

DEPARTMENT OF REGULATORY AGENCIES

Division of Insurance

3 CCR 702-3

NEW REGULATION 3-3-5

PROPERTY AND CASUALTY REINSURANCE AGREEMENTS

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Section 1. Authority

This regulation is promulgated under the authority of §§ 10-1-109(1), 10-3-118(6), 10-3-529(4), 10-6-129, 8-44-205(a), 24-10-115.5, and 29-13-102, C.R.S.

Section 2. Scope and Purpose

- A. The Colorado Division of Insurance recognizes that licensed insurers routinely enter into reinsurance agreements for many legitimate purposes. These purposes can include relief to the ceding insurer from strain to surplus, and may legitimately limit the amount of risk transferred from the ceding company to the assuming company.
- B. However, it is improper for a licensed insurer to consider any contract as a reinsurance agreement if the principal purpose is not true risk transfer. 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 loss, the contracts violate:
 - 1. Section 10-3-109, C.R.S. relating to financial statements that do not properly reflect the financial condition of the ceding insurer;
 - 2. Section 10-3-118, C.R.S. relating to credit for reinsurance, thus resulting in a ceding insurer improperly reducing liabilities or establishing assets for reinsurance ceded; and
 - 3. Section 10-1-110(1)(i), C.R.S and regulation 3-1-7 relating to creating a situation that may be hazardous to policyholders and the people of this State.
- C. The purpose of this regulation is 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. These requirements are necessary to protect the ceding insurers' policy and contract holders and the people of the State of Colorado.

Section 3 Applicability

This regulation shall apply to all domestic property and casualty insurers; title insurers; captive insurers, Pinnacol Insurance, and pools. However, any accident and health business issued by these insurers is specifically excluded from this regulation, and is, instead, subject to the requirements of Colorado Insurance Regulation 3-3-4.

Section 4 Definitions

- A. "Annual Statement" means the NAIC convention blank property and casualty financial annual statement.
- B. "Credit for reinsurance" means any reduction of liability, establishment or asset or contra-liability, or any combination thereof.
- C. "Division" means the Colorado Division of Insurance
- D. "Financial Statement" means any monthly, quarterly or Annual Statement that is submitted to the Division.

Section 5 Accounting Requirements

All ceding insurers are responsible for establishing appropriate statutory gross reserves and reflecting appropriate credit, if any, for reinsurance ceded. A reinsurance agreement that does not comply with this regulation will be considered as a valid contract, unless terminated or voided by the parties to the contract, where all terms and obligations are in effect, but no credit for reinsurance 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 credit for reinsurance in any statutory financial statement for any particular reinsurance agreement.

- A. The essential element of a reinsurance agreement is the transfer of risk. Unless the agreement contains this essential element of risk transfer, no credit shall be recorded. Therefore, no insurer subject to this regulation shall, for reinsurance ceded, establish any credit for reinsurance in any financial statement filed with the Colorado Division of Insurance if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist:
 - 1. Single or multi year agreements in which the premium charged is, or can be reasonably assumed to be, equal to the present value of the maximum insured loss;
 - 2. The ceding insurer is required to make representations or warranties not reasonably related to the business being reinsured;
 - 3. The ceding insurer is required to make representations or warranties about future performance of the business being reinsured;
 - 4. The reinsurance agreement is entered into for the principal purpose of producing significant financial statement enhancement for the ceding insurer, typically on a temporary basis, while not transferring significant insurance risk under the reinsured portion of the underlying insurance agreement and, in substance or effect, the expected potential liability to the ceding insurer remains basically unchanged;

5. Provisions exist whereby the obligation of the assuming insurer to pay claims is conditioned upon some event or situation unrelated to the performance of the underlying business and were not taken into account in the risk transfer analysis. These provisions include such situations as the payment of reinsurance considerations, or performance under a separate contract or agreement being a condition precedent to the payment of claims. This does not preclude the reinsurer's ability to terminate the agreement for breach or default of contract terms.
- B. The following situations require the establishment of additional liabilities or limitations to the credit for reinsurance taken by the ceding insurer.
1. The ceding insurer shall not take any credit for reinsurance in excess of the gross reserve it has established for the portion of the business or risks being reinsured.
 2. 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 the credit for reinsurance reduced by the maximum amount of such future tentative repayment;
 3. For multi-year agreements in which the renewal ceding commission percentage is less than the first year ceding commission percentage, and the agreement requires the ceding insurer to perform administrative, claim or maintenance services on the ceded business: if the renewal commission provided or to be provided to the ceding insurer by the reinsurer is materially less than the cost to the ceding insurer to perform the duties required in connection with the portion of the business reinsured, a liability is to be established for the present value of the shortfall.
- C. Notwithstanding Subsection (5) (A), an insurer subject to this regulation may, with the prior written approval of the commissioner, take such credit for reinsurance as the commissioner may deem consistent with Section 10-3-118, C.R.S, Regulation 3-3-3 or other actuarial interpretations or standards adopted by the Division.

Section 6 Written Agreements

The reinsurance agreement shall contain provisions that provide that:

- A. The agreement shall constitute the entire contract and agreement between the parties with respect to the business being reinsured thereunder and that there are no understandings between the parties other than as expressed in the agreement; and
- B. Any change or modification to the agreement shall be null and void unless made by amendment to the agreement and signed by both parties.
- C. The dual signature requirement of this section does not apply to facultative reinsurance agreements signed by the reinsurer.

Section 7 Existing Agreements

Insurers subject to this regulation shall reduce to zero by December 31, 2007 any credit for reinsurance established with respect to reinsurance agreements entered into prior to the effective date of this regulation which, under the provisions of this regulation would not be entitled to recognition of the credit for reinsurance; provided, however, that the reinsurance agreements shall have been in compliance with laws or regulations in existence immediately preceding the effective date of this regulation.

Section 8 Filings

Per Section 10-3-118 (2), C.R.S., complete copies of all reinsurance contracts and agreements and other information desired shall be filed with the commissioner at the commissioner's request. Any information requested by the commissioner must be submitted no later than 20 days after receipt of the request. Insurers who fail to submit the requested information may be assessed a penalty up to \$100 per day for each day after the date the information is due.

Section 9 Other requirements

All companies subject to this regulation shall provide immediate notification to the commissioner upon the exhausting or impending exhaustion of any reinsurance coverage which is necessary for the ceding insurer to comply with the provisions of Section 10-3-102 (3), C.R.S. or Section 10-11-112, C.R.S.

Section 10 Exceptions

- A. 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 contract 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 credit for reinsurance 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.
- B. 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.

Section 11 Severability

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

Section 12 Enforcement

Noncompliance with this Regulation may result, after proper notice and hearing, in the imposition of any of the sanctions made available in the Colorado statutes pertaining to the business of insurance or other laws which include the imposition of fines, issuance of cease and desist orders, and/or suspensions or revocations of license. Among others, the penalties provided for in Section 10-3-1108, C.R.S. may be applied.

Section 13. Effective Date

This regulation is effective January 1, 2007.

Section 14. History

This regulation replaces, in part, Regulation 3-3-2.