit reduced by the maximum amount of such future tentative repayment; or
8. If the reinsurance agreement provides for financial guarantees by the ceding insurer to the reinsurer, a liability shall be established for the present value of such guarantee (using assumptions equal to the applicable statutory reserve basis on the business reinsured).

VII REINSURANCE AGREEMENT

- A. To qualify for reserve credit, all reinsurance agreements entered into by ceding insurers shall:
 1. set forth the names of all parties to the agreement and be executed by necessary officers, or authorized representatives, of each party to the agreement;
 2. be identified by a unique number with any amendment referencing the same unique number as the agreement to which it attaches;
 3. contain an insolvency clause as required by §§ 10-3-118(3)(b) and (8), C.R.S.;
 4. not allow for a unilateral cancellation by the action of the reinsurer as to previously ceded risks without 90 calendar days advance written notice to the Commissioner. Unilateral termination by the reinsurer of previously ceded risks is only permitted for non-payment of reinsurance considerations by the ceding insurer. This provision does not restrict the recapture or commutation of previously ceded risks with the mutual consent of both

parties. Upon a formal finding of insolvency of the ceding insurer, the required notification period to the Commissioner of cancellation shall be 60 calendar days:

5. clearly indicate in any termination or cancellation provision within an agreement whether the termination or cancellation affects new and/or existing business;
 6. contain a clause which states that all provisions, including arbitration, of the agreement are subject to the laws of the State of Colorado; and
 7. for other than excluded agreements, contain a clause which states that the agreement constitutes the entire agreement between the parties with respect to the business being reinsured thereunder and that the obligations of the parties are determined solely by the terms of the agreement. Any change or modification to the agreement shall be made by written amendment to the agreement and signed by both parties.
- B. All ceding insurers of property, casualty or title risks shall provide immediate notification to the Commissioner upon the exhaustion or impending exhaustion of any reinsurance coverage which is necessary for the ceding insurer to comply with the provisions of § 10-3-102(3), C.R.S.
- C. Reinsurance agreements may permit parties to the agreement to offset mutual debts and credits, subject to the following limitations, and provide that only the balance be paid. In the event of liquidation, offset is permitted to the extent that:
1. a reinsurer may offset, against undisputed amounts which are due and payable to the insurer, only those undisputed amounts due the reinsurer which are not more than 180 calendar days past due on the date of the court order of liquidation;
 2. no offset shall be permitted between any assumed and ceded risks and/or obligations where there is a retrocession of substantially the same risks and obligations by the reinsurer back to the original ceding insurer;
 3. pursuant to the provisions of § 10-3-529, C.R.S., offsets of mutual debts and credits will be allowed to occur within or between one or more reinsurance agreements. Offset of amounts due and payable between assumed and ceded reinsurance agreements shall be allowed if at the time of the cession to the Colorado domestic reinsurer:
 - a. the Colorado domestic reinsurer has surplus at least equal to \$20,000,000: or
 - b. the Colorado domestic reinsurer has surplus of less than the amount determined by Section VII.B.3.a. above, has filed the reinsurance agreement with the Commissioner, and has received written approval prior to executing the agreement. Any filing for approval shall include a current financial statement of the reinsurer and a summary of the type of risks, individual and maximum aggregate exposure of the underlying policies, explanation of the underwriting, feasibility or actuarial analysis of the risks, any actual past experience, actuarial analysis of the stability or volatility of such risks and the methods and assumptions and confidence levels of the reserves to be established and a description of the proposed settlement practices under the contract; and
 4. no reinsurer of life, annuity, health, accidental death or disability ceded business shall exercise any contract provision for capture or ownership of such business, or claim offset or credit by reason of loss of such contract rights, upon the entry of an order of rehabilitation or liquidation of the ceding insurer.

VIII LETTERS OF CREDIT

- A. Letters of credit provided by a reinsurer which have been issued to comply with the provisions of § 10-3-118(6), C.R.S. to enable the ceding insurer to take any reserve credit for reinsurance agreements complying with the provisions of this regulation and which are placed with a reinsurer that is not an authorized reinsurer, shall comply with the following requirements.
1. The letter of credit shall be issued or confirmed by a qualified United States financial institution, as defined in § 10-1-102(9.5), C.R.S.;
 2. The letter of credit must be an unconditional letter of credit which must vest in the ceding insurer an unconditional right to recover thereon;
 3. The letter of credit must expressly provide that it is clean and irrevocable and that it cannot be reduced, modified (other than renewed or increased) or revoked without the consent of the ceding insurer;
 4. The letter of credit must contain an "evergreen clause" which prevents expiration of the letter of credit without some affirmative action by the issuer: the letter must be for a term of not less than one year and must provide that it will be automatically extended for the period of time stated in the original letter, unless, prior to the end of the term, the issuer has given the ceding insurer, the reinsurer and the Commissioner not less than 30 days notice of non-renewal by certified mail, registered mail or hand delivery;
 5. The letter of credit must contain a statement to the effect that the obligation of the issuer under the letter of credit is in no way contingent upon reimbursement with respect thereto;
 6. The ceding insurer must be the named beneficiary on the letter of credit: and
 7. The letter of credit must provide that the issuer shall pay upon presentation of a written notice of default and demand for payment by the beneficiary.
- B. Only one amount may appear on the face of the letter of credit; however, the amount of the letter may decrease by formula or follow the terms of the reinsurance agreement.
- C. Any expiration date must be clearly noted on the face of the letter and must set forth a specific month, day and year on which the letter will expire.
- D. The letter of credit must be issued and remain in full effect at any time reserve credits are taken in order to secure credit.
- E. The letter of credit may be held under a trust account to be drawn on for the ceding insurer's benefit as specified in the reinsurance agreement.
- F. The letter of credit may include other provisions or requirements not specifically referenced herein, so long as such provisions do not conflict, change, or alter the requirements of this regulation.

IX TRUST ACCOUNT

- A. A trust agreement, establishing a trust account to comply with the provisions of § 10-3-118(6), C.R.S., to enable the ceding insurer to take any reserve credit for reinsurance agreements complying with the provisions of this regulation placed with a reinsurer that is not an authorized reinsurer, shall be entered into between the ceding insurer, the reinsurer, and a trustee which is a qualified United States financial institution, as defined in § 10-1-102(9.5), C.R.S.

- B. The trust agreement shall create a trust account into which the assets shall be deposited.
- C. The trust agreement shall:
1. provide that the ceding insurer shall have the right to withdraw assets from the trust account at any time, without notice to the reinsurer, upon written notice to the trustee that the amounts withdrawn are owing and unpaid under the reinsurance agreement and that no other statement or document is required to be presented to withdraw assets; except that the ceding insurer may be required to acknowledge receipt of withdrawn assets;
 2. not be subject to any conditions or qualifications not contained within the trust agreement;
 3. be established for the sole benefit of the ceding insurer;
 4. prohibit invasion of the trust corpus for the purpose of paying compensation to, or reimbursing the expenses of, the trustee;
 5. provide that the trustee shall be liable for its own negligence, willful misconduct or lack of good faith;
 6. provide that the ceding insurer may undertake to use and apply amounts drawn upon the trust account, without diminution because of the insolvency of the ceding insurer or the reinsurer; and
 7. provide that assets deposited in the trust account shall be valued according to their current fair market value and shall consist only of cash, certificates of deposit issued by a United States bank and payable in United States legal tender, and investments of the types permitted for an insurer under Colorado statute, provided that such investments are not issued by the parent, subsidiary or affiliate of either the ceding insurer or the reinsurer, unless such investment is publicly traded. The agreement may further limit the types of investments to be deposited.
- D. The trust agreement shall require the trustee to:
1. receive assets and hold all assets in a safe place within the United States;
 2. determine that all assets are in such form that the ceding insurer, or the trustee upon direction from the ceding insurer, may whenever necessary negotiate any such assets without consent or signature from the reinsurer or any other person or entity;
 3. furnish to the reinsurer and the ceding insurer a statement of all assets in the trust account upon its inception and at intervals no less frequent than the end of each calendar quarter;
 4. notify the reinsurer and the ceding insurer in writing within ten calendar days, of any deposits to or withdrawals from the trust account;
 5. upon written demand of the ceding insurer, immediately take any and all steps necessary to transfer absolutely and unequivocally all rights, titles and interests in the assets held in the trust account to the ceding insurer and deliver physical custody of the assets to the ceding insurer;
 6. allow no substitutions or withdrawals of assets from the trust account, except on written instructions from the ceding insurer, except that the trustee may, without the consent of

but with notice to the ceding insurer, upon maturity of any trust asset, convert said asset and deposit the proceeds into the trust account; and

7. provide at least 30 calendar days written notice to the ceding insurer and to the Commissioner prior to termination of the trust agreement.

- E. The trust agreement shall be made subject to and governed by the laws of the state in which it is established.

X. EXCEPTIONS

A ceding insurer, with the prior written approval of the Commissioner, may have alternative terms or conditions in a reinsurance agreement, that are not otherwise in compliance with this regulation, if such alternatives are reasonably necessary for the protection of the public and the insured policyholders and substantially comply with the intent and provisions of this regulation.

XI. CONFIDENTIALITY

Filings and information submitted in compliance herewith shall generally be considered confidential by the Commissioner. All such information shall be given confidential treatment and shall not be made public by the Commissioner or any other person, except to insurance departments of other states or the National Association of Insurance Commissioners, without the prior written consent of the Colorado domestic ceding insurer. Notwithstanding the foregoing, if the Commissioner, after giving the ceding insurer written notice, determines that the interests of policyholders or the public will be served by disclosure, he may disclose all or any part thereof in such manner as he deems appropriate.

XII. SEVERABILITY

If any provision of this regulation or the application thereof to any person or circumstance is for any reason held to be invalid, the remainder of this regulation shall not be affected thereby.

XIII. EFFECTIVE DATE

This regulation, originally effective on December 1, 1990 and amended on October 1, 1992, is amended and restated in its entirety to be effective for all reinsurance agreements executed, or amended to include business not previously ceded, on or after March 2, 1995. Reinsurance agreements executed prior to March 2, 1995 shall be required to comply with the provisions of this regulation by December 31, 1995.

Repeal effective January 1, 2007.

APPENDIX A

ACCOUNTING FOR THE CESSION OF EXISTING BUSINESS OR RISKS

A. For life ceding insurers, any increase in surplus net of federal income tax resulting from the reinsurance of existing business or risks, shall be identified separately on the ceding insurer's statutory financial statement as a surplus item (aggregate write-ins for gains and losses in surplus in the Capital and Surplus Account, page 4 of the Annual Statement) and recognition of the surplus increase as income shall be reflected on a net of tax basis in the "Reinsurance Ceded" line, page 4 of the Annual Statement as earnings emerge from the business reinsured and shall not be available for distribution as dividends until such earnings emerge.

Example: On the last day of calendar year N, company XYZ pays a \$20 million initial commission and expense allowance to company ABC for reinsuring an existing block of business. Assuming a 34% tax rate, the net increase in surplus at inception is \$13.2 million (\$20 million - \$6.8 million) which is reported on the "Aggregate write-ins for gains and losses in surplus" line in the Capital and Surplus account. \$6.8 million (34% of \$20 million) is reported as income on the "Commissions and expense allowances on reinsurance ceded" line of the Summary of Operations.

At the end of year N+1 the business has earned \$4 million. ABC has paid \$.5 million in profit and risk charges in arrears for the year and has received a \$1 million experience refund. Company ABC's annual statement would report \$1.65 million (66% of (\$4 million - \$1 million - \$.5 million) up to a maximum of \$13.2 million) on the "Commissions and expense allowance on reinsurance ceded" line of the Summary of Operations, and - \$1.65 million of the "Aggregate write-ins for gains and losses in surplus" line of the Capital and Surplus account. The experience refund would be reported separately as a miscellaneous income item in the Summary of Operations.

B. For property and casualty ceding insurers, the surplus gain from any cession of existing loss reserves may not be considered earned surplus until such time as the actual liabilities transferred have been recovered or terminated. Specific accounting for retroactive reinsurance transactions is as indicated in the National Association of Insurance Commissioners Accounting and Procedures Manual.

C. For other ceding insurers, the accounting should be consistent with the intent of this appendix.

APPENDIX B

SIGNIFICANCE OF RISKS OF UNDERLYING PRODUCT CATEGORIES

A. The following provides a listing of the significance of risks for a variety of products. For products not specifically included, the risks determined to be significant shall be consistent with this table.

<u>Product Type</u>	Risk Category <u>a b c d e f</u>
Health Insurance - other than LTC/LTD	s i s i i i
Health Insurance - LTC/LTD	s i s s s i
Immediate Annuities	i s i s s i
Single Premium Deferred Annuities	i i s s s s
Flexible Premium Deferred Annuities	i i s s s s
Guaranteed Interest Contracts	i i i s s s
Other Annuity Deposit Business	i i s s s s
Single Premium Whole Life	i s s s s s
Traditional Non-Par Permanent	i s s s s s
Traditional Non-Par Term	i s s i i i
Traditional Par Permanent	i s s s s s
Traditional Par Term	i s s i i i
Adjustable Premium Permanent	i s s s s s
Indeterminate Premium Permanent	i s s s s s
Universal Life Flexible Premium	i s s s s s
Universal Life Fixed Premium (dump-ins allowed)	i s s s s s

LTC - Long Term Care Insurance
LTD - Long Term Disability Insurance

Risk Categories:

- a - morbidity
- b - mortality
- c - lapse
- d - credit quality
- e - reinvestment
- f - disintermediation

Risk:

- s - significant
- i - insignificant

B. Notwithstanding the requirements of Section VI.B.2., the assets supporting the reserves for the following classes of business and any classes of business which do not have a significant credit quality, reinvestment or disintermediation risk may be held by the ceding company without segregation of such assets:

- Health Insurance - LTC/LTD
 - Traditional Non-Par Permanent
 - Traditional Par Permanent
 - Adjustable Premium Permanent
 - Indeterminate Premium Permanent
 - Universal Life Fixed Premium
- (no dump-in premium allowed)

The associated formula for determining the reserve interest rate adjustment must use a formula which reflects the ceding insurer's investment earnings and incorporates all realized and unrealized gains and losses reflected in the statutory statement. The following is an acceptable formula:

$$\text{Rate} = 2 * (I + \text{CG}) / (X + Y - I - \text{CG})$$

where the following are taken from annual statement figures:

I is the net investment income

CG is capital gains less capital losses

X is the current year cash and invested assets plus investment income due and accrued less borrowed money

Y is the same as X but for the prior year.

APPENDIX C

SUGGESTED FORMAT FOR ANNUAL SUMMARY OF CEDED REINSURANCE AGREEMENTS

NAME OF CEDING INSURER_____

FOR YEAR ENDING_____

PREPARER'S NAME_____

PREPARER'S TITLE_____

Reinsurer		Contract			Reserve Credits Reported As:		
Name	NAIC#	Number	Effective Date	Type of Contract *	Amount in Force (Life), Account Value (Annuity) or Premium Ceded (P&C/A&H)	Assets	Liability Reductions

This suggested arrangement may contain subtotals by reinsurer, and any appropriate footnotes necessary for clarity.

*Life: use the categories and abbreviations contained in Schedule S, Part 3A of the NAIC Annual Statement Blank.

P&C: pro rata (PR), excess of loss (EX), catastrophe (CAT), facultative (FAC), other (OTH) should be footnoted and described. Facultative cessions may be aggregated and reported by reinsurer.